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A Study Of The Impact Of Monetary Policy On Long-Term Interest Rates In New Zealand

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Abstract

This paper examines the impact of monetary policy on the daily long-term interest rate (the 10 year government bond rate) in New Zealand. An attempt is also made to compare the impact of international long-term interest rates (the 10 year bond rate) on domestic long-term rates. The Monetary Condition Index (MCI) and 90 day bill rates are used as proxies for the Reserve Bank's monetary stance over the period 3 October 1994 to 30 September 1997. In the empirical literature, it is common to use the benchmark short-term interest rate as the monetary policy proxy. However, this paper argues that using the MCI as the proxy is more appropriate, as it incorporates the effect of the exchange rate, and in part reflects the monetary policy stance of the Reserve Bank. The study finds that the impact of domestic monetary policy on daily long-term interest rates is limited compared to the impact of international interest rates on those same rates. New Zealand long-term interest rates seem not only to move with international rates, but seem to be largely driven by them.

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