



ELSEVIER

Economic Modelling 21 (2004) 949–964

**Economic
Modelling**

www.elsevier.com/locate/econbase

Would adopting the Australian dollar provide superior monetary policy in New Zealand?

Aaron Drew^a, Viv B. Hall^{b,*}, C. John McDermott^c,
Robert St. Clair^d

^aOECD, Paris, France

^bSchool of Economics and Finance, Victoria University of Wellington, P.O. Box 600, Wellington, New Zealand

^cNational Bank of New Zealand Limited, Wellington, New Zealand

^dMonetary Authority of Singapore, Singapore

Abstract

Counterfactual experiments with the Reserve Bank of New Zealand's core model provide some insight into the implications for New Zealand's economic performance over the 1990s, had it credibly fixed its currency to the Australian dollar. If New Zealand had faced the relatively more stimulatory Australian monetary conditions prevailing over the 1990s, then output growth may have been temporarily boosted. However, demand pressures would have probably been greater and inflation higher. In particular, results suggest that over the latter part of the 1990s annual inflation would have been approximately 1% point higher on average. Stochastic simulation experiments provide a vehicle to analyse what the implications of currency union might be more generally. Results suggest that if New Zealand were to lose its ability to set monetary policy independent of that set in Australia, then the variability of inflation and output would increase over the business cycle.

© 2003 Elsevier B.V. All rights reserved.

JEL classifications: E58; F36; E31; E17

Keywords: Common currency; Australian dollar; Monetary policy; New Zealand

1. Introduction

In a period when countries are becoming increasingly linked to one another through trade and capital flows, the management of the exchange rate regime is a critical

* Corresponding author. Tel.: +64-4-463-5081; fax: +64-4-463-5014.

E-mail address: viv.hall@vuw.ac.nz (V.B. Hall).

factor in economic policy making, and the choice of regime is always controversial. The debate over whether New Zealand should continue to maintain an independent currency, or form a currency union with a larger country, such as Australia, has recently taken on prominence.¹ The initial impetus for this debate came from observing international trends in exchange rate regimes: in particular, the formation of a currency union by the European countries that use the Euro; the contemplation of dollarisation by several Latin American countries; and the adoption of full dollarisation in Ecuador. The key motivating factor behind currency union in Europe was the general move towards tighter political union, while in Latin America it was dissatisfaction with floating exchange rates, and a lack of monetary and inflationary control. However, neither of these reasons applies to the New Zealand situation. The debate in New Zealand is really about the conduct of monetary policy and improved overall performance of the economy in the longer run, rather than the exchange rate regime itself.

Despite the fact that floating exchange rate regimes have not had any detectable ill effects upon economic performance, advocates of currency union for New Zealand have criticised monetary policy for being overly stringent and not taking sufficient risks to allow growth to occur. For example, it has been suggested that New Zealand's growth performance over the last decade would have been better had it adopted Australian monetary conditions.²

However, a-priori, it would be surprising if monetary policy designed for the Australian economy produced superior results for New Zealand. Notwithstanding the similarities of the two economies, the New Zealand economy at times is subject to different shocks, and an ability to set monetary policy independently of that set in Australia may help offset these differential shocks. Even where shocks are similar the transmission of them through the economies may differ, again suggesting superior outcomes may result from an ability to set monetary policy independently.

The contribution of this paper is the use of a general equilibrium approach to directly assess whether the New Zealand economy could have performed better in the 1990s with Australian interest rates and currency movements. It utilises the core model of the Reserve Bank of New Zealand's Forecasting and Policy System (FPS) to examine the potential effects of adopting Australian monetary conditions on key New

¹ For example, see Bjorksten (2001), Coleman (2001, 1999), Hartley (2001), Bowden (2000), Crosby and Otto (2000), Grimes (2000), Bowden and Grimes (2000), Grimes et al. (2000), McCaw and McDermott (2000) and Hargreaves and McDermott (1999).

² See HSBC: *Economics* (1999). Another argument for joining a currency union often put forward is that it removes significant barriers to trade (see Rose and van Wincoop (2001)). This argument is not emphasised for the case of New Zealand joining a currency union with Australia, probably because Australia already accounts for around 20% of New Zealand's exports. A notable exception is Grimes (2000), which considers that in a dynamic context the main drawback to retaining the NZD is that it may restrain firms wishing to expand into the Australian market from New Zealand, thereby constituting a form of non-tariff barrier to exports for smaller firms. Also, if running one's own monetary policy were to result in higher exchange rate volatility, adversely affecting consumption and investment, then the modelling results reported here will understate the cost of operating a separate monetary policy. We thank an anonymous referee for highlighting this latter point.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات