

Minutes
Reserve Bank of New Zealand Board Meeting
Wellington
20 October 2016

The meeting commenced at 7:30am

Present

Professor N Quigley	Chair
Mr G Wheeler	Governor
Dr R Carr	
Ms B Coates	
Mr J Ross	
Ms T Simpson	

In attendance

All items, except 8.3	Mr G Spencer	Deputy Governor, Head of Financial Stability
All items, except 8.3	Mr G Bascand	Deputy Governor, Head of Operations
All items, except 8.3	Dr J McDermott	Assistant Governor, Head of Economics
All items	Mr M Hannah	Head of Communications, Board Secretary
Items 2.1-2.6	Ms G Williamson	Manager Forecasting
Items 2.1-2.6	Mr R Perry	Manager International Markets and Analysis
Items 2.1-2.6	Mr B Cook	Adviser Market Intelligence
Items 2.1-2.6	Ms R Williams	Senior Economic Analyst
Items 3.1, 3.2, 4.1	Mr C Bloor	Manager Financial Systems Analyst
Items 7.3, 7.4	Mr N McBride	Acting Head of Risk Assessment & Assurance
Items 7.3, 7.4	Mr W Shum	Senior Risk Analyst
Items 8.3	Ms L Jenkin	Head of Human Resources

1 Formal Items

1.1 Apologies

Mr K Taylor, Ms K Vautier

1.2 Confirmation of Election of Chair, Appointment of Deputy Chair

The minutes of the 23 September meeting of Non-Executive Directors to elect the Chair were confirmed. The Chair confirmed that he has appointed Ms Vautier as Deputy Chair.

1.3 Register of Interests

The Register was noted. Mr Ross notified an update of his interests, which will be circulated with the November papers. No conflicts were raised in relation to the business of this meeting.

1.4 Minutes

The minutes of the 15 September Board meeting were confirmed.

Matters Arising

None

Outstanding items

The items were noted.

Next Meetings

The Board agreed to move the 16 February 2017 meeting to 23 February, subject to agreement with absent directors (obtained post-meeting)

The following meetings were noted.

- **Thursday, 17 November 2016** (Wellington) – (8:30am Audit Committee – 10:00am Board – 12:30pm Lunch – 2:00pm Board)
- **Thursday, 15 December 2016** (Wellington) – (10:00am Board – 12:30pm Lunch – 2:00pm Board)
- **Wednesday 23 February 2017** (Wellington) – (7.30am Board – 12:30pm Lunch – 2:00pm Board)
- **Thursday, 30 March 2017** (Wellington) – (8:30am Audit Committee – 10:00am Board – 12:30pm Lunch – 2:00pm Board – 5:15pm Function)
- **Thursday, 20 April 2017** (Wellington) – (10:00am Board – 12:30pm Lunch – 2:00pm Board)
- **Thursday, 18 May 2017** (Wellington) – (10:00am Board – 12:30pm Lunch – 2:00pm Board)
- **Thursday, 15 June 2017** (Wellington) – (8:30am Audit Committee – 10:00am Board – 12:30pm Lunch – 2:00pm Board)

2 Monitoring the Performance of Monetary Policy with Respect to the PTA

2.1 September 2016 OCR Background Papers

Ms Williamson said that the economic background to the decision to leave the OCR unchanged was similar to that prevailing before the August MPS, with persistent negative tradables inflation keeping the CPI below the target range. However, the positive output gap was considered to be increasing consumption and construction investment continued to be strong and the economy was probably growing at around 3½ percent. The Bank took a conservative view of the sustainability of the recent recovery in dairy prices.

Withheld: OIA s6(e)(iv) and s9(2)(ba)(i)

Withheld: OIA s9(2)(ba)(i)

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Withheld: OIA s6(e)(iv) and s9(2)(ba)(i)

Directors explored the Bank's thinking on the level of the real neutral interest rate.

2.2 Financial Market Developments

Mr Perry said that global financial market conditions had stabilised in recent weeks, and held prospects for improvement next year. China's growth has recently stabilised at about 6.7 percent officially, with the risks of a 'hard landing' receding; and the Federal Reserve was indicating that US inflation can be allowed to overshoot the 2 percent target, with the Fed adopting a more gradual approach to a policy tightening. The Fed was likely to tighten policy gradually next year; growth in the euro-area was beginning to strengthen, the decline in the sterling meant that further cuts in interest rates by the Bank of England may not be needed; and commodity prices were improving.

Mr Cook said that global bond rates had risen, and yield curves had steepened from low levels. Global markets were anticipating greater use of fiscal policies next year.

2.3 A Review of the Current Business Cycle: 2008 to present day

Ms Williams said that the paper is part of the Bank's regular review of the business cycle ahead of the five-yearly review of the PTA. This first paper provided a narrative of the current cycle. A second paper will look at particular features of the cycle. Both papers will eventually be published in the *Bulletin*.

Directors commented favourably on the paper. [REDACTED]

[REDACTED]
Withheld: OIA s9(2)(ba)(i)

[REDACTED]
Withheld: OIA s9(2)(ba)(i)

[REDACTED]
Withheld: OIA s9(2)(ba)(i)

2.4 *Low Inflation in New Zealand*, a speech by Assistant Governor Dr John McDermott

The paper was noted.

2.5 *The 'New Normal' and What it Means for Monetary Policy*, a speech by Federal Reserve Governor Lael Brainard

The paper was noted.

2.6 *Policy Uncertainty from a Central Bank Perspective*, a speech by Assistant Governor Dr John McDermott

The paper was noted.

