INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/202

NEW ZEALAND

July 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NEW ZEALAND

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 25, 2018, consideration of the staff report that concluded the Article IV consultation with New Zealand.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 25, 2018, following discussions that ended on April 17, 2018, with the officials of New Zealand on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 5, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for New Zealand.

The document listed below will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 18/273
FOR IMMEDIATE RELEASE
July 3, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation with New Zealand

On June 25, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with New Zealand.

Since 2011, New Zealand has enjoyed an economic expansion with notable momentum. Reconstruction spending after the 2011 and 2016 earthquakes was an important catalyst, but the expansion has also been supported by accommodative monetary policy, a net migration wave, improving services exports (especially tourism), and stronger terms of trade.

GDP growth in 2017 at 3 percent was close to trend, rebounding mid-year as weather-related and other temporary factors subsided**,** but below the buoyant rates of around 4 percent in 2014-16. The unemployment rate declined to near the natural rate of unemployment of roughly 4.5 percent by the end of 2017, as strong employment growth absorbed the migration-induced increase in the labor force. While the latter also contained wage pressures, headline inflation remained within the Reserve Bank of New Zealand (RBNZ)'s target range of 1 to 3 percent. After a bounce in early 2017, mostly because of commodity price increases, headline inflation moderated in the remainder of the year, partly reflecting renewed downward pressures on prices for imported goods and services.

The current account deficit has remained generally below its longer-term average in the expansion. It is assessed to be moderately below its fundamental level, with the exchange rate moderately overvalued. The net foreign liability to GDP ratio, among the highest in advanced economies, has been broadly stable. Commercial banks continue to hold strong capital and liquidity buffers. Slower credit and stronger deposit growth have helped to reduce reliance on offshore market funding reliance.

The housing market is cooling and credit growth to households has slowed. The cooling appears to reflect the RBNZ's macroprudential policy intervention of late 2016, as well as possibly weaker foreign demand and self-correction in response to declining affordability. Together with tightening in bank lending standards, growth in household credit moderated in turn, broadly in

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

line with nominal income growth. The household debt-to-income ratio, while still high, has stabilized around 168 percent.

Monetary policy remains accommodative, with the RBNZ policy rate being held at 1.75 percent since late 2016. The countercyclical fiscal stance going forward will balance the macroeconomic policy mix, and the fiscal position is expected to strengthen further, with net debt falling below 20 percent of GDP by FY2022/23. Macroprudential policies have contributed to reducing related risks to financial stability and should continue to mitigate risks from high household debt, even with a very slight easing in loan-to-value ratio restrictions at the start of 2018.

The election of a new government has led to new macrostructural policies. There will be a new system of tax credits to foster research and development (R&D). A three-year increase in the minimum wage to NZ$20.00 will be phased in, giving New Zealand the second-highest minimum-to-median wage ratio in the OECD. Students in tertiary education will now receive one year of government funding. Finally, a NZ$1 billion per year Provincial Growth Fund will foster regional development over the next three years.

Executive Board Assessment[2]

Executive Directors commended the authorities for prudent macroeconomic policies leading to New Zealand's continued solid economic growth. While the outlook remains favorable and near-term risks are broadly balanced, medium-term risks are tilted to the downside including tighter-than-expected global financial conditions and growing protectionist policies in other countries. Against this background, Directors encouraged continued sound policy implementation and reforms to support inclusive growth.

Directors agreed that current macroeconomic policy settings are broadly appropriate and welcomed the authorities' readiness to adjust the policy mix if needed. They viewed the monetary policy stance as sufficiently expansionary to address current, below-target inflation and to lower risks to demand from currency overvaluation. Directors concurred that the strong fiscal position provides space to accommodate the needs from robust population growth, while the pace of debt reduction envisaged in the FY2018/19 budget is appropriately ambitious. They encouraged using stronger structural revenues to increase spending on infrastructure, human capital development, and other public services that would raise potential output.

Directors noted that macroprudential policies have contributed to reducing risks to financial stability and should continue to mitigate risks from high household debt. Bank and household balance sheets have become more resilient with a lower share of loans with high loan-to-value ratios (LVRs). With household debt still elevated, Directors generally did not see further relaxation of LVR restrictions as appropriate in the near term.

Directors welcomed the Review of the Reserve Bank Act. Regarding Phase One of the review, they encouraged maintenance of the employment objective as the updated framework is legislated and fully implemented. Directors saw Phase Two of the Review, focused on financial stability and other

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

policies, as an opportunity to better define the mandate and objectives for the Reserve Bank of New Zealand in this domain. They encouraged the authorities to give emphasis to priority areas in need of reform, such as the macroprudential toolkit and the supervisory pillar suggested in the 2017 Financial Sector Assessment Program.

Directors concurred that the ambitious housing policy agenda centered on strengthening supply and lowering tax distortions will help to restore broad-based housing affordability. They emphasized that the success of the agenda will depend on well-coordinated progress of the *KiwiBuild* program and the *Urban Growth Agenda* across the public sector. Many Directors noted the proposed ban of residential real estate purchases by nonresidents, which is assessed as a capital flow management measure under the Fund's Institutional View, and encouraged the authorities to reconsider the measure. They considered that this measure would be unlikely to improve housing affordability, while the broad housing policy agenda, if fully implemented, would likely address most of the potential problems associated with foreign buyers on a non-discriminatory basis. A number of Directors, however, saw merit in taking into account the social and political economy considerations in the assessment, or did not think that the proposed ban would have a material impact on the balance of payments.

Directors welcomed the government's structural policy agenda, which seeks to support productive, sustainable, and inclusive growth. They noted that an R&D tax credit, if well designed, could be an efficient instrument to support innovation in the business sector, while tax reform could play an important role in shifting incentives toward broader business investment. Directors welcomed the authorities' ongoing commitment to open, multilateral trade integration.

