MANUFACTURERS AND EXPORTERS ASSOCIATION

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OutLook

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Monetary Union Discussion

There is a difference between “currency union” (implying a new – Reserve Bank Australia New Zealand [RBANZ] – central bank and a new currency to cover a range of countries, as in the case of the European Monetary Union - Euro) and other approaches, i.e. a pegged currency rate against another currency, or adoption of some other countries currency. Currency pegging or the adoption of some other currency would mean that we would have little say in what happens to monetary policy in the pegged or adopted currency, say the RMB and US$ for example.

Currency union implies some commitment to match and consider the conditions across the currency zone, as with the Euro, and matching some interactions between fiscal and monetary policy.

The creation of a RBANZ would give New Zealand a say in monetary policy but not control. The absence of unique and independent decision-making has some benefits and issues.

Sovereignty

Many feel that the currency is another manifestation of “country”, that it makes an individual statement and confers some further uniqueness to national identity. Further it is “ours” and “we” make all of the decisions associated with it. This is a bit more emotional than the applicability arguments, the same sort of emotions evoked by, say, the national flag.

New Zealand policy would have to take into account the policy of the other currency partner or partners. Clearly this could be seen as an unacceptable restriction on the democratically elected government’s right to determine policy, fettered only by local process.

Applicability

Loss of sovereignty, conditions prevalent in, say Australia, is at odds with the conditions in New Zealand. Essentially, the Auckland problem writ large, the Auckland housing market driving the monetary conditions for Canterbury manufacturers – often what suits one does not suit the other.

The populations of both countries (Australia ~20m, New Zealand ~4m) have similar aspirations and lifestyles, probably closer than those across the Euro zone.

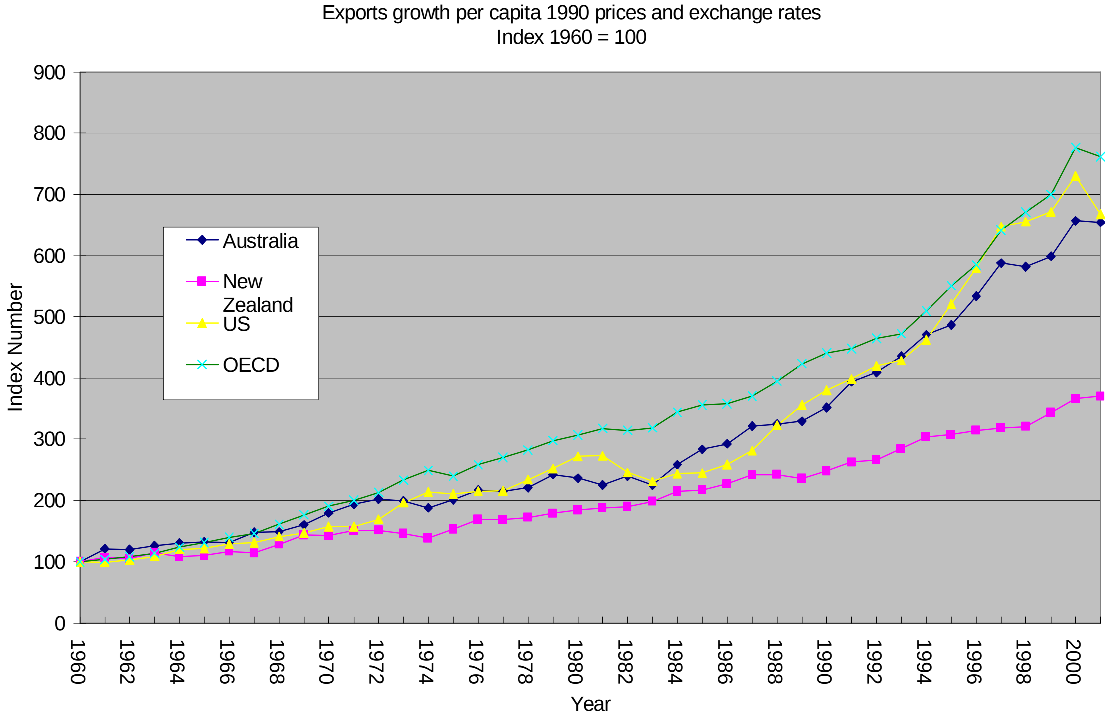
Volatility in Exchange Rate

The New Zealand dollar is, on a GDP basis, the most traded currency in the world. The daily trade average for 2006 was around 20¢ per dollar of GDP. The United Kingdom was second at 18¢ per dollar of GDP, Australia 17¢, USA 14¢, Japan 10¢ and Euro 8¢, all in USD at April 2004 cross rates. (Note, calculated using GDP (PPP) data by the International Monetary Fund 2004 and foreign exchange market daily average turnover data from Triennial Central Bank Survey 2004.)

New Zealand GDP is NZ$153b, Australia NZ$967b. The combined “weight” of the currency might be less easily pushed around by speculative pressure, and be more biased towards trade fundamentals that might better suit the export sector.

Export Growth

The growth in New Zealand exports is much worse than that of Australia and the OECD generally. This may be structural, we just make cheap stuff, or it could be that the risks associated with exports are simply too great for more people to take the risk in building export focused businesses. The graph below shows historical export growth.



Transaction Costs

Monetary union would reduce significantly cross border transaction and associated planning and currency fluctuation management costs.

Markets

For elaborately transformed manufacturers, Australia represents about 50% of the export volume from New Zealand. Stabilisation of exchange rate and broader monetary policy as one market would be positive for manufacturers, their Australian distribution channels and their Australian users. Higher levels of certainty may increase investment in export focused activities.

Union with Whom

Many of the scales and stability benefits of “union” follow regardless of which currency is joined, the tension comes from the Auckland, Sydney, Washington or Brussels problem - which of these is least likely to do damage on the downside in exchange for the greater stability and increased weight of currency? In selecting a partner, if the decision is ours to make, we should find someone roughly like us in economic profile.

Export Profile

	Export/Capita (USD)	Export/GDP (%)
US	3431.13	7.89%
UK	7734.81	24.63%
NZ	5811.87	22.35%
AUS	5773.76	17.56%

Source: CIA - The World FactBook, 8 Feb 2007

Export comparisons by main commodity group (ITS)

	USA	UK	Australia	NZ
Agricultural (%)	9.1%	5.9%	20%	59.9%
Fuels & Mining Products (%)	5.6%	12.4%	48.4%	5.6%
Manufactures (%)	81%	77.5%	20.4%	30.4%

Source: International Trade Centre UNCTAD/WTO - 2005

Country comparisons of services exports as % of total exports

(US$m)	Goods	Services	Total Exports	%Services
US	904,383	354,020	1,258,403	28.13%
UK	382,761	188,740	571,501	33.03%
NZ	21,729	8,222	29,951	27.45%
AUS	105,825	27,684	133,509	20.74%

Source: World Trade Organization - 2006

GDP composition by sector

	USA	UK	Australia	NZ
Agricultural (%)	0.9%	1%	3.8%	4.3%
Industry (%)	20.4%	25.6%	26.2%	26.9%
Services (%)	78.6%	73.4%	70%	68.8%
Mineral (%)	2%	10%	4%	1%

Note: all figures are 2006 est. except the figures for Australia which are 2005 est.
Source: CIA - The World FactBook, 8 Feb 2007

Summary

There is no all upside choice. However the New Zealand economy does have a number of distortions that seem to stymie the tradable export sector and yet New Zealand depends on the export sector more than many other nations to support living standards. Growth in exports is slower in New Zealand than Australia, the United States and the OECD, that suggests living standards will slip unless the export growth rate is boosted. The ever growing current account and trade deficit further underlines the threat to living standards if exports do not grow faster.

To grow faster, the export sector needs better long term policy support, viewed from the export perspective the balance of the argument falls towards monetary union as a priority.

For:

- Some ability to influence the RBANZ monetary policy response to conditions across the currency zone.
- A more stable exchange rate.
- Larger and lower cost market for manufacturers and producers.
- Would be a catalyst for further economic integration.
- Promotes interest rate / policy convergence in the partner countries.

Against:

- Loss of ability to run independent monetary policy.
- Perceived loss of sovereignty.
- Loss of independent exchange rate response to terms of trade and other shocks.

Conclusion

Of the economies considered here, the best match and most attractive partner would seem to be Australia. However whilst the problems faced by our export sector might be helped by currency union there are practical difficulties in implementation, not least of which is that it would take considerable time and might shift policy focus to a minor issue that might be lost in the emotional sovereignty debate.

Stability in exchange rates follows from monetary policy that has effective control across the entire economy in all global monetary conditions. A stable exchange rate flows from balanced fiscal policies and coordinated social policy. These issues are the real heart of the problem, looking to a monetary union to solve these broader problems that result in a yo-yo currency would be a side show.

[End]