



# The New Zealand experience of short- and medium-term real exchange rate volatility: drivers and policy implications

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# Key results and conclusions

- e/r cycles longer & larger, and short-term vol. higher, in NZ cf. elsewhere
- real economic developments offer directional explanations for cycle
- economic flexibility and less procyclical policy can help
- monetary and FX intervention policy have some scope, but limited by trade-offs and identification problems



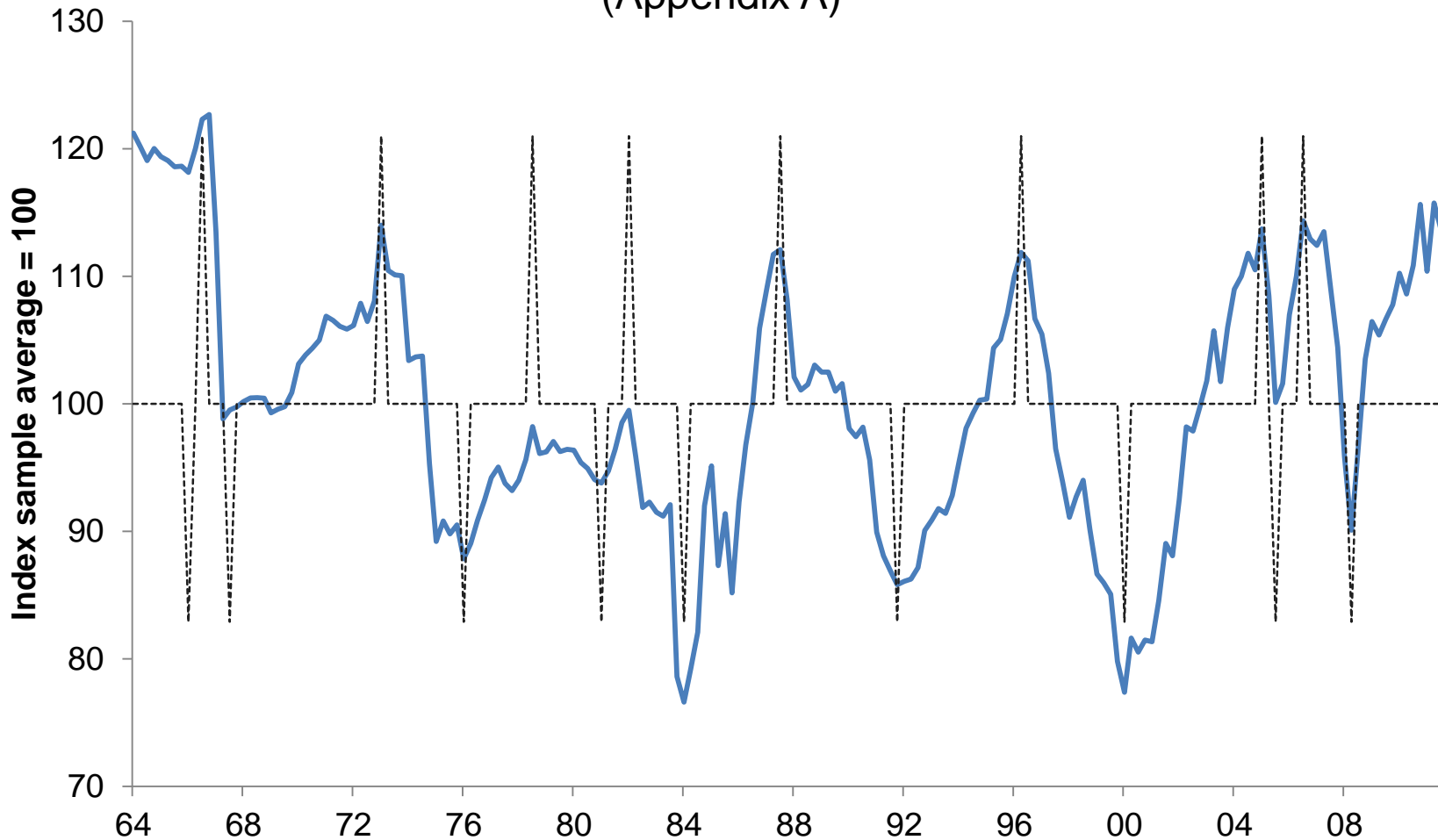
# Presentation outline

1. defining and measuring volatility
2. explaining volatility
3. reducing volatility