Table 1. New Zealand: Main Economic Indicators, 2013-2023

(Annual percent change, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Est.			Projections			
NATIONAL ACCOUNTS											
Real GDP (production)	2.2	3.6	3.5	4.0	2.9	3.1	3.2	3.1	2.9	2.7	2.6
Real GDP (expenditure)	2.2	3.2	4.2	4.2	3.0	3.2	3.2	3.1	2.9	2.7	2.6
Domestic demand	3.7	4.5	3.2	4.7	4.0	4.9	3.1	3.1	2.8	2.6	2.4
Private consumption	3.5	3.2	3.8	5.0	4.5	3.8	3.1	3.0	2.7	2.4	2.4
Public consumption	1.4	3.3	2.7	1.7	4.7	3.9	1.8	1.5	1.5	1.5	1.5
Investment	6.6	11.2	2.8	6.3	3.3	4.3	4.0	4.3	4.1	3.6	3.1
Public	7.0	6.5	6.1	-2.9	-0.3	9.0	2.0	1.5	1.5	1.2	1.2
Private	8.2	10.6	3.7	9.7	4.4	3.7	4.6	5.1	4.9	4.2	3.6
Private business	3.9	11.1	2.5	8.6	6.4	4.8	5.2	5.1	4.8	4.2	3.8
Dwelling	17.7	9.8	6.0	11.8	0.6	1.4	3.3	5.3	5.2	4.2	3.3
Inventories (contribution to growth, percent)	-0.2	0.4	-0.3	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	-1.6	-1.6	0.8	-0.6	-1.4	-1.5	-0.1	-0.2	-0.1	-0.1	0.0
Real gross domestic income	4.4	5.2	2.0	4.6	4.3	4.5	3.2	3.1	2.9	2.7	2.7
Investment (percent of GDP)	21.9	22.7	23.1	23.7	23.8	24.3	24.6	25.0	25.4	25.6	25.8
Public	5.6	5.7	5.9	5.5	5.3	5.6	5.6	5.5	5.4	5.4	5.3
Private	16.3	17.1	17.2	18.2	18.5	18.7	19.1	19.5	20.0	20.3	20.5
Savings (gross, percent of GDP)	19.0	19.5	20.0	21.4	21.0	21.6	21.8	22.0	22.4	22.6	22.8
Public	3.3	4.0	4.1	1.2	1.4	0.8	0.9	1.3	1.6	2.0	2.0
Private	15.8	15.4	16.1	20.2	19.6	20.8	20.8	20.7	20.8	20.6	20.8
Potential output	2.4	2.6	2.8	3.0	3.0	3.0	3.0	2.9	2.8	2.7	2.7
Output gap (percent of potential)	-2.4	-1.6	-0.9	0.1	0.0	0.1	0.3	0.4	0.6	0.5	0.4
LABOR MARKET											
Employment	1.5	3.5	2.2	4.6	4.1	2.8	1.8	1.4	1.3	1.3	1.4
Unemployment (percent of labor force)	5.8	5.4	5.4	5.1	4.7	4.5	4.5	4.4	4.3	4.3	4.4
Wages (nominal percent change)	2.4	2.5	2.3	1.9	2.1	2.9	2.1	2.5	2.5	2.4	2.6
PRICES											
Terms of trade index (goods, % change)	8.5	5.6	-5.0	1.2	6.6	2.1	-0.6	0.1	0.0	0.1	0.5
Consumer prices (avg, % change)	1.1	1.2	0.3	0.6	1.9	1.4	1.7	1.9	2.0	2.0	2.0
GDP deflator (avg, % change)	3.2	1.9	0.8	1.9	3.6	2.7	2.0	2.0	2.0	2.1	2.0
MACRO-FINANCIAL											
Official cash rate (policy rate, percent, avg)	2.5	3.1	3.2	2.2	1.8	1.8	1.8	2.1	2.4	2.9	3.0
Credit to the private sector (percent change)	5.1	4.5	8.4	7.3	4.9	5.1	5.3	5.1	5.0	5.0	4.7
House prices (percent change, avg)	9.0	6.5	11.6	13.0	6.4	4.5	4.5	4.2	4.0	4.0	4.0
Interest payments (percent of disposable income)	8.4	9.0	9.3	8.5	8.4	8.6	8.8	9.1	9.3	9.5	9.8
Household savings (percent of disposable income)	3.3	2.1	2.0	2.2	2.4	2.6	2.8	3.0	3.1	3.3	3.5
Household debt (percent of disposable income)	151	155	161	167	168	166	165	163	161	160	159
GENERAL GOVERNMENT (percent of GDP) 1/											
Revenue	37.3	37.2	37.7	37.6	37.2	37.0	37.1	37.2	37.2	37.3	37.3
Expenditure	38.5	37.7	37.3	36.4	35.8	36.2	36.1	35.9	35.6	35.3	35.3
Net lending/borrowing	-1.3	-0.5	0.3	1.2	1.4	0.8	0.9	1.3	1.6	2.0	2.0
Operating balance	0.2	1.0	1.9	2.7	3.0	2.9	2.9	3.0	3.1	3.3	3.3
Cyclically adjusted balance	0.4	0.7	1.2	1.9	2.3	1.8	1.8	2.1	2.3	2.7	2.7
Gross debt	34.6	34.2	34.3	33.5	31.7	30.0	29.0	28.1	27.6	26.2	23.0
Net debt	11.0	10.4	9.8	9.1	8.6	10.0	11.0	10.8	10.2	8.1	4.9
Net worth	87.5	89.1	90.7	93.0	86.0	75.9	74.7	73.4	71.5	71.2	72.1
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-3.2	-3.2	-3.1	-2.3	-2.7	-2.6	-2.9	-3.0	-3.0	-3.0	-3.0
Export volume	0.8	3.1	7.0	1.5	2.6	2.7	3.9	4.0	4.3	4.3	4.1
Import volume	6.2	7.9	3.8	3.3	6.6	6.7	3.6	3.8	3.8	3.7	3.5
Net international investment position (percent of GDP)	-64.4	-65.3	-61.3	-59.3	-54.8	-54.3	-54.5	-54.8	-55.2	-55.7	-56.2
Gross official reserves (bn US$)	16.5	15.8	14.3	18.2	20.3	…	…	…	…	…	…
MEMORANDUM ITEMS											
Nominal GDP (bn NZ$)	228	241	251	266	283	300	316	332	349	366	383
Percent change	5.5	5.5	4.4	6.0	6.6	5.9	5.2	5.2	5.0	4.8	4.7
Nominal GDP per capita (US$)	41,777	43,876	37,825	39,050	41,591	44,508	46,340	48,413	50,598	52,854	54,985
Real gross national disposable income per capita (NZ$)	46,491	47,896	48,204	49,851	50,560	51,808	52,176	52,741	53,365	53,916	54,538
Percent change	3.2	3.0	0.6	3.4	1.4	2.5	0.7	1.1	1.2	1.0	1.2
Population (million)	4.4	4.5	4.6	4.6	4.7	4.8	4.9	5.0	5.1	5.2	5.3
US$/NZ$ (average level)	0.821	0.831	0.700	0.697	0.711	…	…	…	…	…	…
Nominal effective exchange rate	112.3	116.6	111.2	112.0	113.3	…	…	…	…	…	…
Real effective exchange rate	111.5	115.2	109.3	109.6	111.0	…	…	…	…	…	…

Sources: Authorities' data and IMF staff estimates and projections.

1/ Calendar year.

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

June 5, 2018

KEY ISSUES

Context. New Zealand's economy has enjoyed a solid expansion since 2011. With a persistent net migration wave, potential output has moved closely in line with actual output, and economic slack has decreased slowly. Macroeconomic imbalances overall have narrowed, although macro-financial vulnerabilities have risen with rapid house price increases. The new coalition government seeks to make growth more inclusive.

Outlook and risks. After a lull in 2017 amid a cooling of the housing market, growth is expected to remain at around 3 percent, driven initially by higher spending supporting infrastructure and structural reform. Inflation should pick up, gradually converging toward the midpoint of the 1-3 percent target range. Risks to growth are balanced in the near term, with upside risks from a stronger global economy and stronger-than-expected net migration, and downside risks from a smaller fiscal impulse due to implementation lags and external risks, including tighter global financial conditions.

Policy recommendations. The main issues facing policymakers are the appropriate macroeconomic policy stance with prolonged inflation undershooting and the economy at capacity, meeting the infrastructure and other needs of a rapidly growing population, improving housing affordability and managing related macro-financial vulnerabilities, and raising productivity.

- **Macroeconomic policies**. The accommodative monetary policy stance is appropriate, given persistent inflation undershooting and lack of price pressures. New Zealand has fiscal space and the higher spending on infrastructure and macro-structural reforms is welcome.
- **Housing and financial sector**. Macroprudential policies have contributed to reducing related risks to financial stability and should continue to mitigate risks from high household debt. The ambitious housing policy agenda appropriately focuses on strengthening supply and lowering tax distortions. Banks have strong capital and liquidity buffers.
- **Structural policies**. The new government's agenda appropriately focuses on reducing infrastructure gaps, lifting productivity, and fostering regional development, while seeking to make growth more inclusive.

Approved By
Odd Per Brekk (APD) and Kristina Kostial (SPR)

Discussions were held in Auckland and Wellington during April 5-17, 2018. The staff team comprised Thomas Helbling (head), Dirk Muir, Ryota Nakatani, Yu Ching Wong (all APD), and Zoltan Jakab (RES). Grant Johnston (OED) joined the discussions. Ioana Hussiada and Nadine Dubost assisted from HQ.

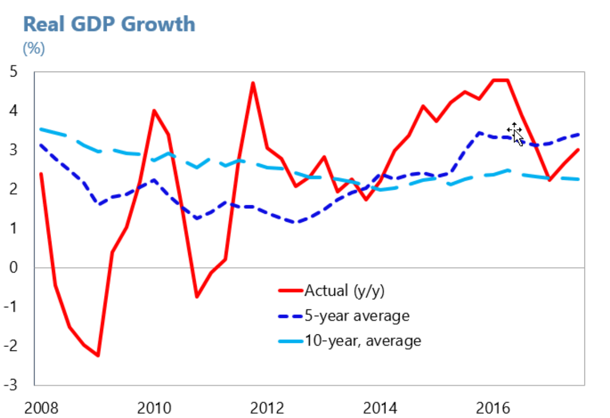
CONTENTS

TABLES

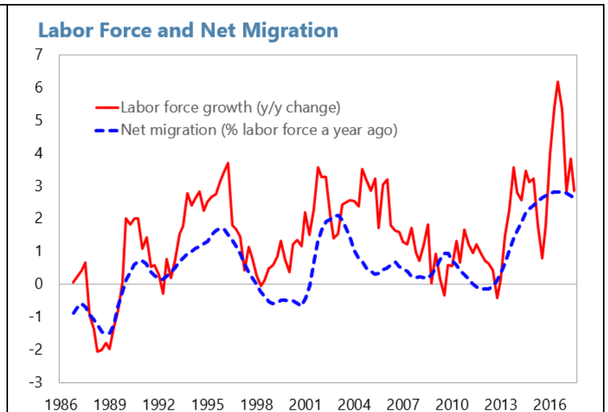
ANNEXES

CONTEXT

1. **New Zealand's economy has enjoyed a solid expansion, but, as elsewhere, inflation has been unusually weak.** Reconstruction spending after the 2011 and 2016 earthquakes and a net migration wave, partly driven by external factors, have been important growth drivers, with support from accommodative monetary policy, increasing terms of trade, and strong external demand from Asia. With net migration and labor supply increases more persistent and stronger than expected, potential output has been revised upward, while the output gap has decreased more slowly. Inflation has been either below or in the lower half of the 1 to 3 percent target range of the Reserve Bank of New Zealand (RBNZ).

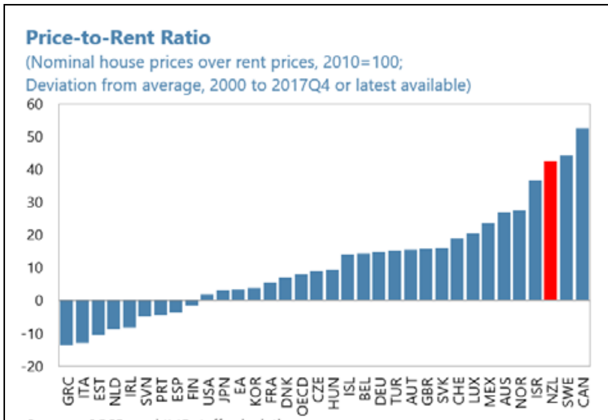


Sources: Haver Analytics and IMF staff calculations.

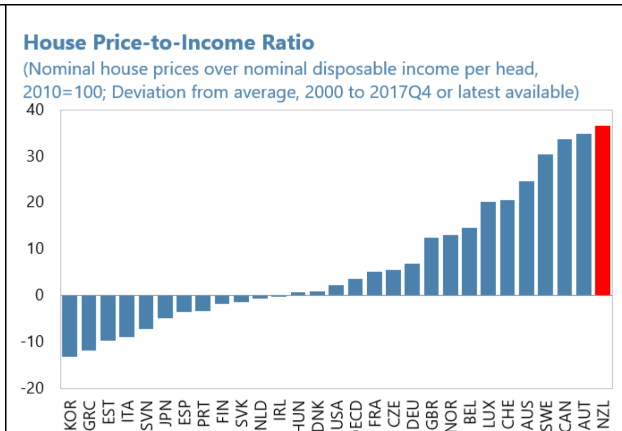


Source: Haver Analytics.

2. **Housing-related macro-financial vulnerabilities have increased in the expansion, and macro-prudential policies have been deployed to contain the risks**. Rising house prices have resulted in rapid household credit growth through 2016 and household debt ratios rising from already high levels. The RBNZ has used loan-to-value ratio (LVR) restrictions to curtail related risks. While the negative impact of high house prices on affordability has been offset by substantially lower interest costs, they have become an affordability constraint for some potential buyers, notably first-time home buyers.



Sources: OECD; and IMF staff calculations.



