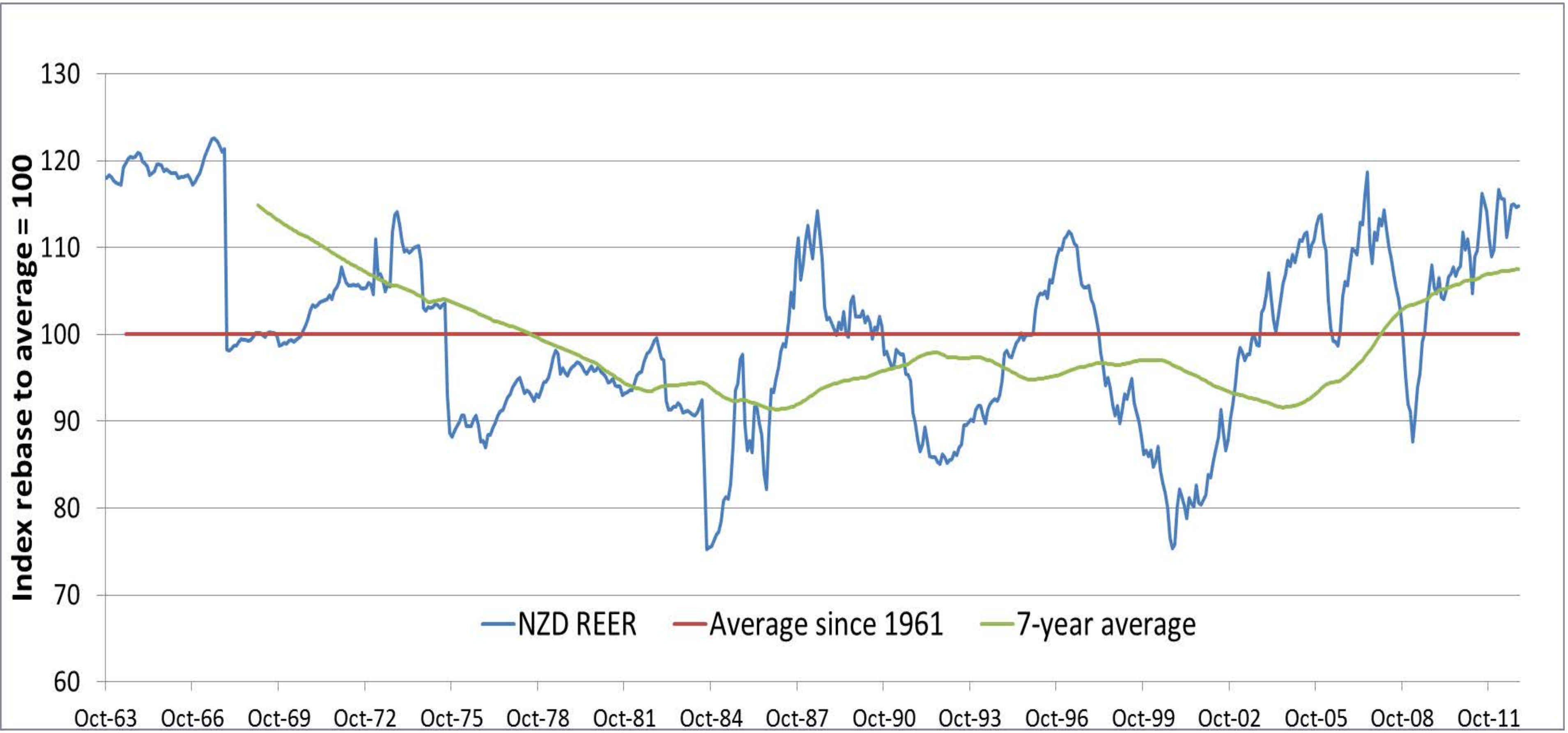
History of New Zealand monetary and exchange rate regimes

