# ECONOMIC NOTES

## GOVERNMENT FLOATS NZ DOLLAR

The Government decided to float the New Zealand dollar from Monday, 4 March the Minister of Finance, Roger Douglas, announced on 2 March 1985.

As a result the Reserve Bank would cease to quote official buy and sell rates for the New Zealand dollar against foreign currencies.

"We have decided that our overall economic strategy would be helped by changing to a more flexible exchange rate system. Floating is the right option."

He said this economic decision is a natural progression from the measures taken since July 1984 to reform monetary policy and financial markets and this would increase the strength and stability of policies keeping New Zealand on track for improved future growth.

"It is imperative that New Zealand's exchange rate system should assist producers in adjusting to a rapidly changing external world, and also be fully credible in the eyes of the outside world."

The Reserve Bank would oversee the change to the new system and officials would be meeting with foreign exchange dealers to brief them on the new procedures.

Mr Douglas said the Reserve Bank would not be withdrawing from the market. Government requirements for foreign exchange would be met by the Bank acting in the market place. In addition the Bank would now have two other roles:

— through minor market dealings, it would monitor market trends and developments;

— if undue volatility occurred, especially during the introductory phase of the new policy, it would have the option of entering the market to smooth exchange rate adjustments in periods of disturbed conditions.

He listed the advantages of the floating rate over exchange rates fixed by periodic government decisions, either on a basis of large infrequent changes or small and frequent 'crawling-peg' adjustments:

— it lowered the risk that changes in world currency markets could upset the local economy, reduce output, create unemployment and jeopardise Government policies aimed at economic growth;

— a float ensured that the risks of changes in exchange rates are shifted from the taxpayer to currency traders;

— it provided more prompt and accurate price signals to producers throughout the economy about the real rewards and costs involved in export and import activity. This will lead to better business decisions;

— it reduced extremes of upward and downward pressure on both interest rates and overseas reserves by spreading the pressure across a wider range of adjustment mechanisms.

He said the dollar was being floated because no other option offered comparable advantages in dealing with the current world economic climate or achieving the objectives of Government policy.

"Immense changes in the last five years have increased the odds against governments which tried to administer their exchange rates rigidly.

New Zealand cannot change the world's financial system, but this country does have to formulate policies to deal with conditions as we find them on the most effective possible basis."

The best policy was undoubtedly a floating rate, because it gives the New Zealand dollar visible credibility in world eyes.

"If we try instead to fight the world through an exchange rate which lacks credibility, we risk events which destabilise exchange flows, and undermine our growth.

International financial markets know that New Zealand's improving internal and external deficits and our economic policies in general are strengthening the economy so that the appropriate time to float is now.

The new system will quite simply give the Government better control over our economy and ensure that speculators are deprived of the possibility of profiting from the New Zealand public" Mr Douglas said.

## KIWI SAVINGS STOCK FOURTH ISSUE

The Minister of Finance, Hon. R.O. Douglas, on 22 February 1985 announced that the third issue of Kiwi Savings Stock would be closed on 27 February and that it would be replaced by a fourth issue on 28 February.

He said the new issue would be available with a rate of 17 per cent for either a two or a four year term.

"That rate is a little higher than the previous stock, but this has to be seen in the light of what the Government is doing with its monetary policy.

The primary aim of monetary policy is to borrow enough from the private sector to offset the impact of the Government's deficit. If we can borrow more using the Savings Stock, then we don't have to borrow so much in the stock tender programme, which is where the main emphasis of monetary policy has been.

That would ease the pressure on interest rates in the wholesale market. Overall, the Government's debt servicing costs should be reduced by this move," Mr Douglas said.

"Interest will be paid each quarter with the first payment on 15 July 1985. Stock is redeemable after 15 January 1986 on 7 working days' notice. If stock is redeemed before the maturity date, interest will be adjusted to the rate of 10 per cent per annum from 15 July 1985.

As with the Third Issue, an alternative to redeeming stock is that holders may transfer (sell) all or part of their stock to someone else. Anyone seven years of age or older and corporate entities will be eligible to invest and there will be no maximum on the amount which may be held."

He said that, like the previous issue, the fourth issue provided an excellent combination of quarterly interest, Government guaranteed security and availability of capital.

The minimum amount for each application would be $100 for each term with multiples of $50 thereafter. Application forms will be available from post offices, trading or savings banks, members of the Stock Exchange, solicitors or accountants in public practice, registered sharebrokers or from the Reserve Bank of New Zealand.

Commission would be paid at the rate of 50 cents per $100 of stock registered in response to applications, Mr Douglas said.

## TREASURY BILL TENDERS

No Treasury Bills were offered for sale in the regular weekly Treasury Bill tenders during the last two weeks of February. The Bank considered that the combination of tightness in the money markets during February and the March tax drain period made the regular offer of bills through the tenders unnecessary.

Decisions on the magnitude of each weekly bill tender take account of both immediate and prospective liquidity influences to the extent that these can be forecast, as well as ensuring that liquidity management is consistent with the monetary policy stance implemented through the stock tender programme. Under the third exchange rate regime, that consistency requires attention to the nature of foreign exchange flows, and to the general rate of growth of credit. credit.

## IMF INTERIM COMMITTEE CHAIRMAN

On 4 January 1985 the International Monetary Fund (IMF) announced that the members of the IMF's Interim Committee have selected the Honourable H. Onno Ruding, Minister of Finance of the Netherlands, to be the Chairman of the Committee. Mr Ruding succeeds the Honourable Willy De Clercq of Belgium.

Mr Ruding has been the Netherlands' Minister of Finance since November 1982. Previously, he had been a member of the Managing Board of a leading commercial bank in his country, and, from 1977 through 1980, Executive Director of the Fund for the Netherlands, Cyprus, Israel, Romania, and Yugoslavia. He assumed that position after a career in both government and commercial banking.

The Interim Committee, formally the Interim Committee of the Board of Governors on the International Monetary System, was established in October 1974 to advise the Board of Governors of the Fund on supervising the management and adaptation of the international monetary system as well as dealing with sudden disturbances that might threaten the system. The Committee, whose members are Governors of the Fund, Ministers, or others of comparable rank, reflects the composition of the Fund's Executive Board: each member country that appoints, and each group of member countries that elects, an Executive Director, appoints a member of the Committee and a number of associates up to seven of which may attend meetings of the Committee.

Within the IMF New Zealand is a member of a country grouping which has as its other members Australia, the Philippines, Korea, Papua New Guinea, the Seychelles, Western Samoa, Vanuatu and the Solomon Islands. Because Australia has the largest share of the votes within this group it is usual for an Australian to be elected to the position of Executive Director and for the Australian Treasurer, who is the Governor of the Fund for Australia, to represent the country group at the Interim Committee. Representatives from New Zealand have attended Committee meetings as associates with this role being filled at various times by the Minister of Finance as Governor of the Fund for New Zealand, and by senior officials of the Reserve Bank and Treasury.

The Committee, which at present has 22 members, last met in September 1984.

## USE OF IMF RESOURCES

The use of IMF financial resources by member countries in 1984 fell by 42 per cent from the preceding year. Purchases (i.e. borrowings) by Fund members totalled SDR 7.3 billion in 1984, down from SDR 12.6 billion in 1983.[1] With a slight increase in repayments from SDR 2.0 billion in 1983 to SDR 2.3 billion in 1984, net purchases fell to SDR 5.0 billion.

The slowdown in the use of Fund resources from the peak in 1983 (when severe external difficulties and debt problems were faced by developing countries in particular) can be attributed to an improvement in external current account imbalances following significant adjustment efforts undertaken by those countries in 1984.

Of the SDR 7.3 billion total drawings, SDR 3.1 billion was drawn under standby arrangements through the credit tranches and SDR 3.3 billion was drawn under the Extended Fund facility. Drawings under both of these facilities are subject to the borrowing country undertaking various adjustment measures that will ensure it meets particular economic criteria as specified by the Fund. Drawings under special-purpose facilities

1 SDR1 = NZ$2.0559 at 31 December 1984

(the compensatory financing facility and the buffer stock financing facility) are not subject to these types of conditions. They totalled only SDR 0.8 billion which represented the smallest drawing under such facilities since 1979.

