Monetary reform in a small resource-rich economy – the case of New Zealand

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Session2 Bank of Mongolia Conference
Ulaanbaatar, July 2024

New Zealand is a small resource-rich economy

- Population: 5.2m
- GDP per capita: $US 48,000
- Main exports: Dairy products, tourism, meat, logs, fruit, seafood
- Main export markets: China, Australia, USA
- 85% foreign ownership of banking system
- Vulnerable to international commodity prices
- Vulnerable to earthquakes and severe weather events

Prior to 1984-1990 reforms, the NZ economy was highly controlled and out of balance

- A stop-start economy: Terms off Trade shocks, weather shocks, pro-cyclical fiscal policies
- Early 1980’s saw weak TOT, incomes supported by large fiscal deficits, highly regulated markets and price and interest rate controls
- Large external deficits and pressure on foreign reserves as Central Bank defended an overvalued exchange rate
- High and variable inflation

Financial reforms aimed to achieve:

1) a sustainable fiscal policy
2) monetary policy aimed at price stability
3) more flexible financial markets

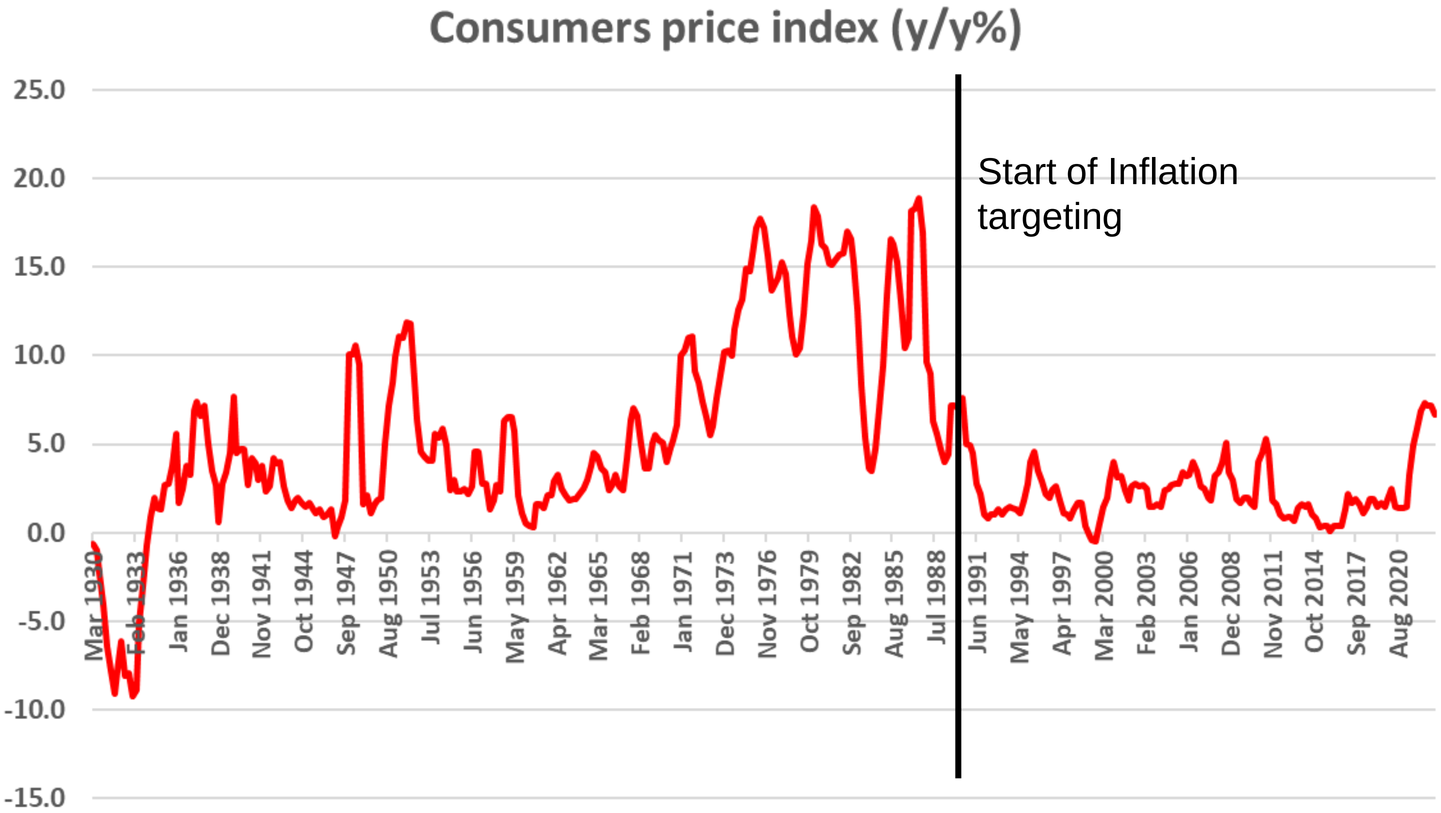
Key elements of NZ’s monetary reforms

- Float the NZD to allow an independent domestic monetary policy and to provide a buffer against external shocks
- CB operational independence to pursue med term target and held accountable
- Govt needs to fund its activities in the market
- Financial deregulation to promote efficient credit allocation and a market based monetary policy

Outcome of the reforms

- Initial period of disruption and resource reallocation
- Price stability achieved within 2-3 years
- Initial exchange rate volatility before markets settled down
- Rapid development and deepening of Govt debt market
- Significant capital inflows and integration with international markets
- Reforms delivered a robust macro-policy regime that could buffer external shocks and provide a foundation for growth
- Reforms have stood the test of time

Inflation Targeting delivered 30 years of price stability



Lessons from the NZ financial reform process

- Political commitment at the top is essential
- Reforms cannot be perfectly sequenced. Once reform starts it will broaden
- Upheaval in the financial sector is likely to have some fallout, which needs to be managed
- Initial economic disruption is unavoidable, with support needed for the most adversely affected sectors
- The long-term benefits are major

End of presentation