Richard Sullivan
Reserve Bank of New Zealand

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



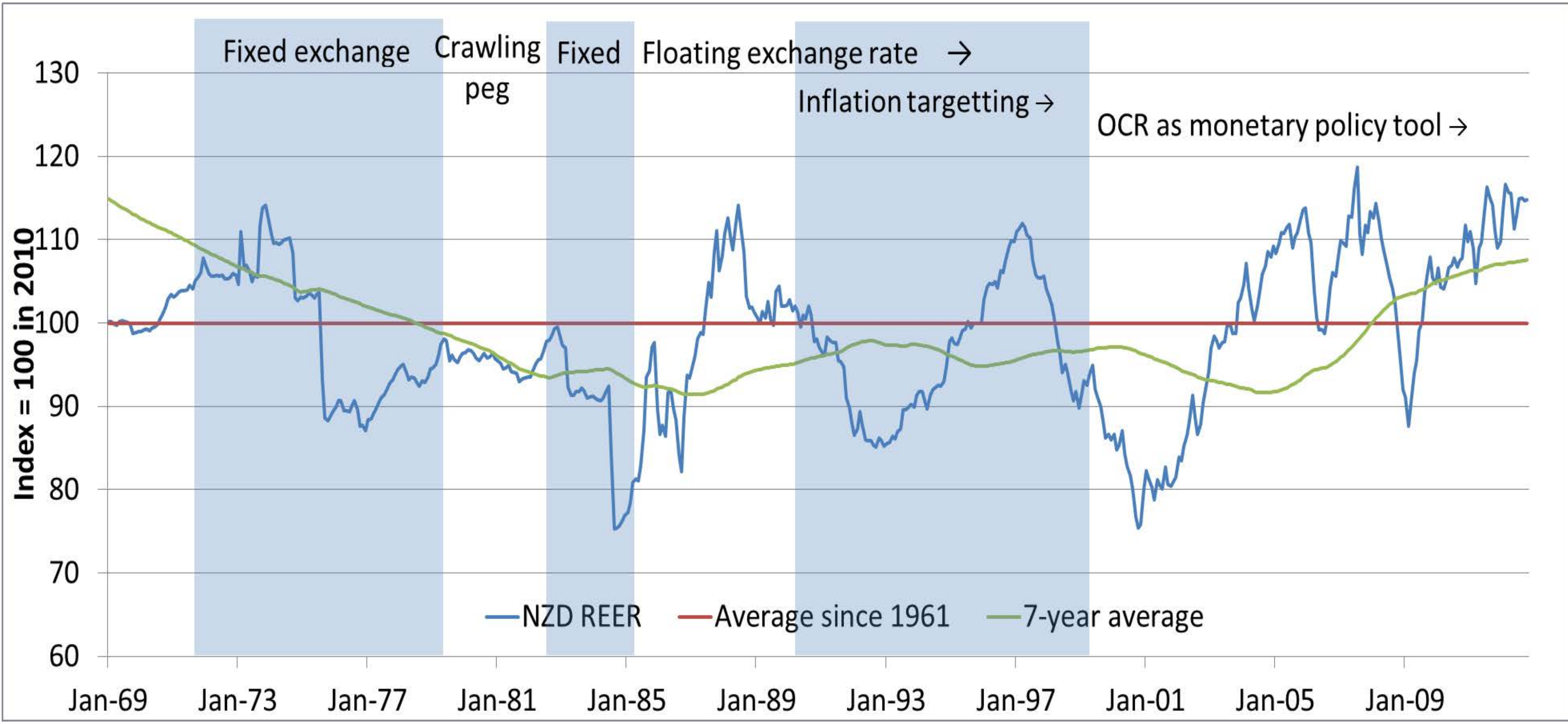
Inflation targeting has had no effect on REER

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

	NZD REER (monthly. Index = 100 in 2010)		
	Full sample	**1963-1989**	**1990-2012**
mean	93.49	94.35	92.49
median	92.88	92.88	92.91
maximum	114.51	114.51	110.86
minimum	70.33	70.33	70.4
std dev	9.79	9.92	9.56
skewness	0.07	0.27	-0.22
kurtosis	2.47	2.62	2.01