**FUND PURCHASES AND REPURCHASES**
**(billion SDRs)**

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|---|---|---|---|---|---|---|
| *Total Purchases*[1] | 1.2 | 1.7 | 3.4 | 6.8 | 7.4 | 12.6 | 7.3 |
| Credit tranches | 0.4 | 0.9 | 1.8 | 3.4 | 2.5 | 4.9 | 3.1 |
| Extended Fund facility | 0.2 | 0.2 | 0.6 | 2.1 | 2.1 | 4.6 | 3.3 |
| Compensatory financing facility | 0.6 | 0.6 | 1.0 | 1.2 | 2.6 | 2.8 | 0.8 |
| Buffer stock financing facility | -- | -- | — | — | 0.1 | 0.3 | -- |
| *Total Repurchases* | 4.8 | 4.1 | 3.2 | 2.1 | 1.6 | 2.0 | 2.3 |
| *Net Purchases* | -3.6 | -2.4 | 0.2 | 4.7 | 5.8 | 10.6 | 5.0 |

1 Excludes reserve tranche purchases and Trust Fund loan disbursements.

The figures given above exclude member country drawings under the reserve tranche which fell from SDR 1.5 billion in 1983 to SDR 0.8 billion in 1984. All member countries are required to pay part of their subscription to the Fund in foreign currencies or SDRs. This part of a country's subscription is held as its reserve tranche and is considered to be part of its overseas reserves. As such, reserve tranche drawings can be made by a member country virtually on request and without the country being required to undertake adjustment measures. Furthermore the drawings do not incur any interest charges.

In 1984 New Zealand withdrew SDR 28.4 million from its reserve tranche and has now withdrawn the total reserve tranche (SDR 107.9 million). The 1984 drawing was undertaken in June, prior to the devaluation of the New Zealand dollar, at a time when New Zealand was forced to reduce its overseas reserves in the face of strong market demand for foreign funds. Apart from reserve tranche drawings New Zealand has made very little use of Fund resources, preferring to use the private market to raise overseas loans. Although these loans generally incur a higher rate of charge than the use of Fund resources, they are more attractive to countries since they do not have specific economic conditions attached to them, and more flexible borrowing arrangements are possible.

For a summary of New Zealand's position with the IMF see table G.2 included in this issue.

## CHANGES TO THE 'MONEY AND LIQUIDITY' TABLES

Some changes have been made to the titles and headings on three of the tables which appear in the 'Money and Liquidity' section of the *Bulletin* (tables D.1, D.2, and D.3).

Previously, the headings used in these tables may have given the impression that there is one 'true' measure of the money supply — that corresponding to the narrowest measure currently published by the Bank, M1 — to which other liquid financial instruments were added to provide a broad measure. In reality, there are a number of different measures of the money supply, each of which may be useful in interpreting monetary conditions.

The Bank currently compiles and publishes three money aggregates:

— a narrow monetary aggregate, M1 defined as notes and coin on issue minus till money of the trading banks; trading bank cheque account deposits minus the total of government deposits and demand deposits of other selected financial institutions held with the trading banks; and POSB and trustee savings bank cheque accounts;

— M2, which includes M1 plus demand and call deposits of POSB and trustee savings banks (excepting personal cheque accounts which are included in M1), private savings banks, finance companies and current accounts of stock and station agencies, net of demand deposits which these financial institutions hold with each other;

— a broad monetary aggregate, M3, defined as M2 plus fixed deposits at trading banks, all other time and special deposits of POSB (including National Development Bonds and Bonus Bonds), private savings banks, trustee savings banks, term deposits of stock and station agencies and finance companies, net of time deposits which these institutions hold with each other.

As a result of the trend in recent years for individuals to maximise the interest earnings on their savings, which has often involved a shift from non-interest-bearing M1-type accounts into an M2 or M3-type account, coupled with the rapid changes which have taken place in the financial system, the authorities have tended to focus more on the broad money aggregate, M3, as the main indicator of monetary conditions. This reflects the fact that M3 is less affected by institutional changes than is a narrower measure. Nevertheless, there is still a need to keep all the main monetary aggregates under review, and work is currently underway within the Bank to this end.