# NZ real effective exchange rate cycles



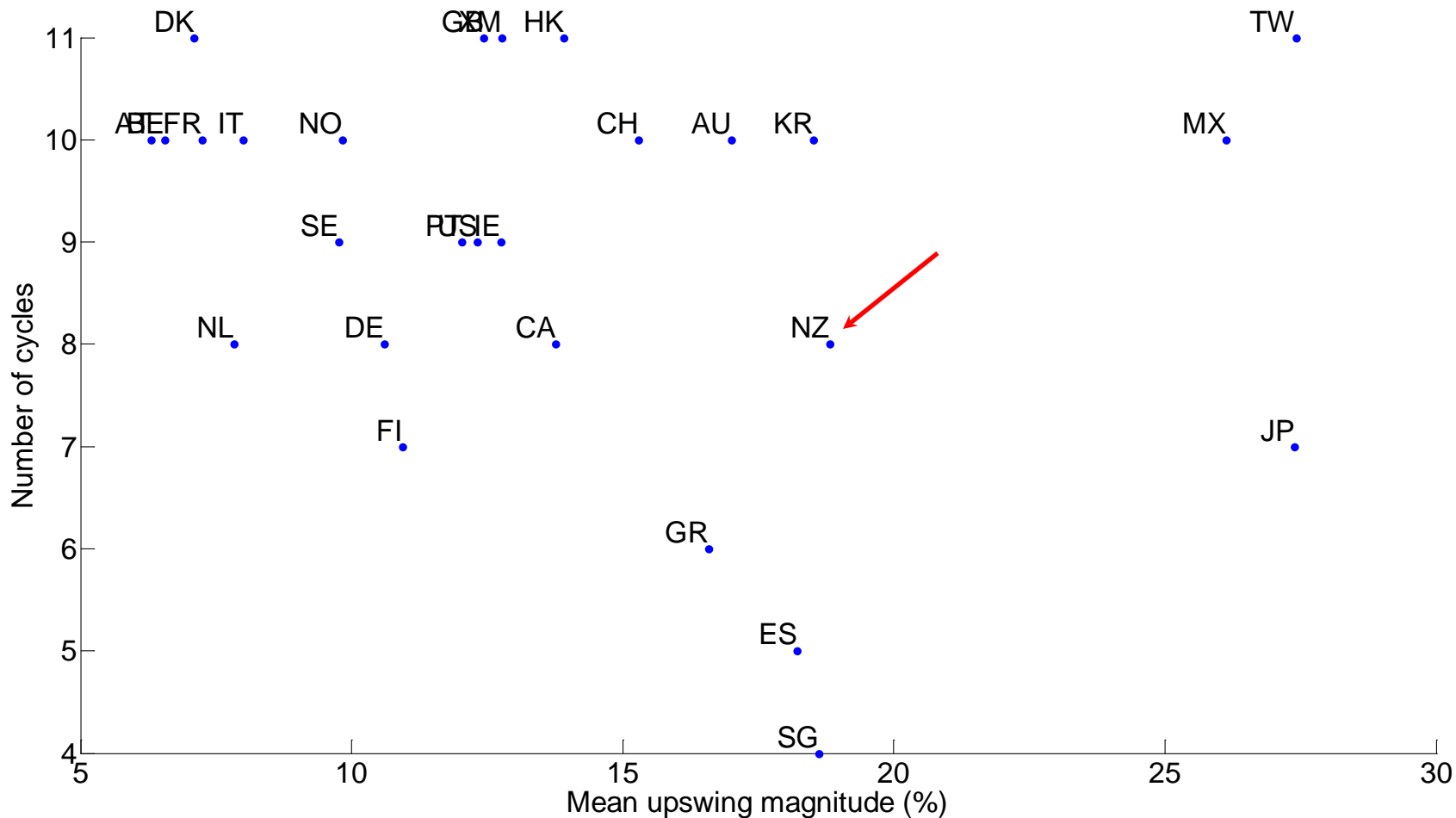
(Appendix A)



# NZ's upswings larger than most others'



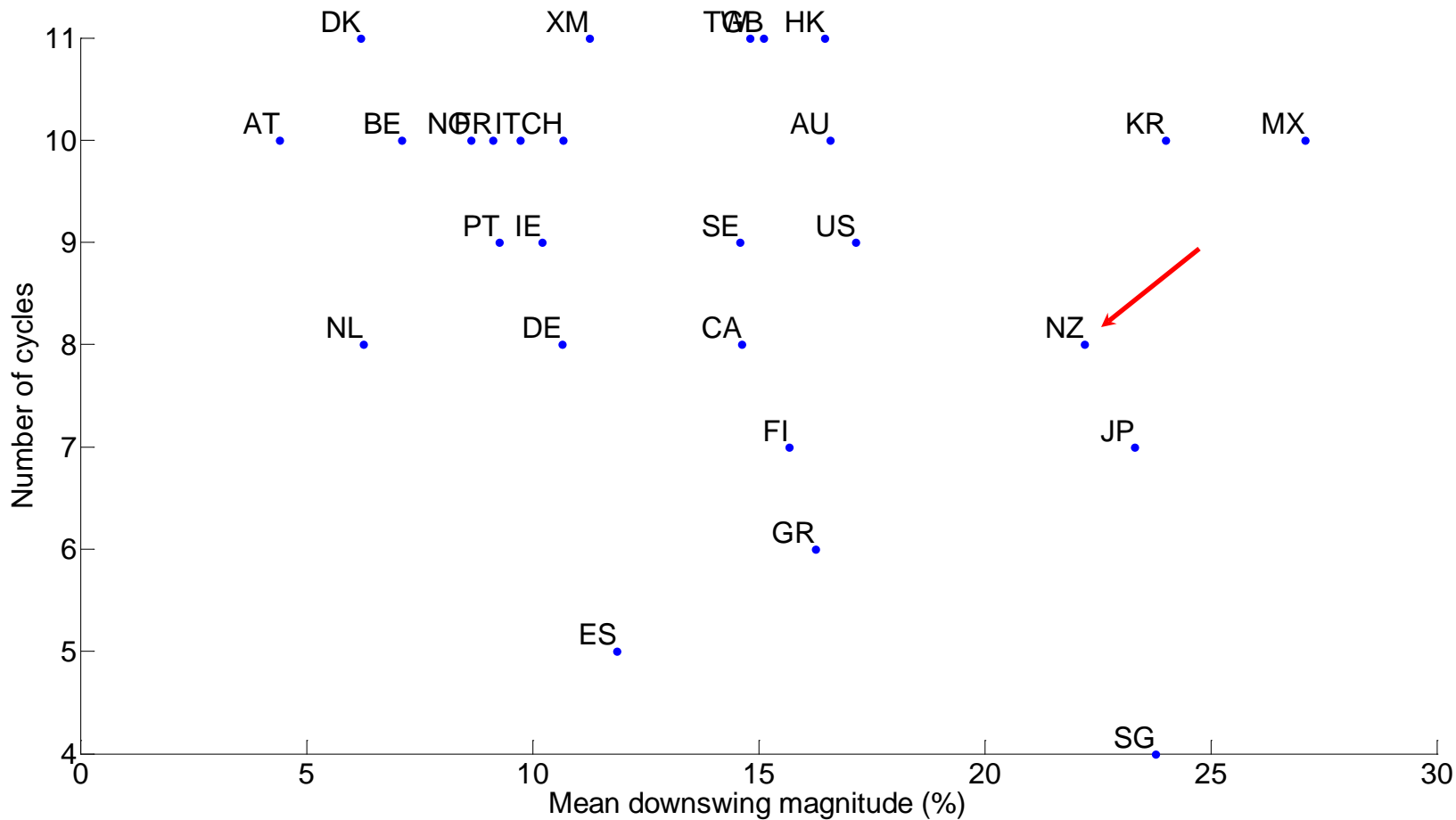
(Figure 4)





