Overview

- New Zealand has employed just about every type of exchange rate regime since end of Bretton-Woods
- Effect on REER behaviour from regime is neither large nor lasting
  - Major exception being reduced volatility during crawling peg
  - Exchange rate regime not only part of economic policy that has changed significantly in last 40 years
- Income and relative economic performance more significant determinants
REER displays large cycles

The chart illustrates the fluctuations of the NZD REER (Real Effective Exchange Rate) over time, showing large cycles with a base year index set to 100. The green line represents the 7-year average, the red line represents the average since 1961, and the blue line represents the NZD REER index.
Inflation targeting has had no effect on REER

Table 1 – Analysis of NZD REER pre- and post-IT

<table>
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<tbody>
<tr>
<td>mean</td>
<td>93.49</td>
<td>94.35</td>
<td>92.49</td>
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<td>median</td>
<td>92.88</td>
<td>92.88</td>
<td>92.91</td>
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<tr>
<td>maximum</td>
<td>114.51</td>
<td>114.51</td>
<td>110.86</td>
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<td>minimum</td>
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<td>70.33</td>
<td>70.4</td>
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<td>std dev</td>
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<td>9.92</td>
<td>9.56</td>
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<td>0.27</td>
<td>-0.22</td>
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<td>kurtosis</td>
<td>2.47</td>
<td>2.62</td>
<td>2.01</td>
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</table>
ER regime has little effect

Figure 1 – New Zealand Real Exchange Rate
Setting a fixed exchange rate

- PPP method
  - Estimated using relative prices between New Zealand and trading partners

- External Balance method
  - Estimate of sustainable future level of balance of payments, using assumed trade elasticities

- Need estimates of
  - Equilibrium REER
  - Current REER (local and foreign inflation)
  - Expected REER (forecasts of local and foreign inflation, exchange rate, trade flows etc)

- Administratively cumbersome
  - Unless you accept macro volatility consequences
Fixed regime characteristics

- ‘Financial repression’
- Controls over
  - Asset holdings of banks (type and amounts)
  - Interest rates on Government debt
  - Lending growth by private institutions
  - Exchange controls (outward and inward)
  - Level of nominal exchange rate
- RBNZ implementing the Government’s monetary policy
  - Concerns over current account deficits
Floating the exchange rate

• Part of wide ranging financial liberalisation that had begun many years before
• Preparation well underway prior to 1985
• Shift costs of exchange rate changes from taxpayer to market participants
• Transform CAD from fiscal issue to market based phenomenon
Terms of trade suggest higher REER
Relative GDP suggests lower REER

Figure 7 – New Zealand REER and relative GDP
Summary

- New Zealand has employed just about every type of exchange rate regime since end of Bretton-Woods
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