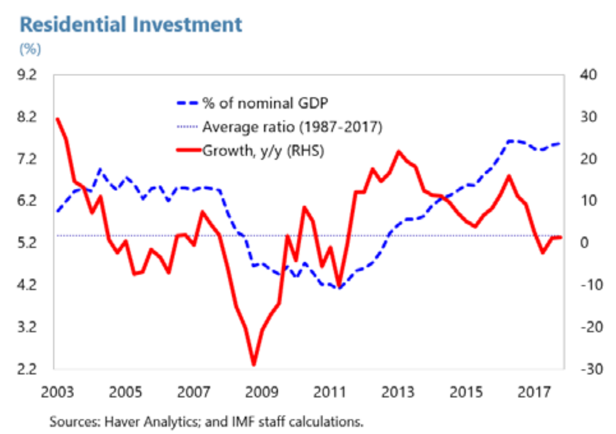
Sources: OECD; and IMF staff calculations.

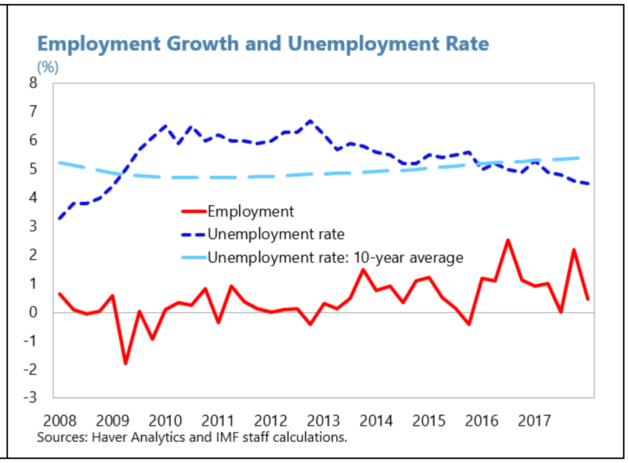
3. The New Zealand economy faces a productivity challenge despite favorable regulatory settings. Growth in per capita income or GDP per hour has been relatively low. Remote location ("distance") and a small market size have been identified as obstacles to higher productivity.

RECENT DEVELOPMENTS, OUTLOOK AND RISKS

A. Developments Over the Past 12 Months

4. GDP growth rebounded in mid-2017 as weather-related and other temporary factors subsided (Figure 1). Export growth recovered, as dairy and meat production picked up with higher prices. Private consumption continued to grow robustly, supported by strong employment gains. Business investment was also strong, partly due to the strong tourism demand (Box 1). Residential investment growth, in contrast, decelerated and its momentum remains softer, while import growth picked up. Overall, at around 3 percent, growth in 2017 was close to trend but below the buoyant rates of around 4 percent in 2014-16 implied by revisions to national accounts data late last year (Box 2).



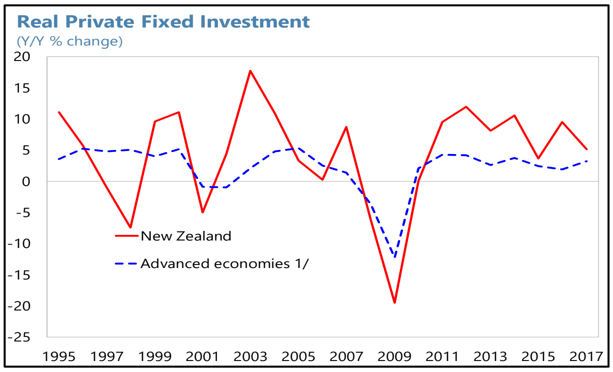


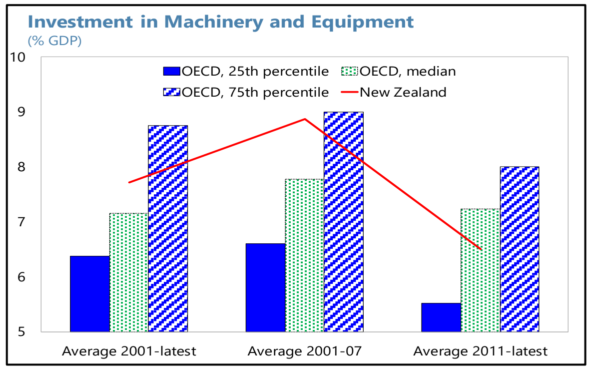
5. Net migration remained at recent record high levels. Strong immigration continued, while emigration did not increase, improving labor market conditions in Australia (the main destination country) notwithstanding. Employment continued to grow above trend, while the unemployment rate declined slightly below recent NAIRU estimates through 2017.