# Downswings larger too

(Figure 4)

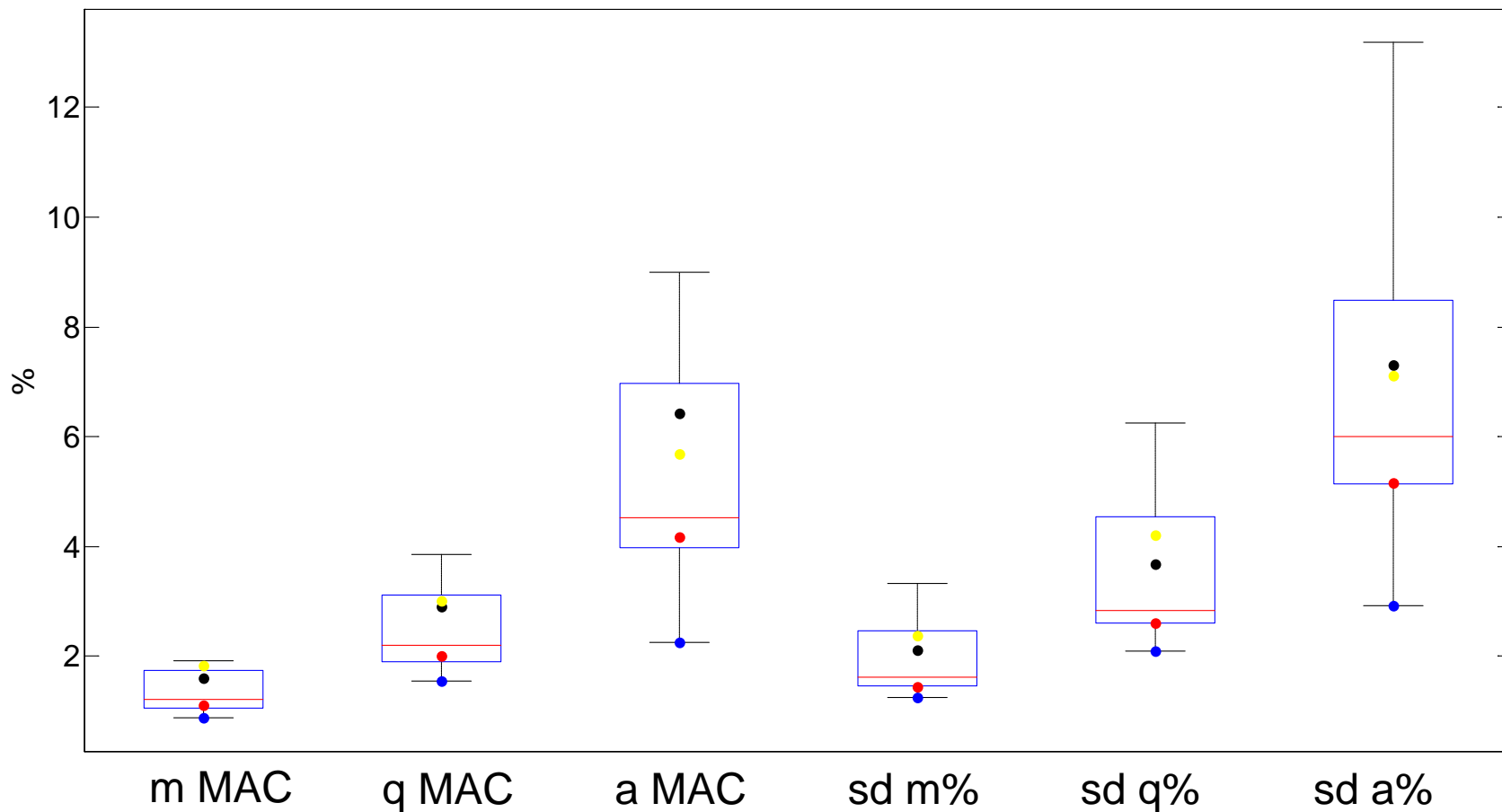




# S-t vol also larger than typical

dots: black NZ, yellow AU, red CA, blue NO

(Figure 6)





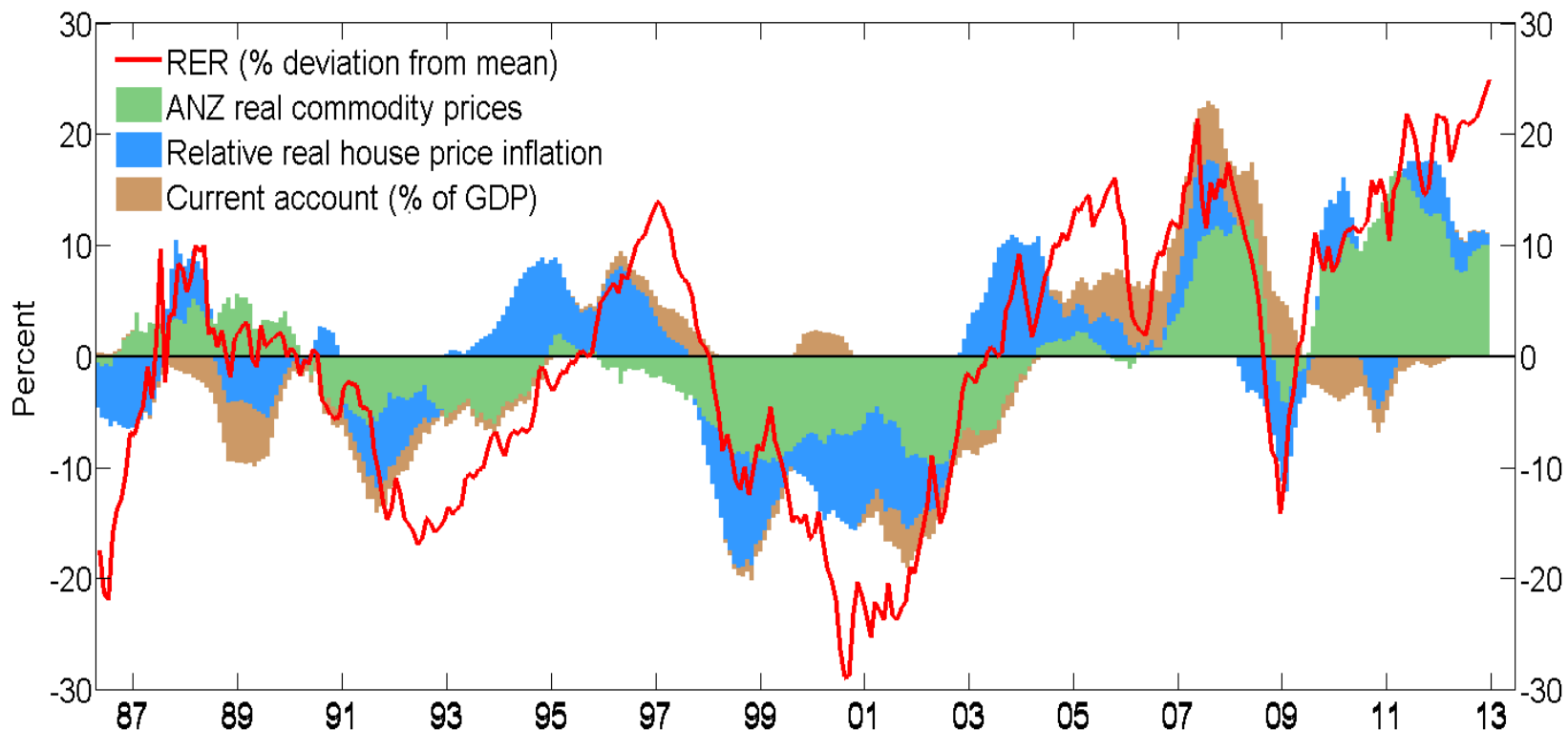
# Explaining exchange rate movements

- exchange rate is an asset price driven by relative risk and returns
