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CEO Comment

Monetary Policy Inquiry Needed

The debate over whether banks have been passing on Official Cash Rate cuts from the Reserve Bank to customers has fallen into a political point scoring competition. There is still some scope for an investigation into bank margins but the more important issue is how to create a well finance sector that serves the whole economy, not just its own interests. A competitive and stable financial system needs and serves the real economy. When that job is done well the real economy can grow, create wealth and spread it around by creating jobs and paying wages. When the job is done badly, good firms are starved of credit, or competitiveness is negatively impacted by inappropriate risk premiums charged by lenders. At the macroeconomic level, volatility in interest and exchange rates damage the level of investment.

The solutions to the banking problem are obvious. The Reserve Bank has the power to enforce lower rates if it chooses, so its action or inaction is really a judgment on how serious it believes the issue is. Another solution is for the Government to increase the state backing of Kiwibank so that it can increase its market share. Kiwibank gives the Government a vehicle with which it can look to increase competitiveness in the retail banking sector and put downward pressure on the margins of the 'big four' banks.

Monetary policy settings are a more complicated issue, as recent experience has shown current policies to be ineffective at both ends of the economic cycle. High interest rates, designed to curb inflation, caused the New Zealand dollar to rise to over 80 US cents when the economy was in its 'boom' period and now we are seeing comparatively high interest rates holding up the exchange rate, even though our terms of trade have fallen away and the economy as a whole has faltered.

The Reserve Bank needs additional tools to address the volume of money in the economy. This tool could seek to limit credit volumes via variable lender capital ratios or borrower equity limits in addition to controlling the price of credit as the OCR does currently. Other methods to control the volume of money include a Variable Excise Tax, a variable savings scheme and a variable GST rate. These options all have the same affect of reducing the volume of money or credit when inflation is high and increasing the volume when inflationary pressures subside.

Variable reserve ratios would require higher reserve ratios in 'boom' years and these would be lowered in times when monetary stimulus is needed.

As Bill English has mentioned, the tradeable sector of the economy has been in recession for five years. Any inquiry needs to look at how to realign a financial sector, and our fiscal and monetary policy settings so that they collectively promote, rather than inhibit growth in the real economy.