



MEACTIVE – November 2009

CEO Comment

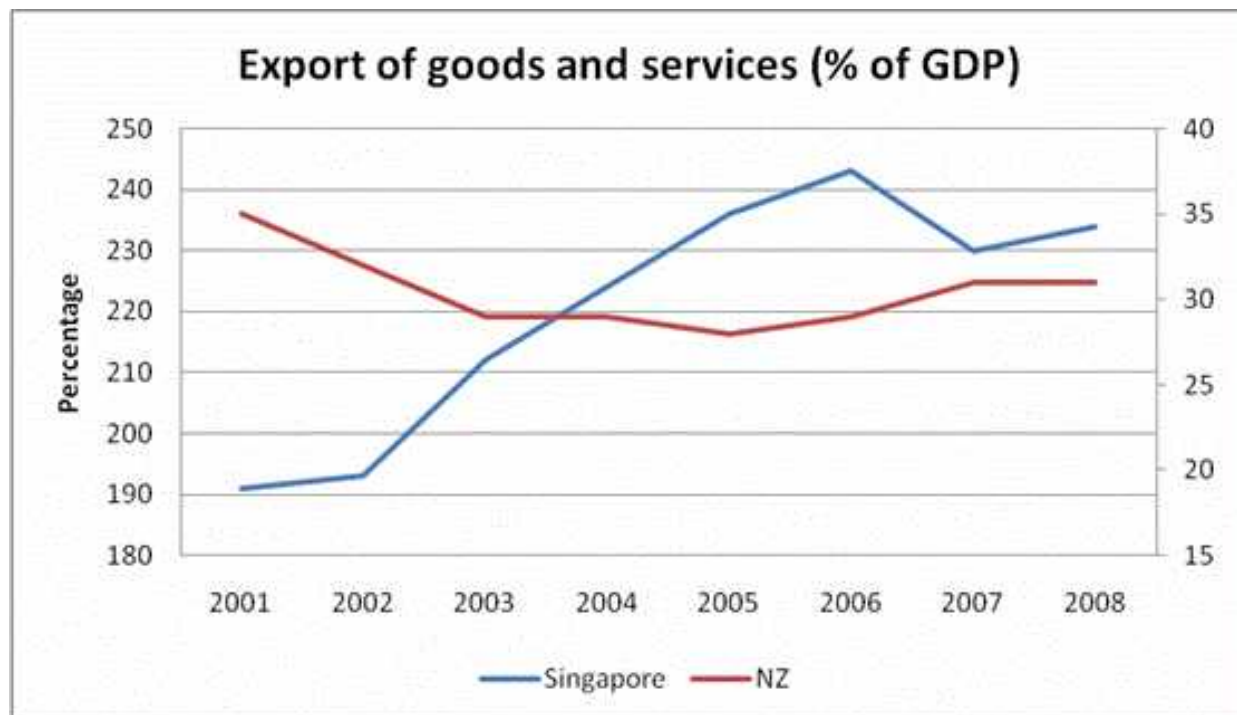
Consensus broken – where to from here?

Recognition that inflation targeting has been a key contributor to New Zealand’s slide down the OECD wealth tables has led Labour to reject the consensus on monetary policy. This opens discussions on alternatives as we move past the TINA (there is no alternative) approach; discussion around alternatives is vital if a better policy framework is to be built. It was disappointing to see John Key’s TINA comment backed up with the comment that we have “state of the art” monetary policy – neither exporters nor anyone in the traded economy see things that way and Treasury agrees.ⁱ

The monetary policy review in 2007 basically ignored the impact of current policy on the tradeable sector; essentially a TINA response. Clearly the economic problems since then have brought this issue back into the spotlight. A substantive and open minded review is long overdue.

Phil Goff’s comment that, “We want policy that will keep our exchange rate as stable and competitive as possible”, is the starting point. It has been clear for some time that for a small trading nation like New Zealand a stable external economy is vital if we are to see greater investment by exporters. While countries of similar size have been increasing the ratio of exports to total GDP New Zealand’s ratio has been stagnant.ⁱⁱ

This comparison with Singapore demonstrates the effect of our policy settings. Singapore has returned higher growth, lower inflation and lower interest rates than New Zealand over the long run. We need to learn from this.



What can be done to fix the problem?

Any review must encompass supplementary tools which can be used to suppress inflation without adding speculative pressure to the NZ\$. Such changes should be underpinned by fiscal policy that can curb the demand for borrowing in the non-traded areas of the economy. Loan to value ratios for borrowers, capital adequacy ratios for lenders, variable compulsory savings and the removal of the tax advantages around capital gains and property investments need to be considered. All of these measures are aimed at controlling inflation without offering high interest rates to foreigners that amplify pressure on our exchange rate. The Tax Working Group and Treasury have already indicated that these sort of structural changes are necessary.

Whatever else happens we need a long period of lower interest and lower exchange rates to encourage productive capacity investment in New Zealand; we must use appropriate means to deal with inflation that do not rely on interest rates. Unless this happens any notion of being back in the top half of the OECD and reversing or even slowing our decline in relative wealth terms is, and will continue to be, a dream.

ⁱ <http://www.treasury.govt.nz/publications/informationreleases/closingincomegaps/t2009-1953.pdf>

ⁱⁱ <http://www.interest.co.nz/ratesblog/index.php/2009/11/20/opinion-what-new-zealand-can-learn-from-singapores-monetary-policy/>