- as a highly flexible market, it tends to “jump” in response to economic developments





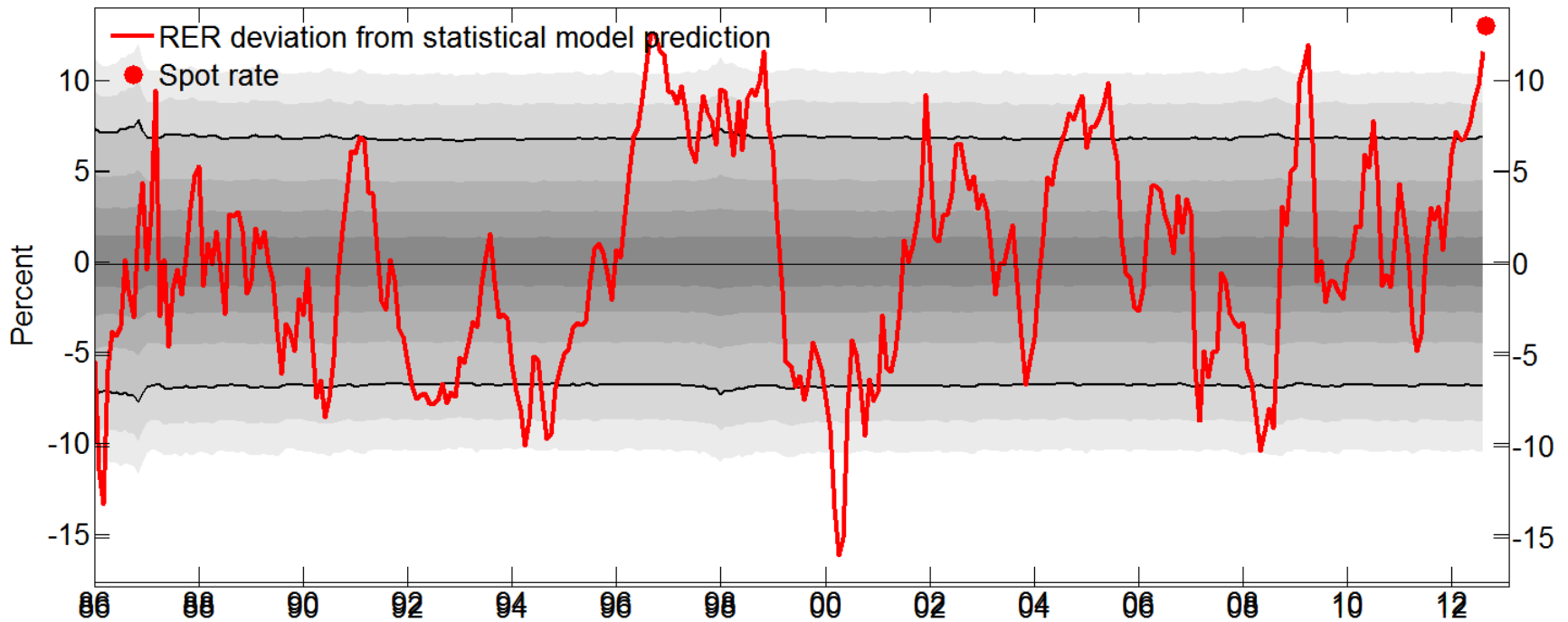
# Cycles are mostly explainable...



