

MEACTIVE – September 2009

CEO Comment

Relief may be short-lived if dollar remains high

Some positive economic news caused the New Zealand dollar to rise further last week. For the year ending in June the current account deficit was 5.9 percent down from 8.1 percent in the year to March and Gross Domestic Product (GDP) grew 0.1 percent in the June quarter. The Fonterra payout forecast rose from \$4.55 per kilogram of milk solids to \$5.10 which will see farmers paid out an extra \$700 million.

A closer look at some of these statistics shows that the picture is not quite so rosy. The rise in commodity prices has not been matched in other sectors. Exports of goods actually fell \$771 million despite an increase in export volumes. Also, both the manufacturing and construction sectors shrunk despite GDP growing overall.

The high dollar is preventing growth from occurring across the board. Instead, pockets of the economy where prices have made a quick recovery and stimulus spending is prominent will grow, further fuelling pressures on those sectors where demand is still lacking.

Business and Economic Research Limited (BERL) estimates that a Trade Weighted Index in the mid 50s would be necessary for an export led recovery to materialise, but this seems unlikely to happen while the major economies continue to devalue their currencies and our own policy makers continue to do nothing in response.

The Reserve Bank Governor seems fearful of changing interest rates. Dr Alan Bollard's comments at the last Monetary Policy Statement indicated that he doesn't think a cut to the rate would have much impact on the dollar and he is clearly concerned about the housing market taking off again. This once again spells out the problems with using the Official Cash Rate as the only monetary policy tool. Our persistently high OCR only serves to encourage offshore investors to buy New Zealand currency to take advantage of high interest rates, thereby causing the dollar to rise. In essence the OCR only serves to shift the pain from the non-tradeable sector to the tradeable sector. It is worth noting that commercial rates for long term money are well under four percent in [France](#) about 2.5 times lower than in New Zealand. The situation was summed up by one manufacturer who commented that "We can only build a paint line while our competitors offshore can build a new factory for the same cost of money."

A credit volume control tool needs to be given to the Reserve Bank so that inflation can be managed without destroying the tradeable sector. Initiatives such as a Variable Excise Tax, Variable Superannuation and a Variable GST rate would provide this credit volume control.