3 *Assessing the Performance of the Bank in Promoting the Maintenance of a Sound and Efficient Financial System*

3.1 *Financial Stability Report Issues*

Directors discussed potential financial stability risks in various sectors. A director asked about pressures in the housing market. Mr Bloor said that high house-price-to income and debt-to-income ratios, strong credit growth and high household debt levels indicated that households are vulnerable to a correction, although loan-to-value ratio limits have helped to moderate credit risk on bank balance sheets. The director said that vulnerability often related to a risk of rising interest rates or unemployment, but interest rates had been falling and unemployment was steady. Mr Spencer noted that global bond yields were rising. The Governor added that China's financial markets had provided two global financial market disruptions in 2015 and 2016, and risks remained high in the Chinese financial system.

Withheld: OIA s9(2)(ba)(i) and s9(2)(g)(i)

3.2 New Zealand's FSAP 2016 – the August Mission

Mr Spencer briefed the Board on the progress of the IMF FSAP Review's first mission, which had just been completed. The Board discussed the outcomes to date. Mr Spencer said that a second mission is due in November, and a final Aide-memoire would be produced for the IMF Board next year. The overall tone of that Aide-memoire would be of most interest to the Bank as it was where the IMF could add greatest value to the thinking about New Zealand's financial system.

4 Monitoring the Bank's Regulatory Processes

4.1 Debt-to-income as a macro-prudential tool

Mr Bloor said that the Bank considered DTI ratio limits to be a useful tool to have in its macro-prudential 'toolkit', and three stages of work are underway. The Bank has requested that DTIs be included in the Memorandum of Understanding on Macro-prudential Policy between the Minister of Finance and the Reserve Bank. The Minister has sought more information. Secondly, the Bank is developing consistent data from banks on the nature of borrowers and risks. Thirdly, a working group with the banks is exploring how such a tool could be implemented consistently across banks. These stages could take several months to complete.

The Governor said that Auckland house price inflation had slowed recently, possibly reflecting tighter credit standards by banks. Banks were reducing their mortgage lending to foreign borrowers and reviewing their lending to apartment developments. Two- to three-year mortgages rates had risen as banks were having to compete more for domestic deposits and access funding from more expensive offshore wholesale markets.

Withheld: OIA s9(2)(ba)(i) and s9(2)(g)(i)

Mr Spencer said that not all the tools in the macro-prudential MOU are currently being used. However, DTIs are at the front of a chain of factors that could mitigate losses: DTI ratios could influence the likelihood of default; LVRs ensured there was sufficient security covering potential losses; and capital standards ensured banks were adequately covered. However, capital buffers had little influence on credit standards and loan risk.

The Chair suggested that other relevant factors complicating the environment for DTI ratio limits were a borrower's working life, which was getting longer, and the amortisation of loans, which could be lengthened. Mr Spencer acknowledged that banks already use internal DTI ratio limits, but they required harmonising and a joint working group would look to do this.

Withheld: OIA s9(2)(ba)(i) and s9(2)(f)(iv)

The Governor noted that other countries have found DTI ratio limits useful, including the UK, Ireland and several countries in Asia. Mr Spencer said that serious issues were arising in the housing market, including those related to supply, taxation and planning regulations. If supply was not quick enough to respond to the demand fuelled by high immigration levels and low interest rates, the Bank had to consider when it should act on its statutory responsibility for financial stability.

Withheld: OIA s9(2)(ba)(i)

A director asked if DTI ratios would adversely affect first-home buyers more than other borrowers. Mr Bloor said that they were more likely to affect high-income borrowers and investors, as these groups tended to borrow at higher DTI levels than low-income earners.

Directors agreed that the Bank was sensible to research the potential role of DTI ratio limits, but noted that there would be challenges in designing possible DTI measures and that design and implementation measures would need careful consideration.

4.2 *Informed investment decisions support financial system stability, a speech by Deputy Governor Grant Spencer*

The paper was noted.

5 Monitoring the Bank's Relationships

5.1 Governors' Key Engagements

5.2 IMF Trip Report

The papers were briefly discussed and noted.

6 Monitoring of Operational Functions

6.1 Balanced Scorecard – September 2016

A director sought clarity on some items. The paper was noted.

7 Organisational Strategy and Financial Management

7.1 Chief Executive's Report

Withheld: OIA s9(2)(ba)(i) and s9(2)(f)(iv)

Withheld: OIA s9(2)(ba)(i) and s9(2)(f)(iv)

Withheld: OIA s9(2)(ba)(i) and s9(2)(f)(iv)

7.2 External Audit for 2015/16: Letter from Auditor-General to Minister

The paper was noted.

7.3 Bank Risk Profile and Enterprise Risk Management Report

Mr Shum spoke to the findings of the Bank's Enterprise Risk Management review. He said that the key risks were well understood with appropriate mitigation actions in place. Directors explored the Bank's preparedness for cyber risks and business continuity for cash distribution.

7.4 Proactive Problem Management – 12-Month Review

The paper was noted.

7.5 Governor's Performance Agreement

Directors approved the draft Performance Agreement with one minor amendment.

8 General

8.1 Draft Interim Board Report to Minister for July-September 2016

Amendments were recommended and the Chair said he would provide a final version.

8.2 Any other business

The Board discussed matters that would be raised with the lunch guests.

The Chair asked the Governor whether there were any further issues that he should bring to the Board's attention. The Governor said there were no further issues.

8.3 Directors-only Discussion

The meeting concluded at 12:30pm, when Directors joined guests Bob Fay, Bank of Canada, and Dr Anders Vredin, Sveriges Riksbank, for lunch.

Confirmed

Chair