Source: McDonald (2012)



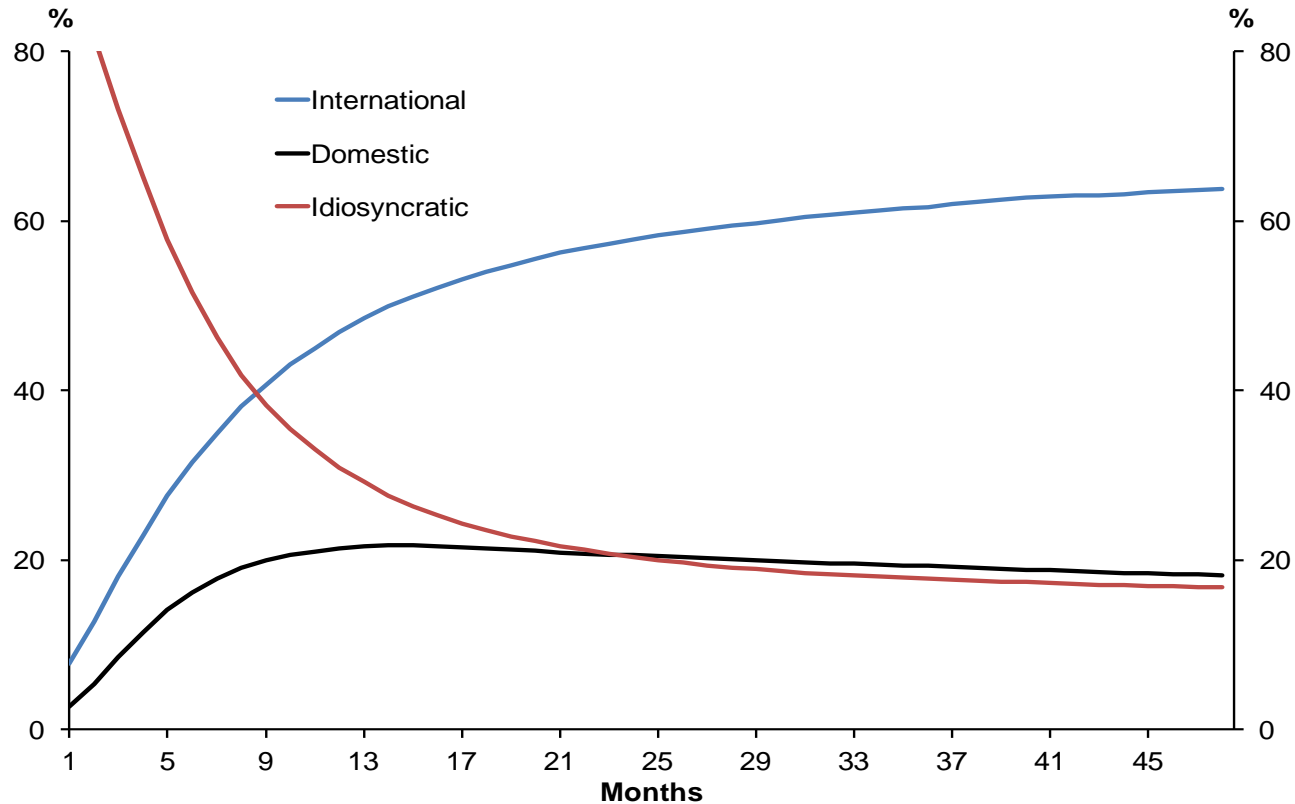
# ... but some “noise” remains



Source: McDonald (2012)



# ... another cut at noise



Source: McDonald (2012)



# What to do?

- Change trilemma choice
- Improve economy's flexibility
- Non-monetary stabilisation
  - SSI
  - fiscal
  - (macroprudential)
- Monetary policy (4b etc.)
  - no free lunch
- FX intervention

→ There are limits to what can be achieved