6. Disinflation re-emerged in 2017 even though the economy seems to have been operating close to capacity for the past two years. After a bounce in early 2017, mostly because of commodity price increases, headline inflation moderated in the remainder of the year, partly reflecting renewed downward pressures on prices for tradable goods and services. Underlying inflation increased modestly to around 1½ percent, while wage increases remained weak in 2017 even though many indicators point to the economy being broadly at full employment (Figure 2).

Box 1. Recent Developments in Business Fixed Investment

Business fixed investment growth has remained relatively weak. In general, private fixed investment growth in New Zealand has been stronger than in other advanced countries in recent years. But much of that growth has reflected residential rather than business investment. Outside fixed investment in tradable services, which have seen strong demand, especially in tourism-related services, business investment has remained relatively weak compared to (unexpectedly) rapid labor force and employment growth, notably in tradable goods production and in machinery and equipment. Capital intensity in the economy has thus broadly stagnated in New Zealand's solid expansion.

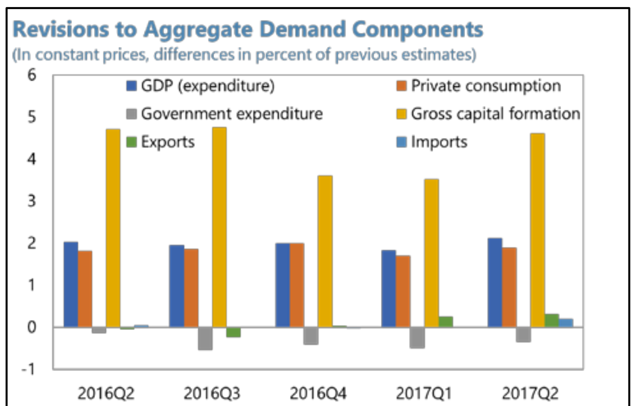




Sources: IMF, World Economic Outlook; OECD; Orbis and IMF staff Calculations.

Box 2. Revisions to New Zealand's GDP and Their Implications, 2014-16

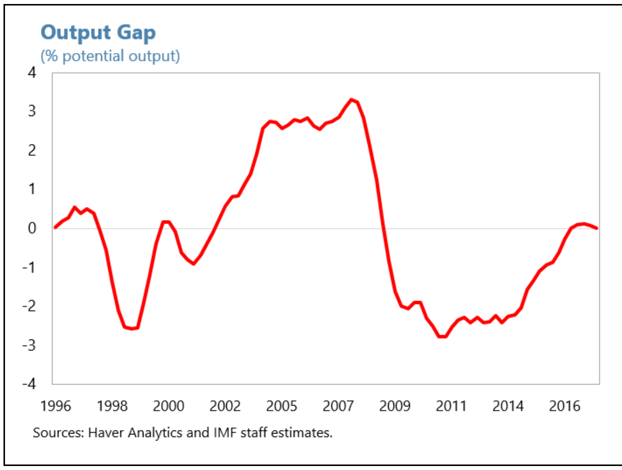
Revisions to historical GDP data suggest substantially higher economic growth in 2014-16. The revisions to GDP reflect additional survey and other data. First, the 2016 annual enterprise survey suggests higher business income. Second, the 2016 Household Expenditure Survey revised household consumption growth upwards since 2014. Third, residential investment was revised, using housing insurance data to account for building activity not requiring consent.