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

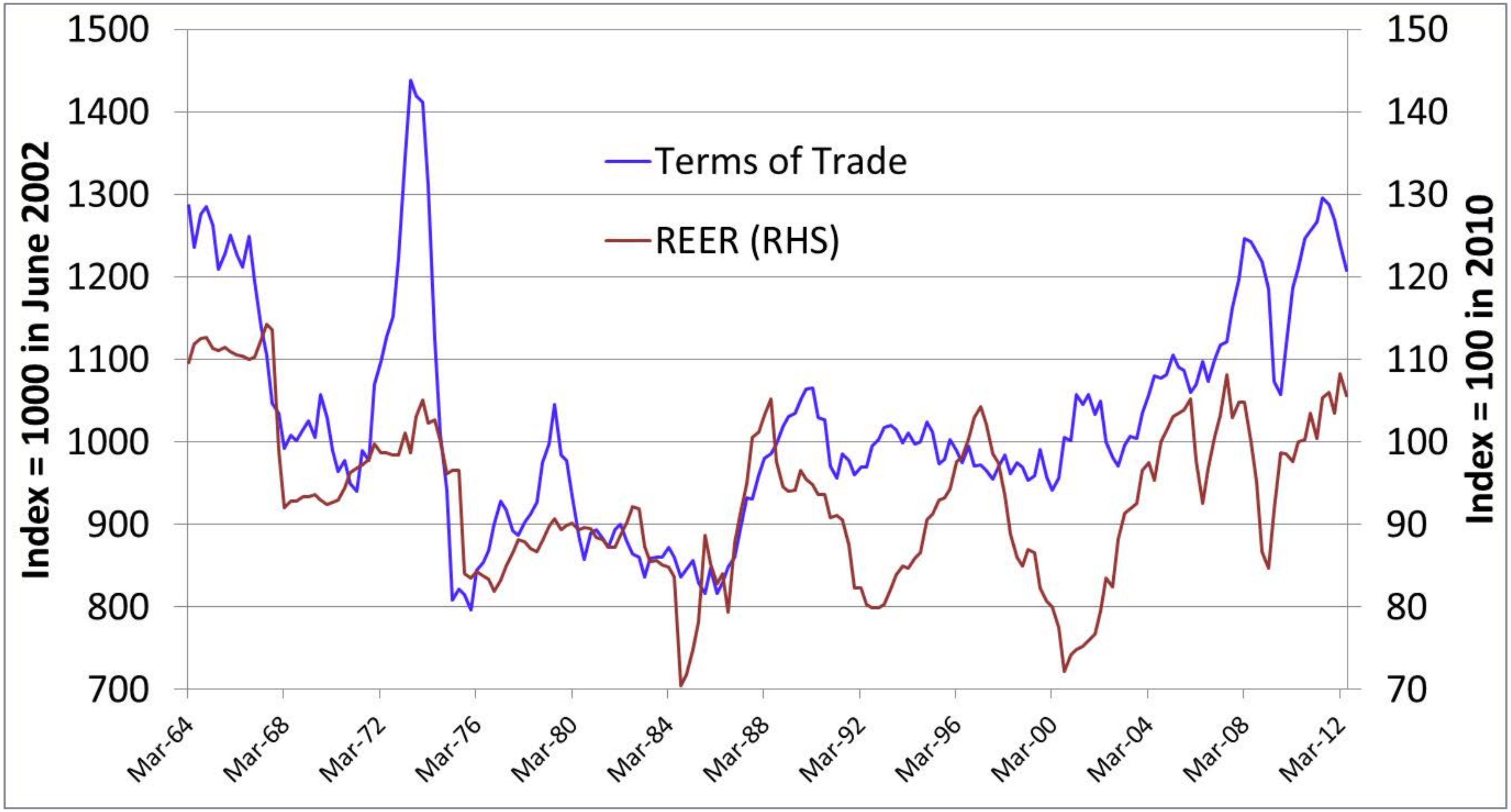
- ‘Financial repression’
- Controls over
  - Asset holdings of banks (type and amounts)
  - Interest rates on Government debt
  - Lending growth by private institutions
  - Exchange controls (outward and inward)
  - Level of nominal exchange rate
- RBNZ implementing the Government’s monetary policy
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

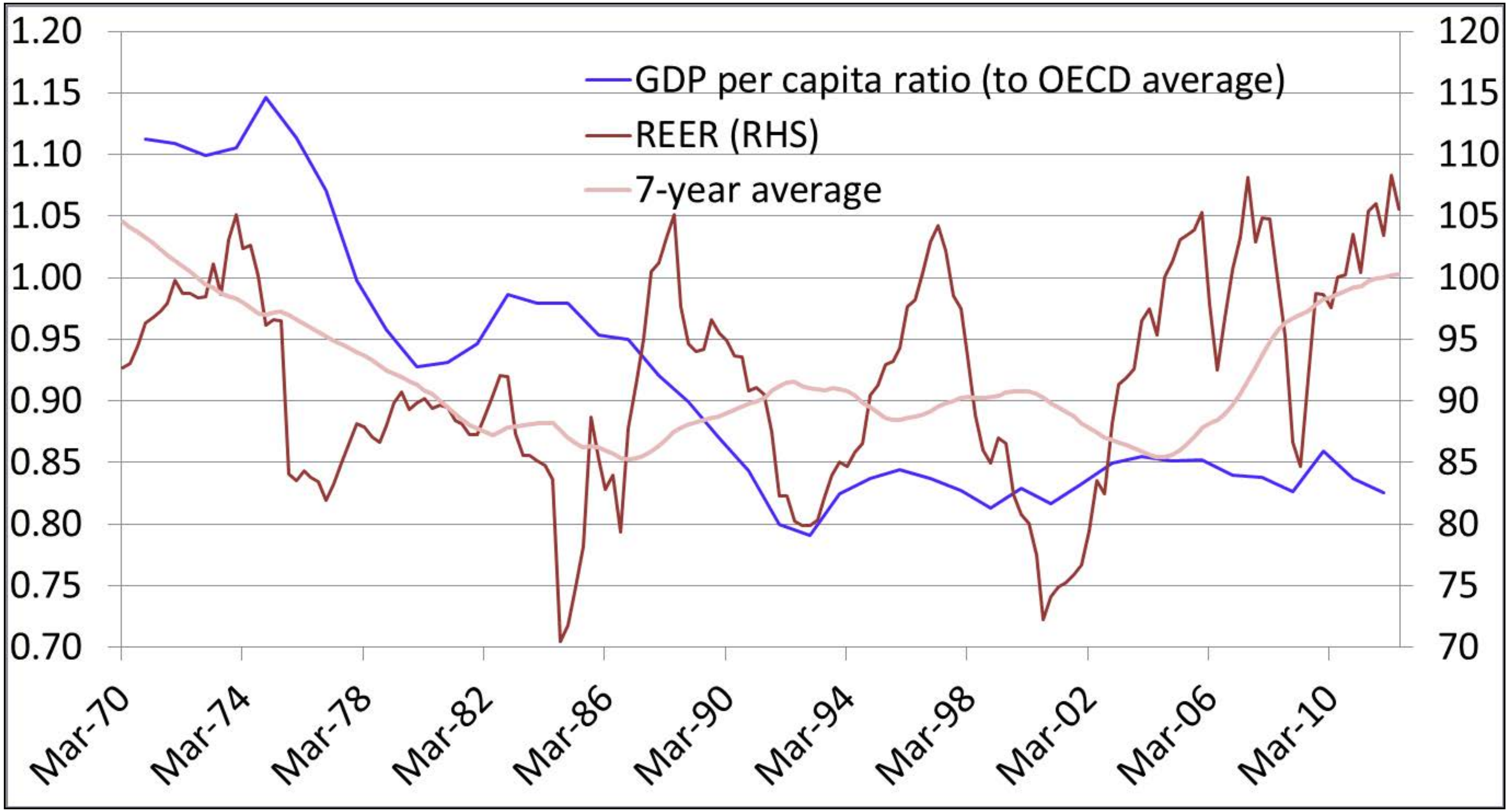
Terms of trade suggest higher REER

Figure 6 – New Zealand REER and Terms of Trade



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
- 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