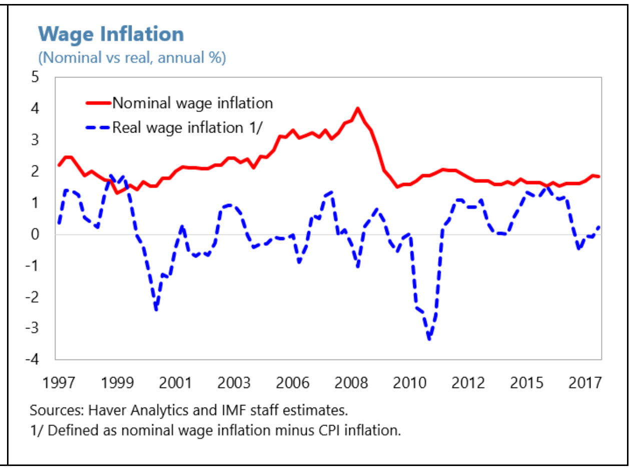


Sources: Statistics New Zealand; and IMF staff calculations.

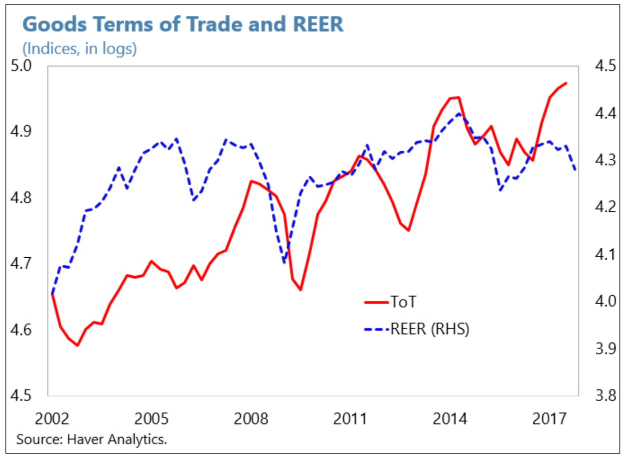
The higher real GDP growth mostly reflects stronger domestic demand. Levels of both private consumption and gross capital formation were strongly revised upwards, whereas that of government expenditure was slightly revised downwards. In sum, these revisions resulted in real GDP by expenditure being 2.0 percent higher by end-2016 than previously reported.

Potential output has been also revised upward. The higher GDP implies that labor productivity growth in 2014-16 has been higher than previously thought. With productivity growth closer to recent averages, the stronger aggregate demand is widely assessed to have been mirrored in strong potential output growth. This assessment is consistent with the view that strong labor force growth, supported in part by a net migration wave driven by external factors, and strong employment growth have resulted in a partly supply-driven expansion of the New Zealand economy. Interestingly, however, fixed private business investment has been revised upward in line with GDP, and the capital intensity of production is broadly unchanged.



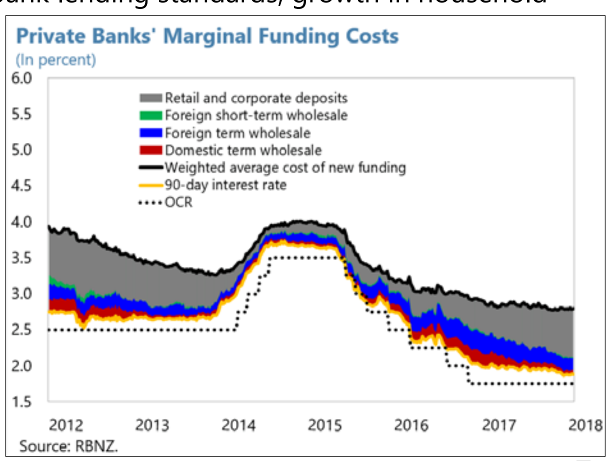


7. The external position in 2017 was moderately weaker than implied by medium-term fundamentals while the New Zealand dollar was moderately overvalued (Annex I). The expansion was mostly domestic demand-driven, which led to lower contributions to growth from net exports and lower trade surpluses (Figure 3). The trade balance impact was broadly offset by stronger terms of trade and by a lower primary income deficit, which narrowed with lower interest rates. The New Zealand dollar depreciated by about 6 percent in real effective terms in the second half of 2017, likely correcting some of the currency overvaluation.



8. The housing market is cooling and credit growth to households slowed. House price increases moderated since mid-2016, led by Auckland, while house sales declined and increases in residential building approvals slowed. The cooling appeared to reflect macroprudential policy intervention as RBNZ further tightened LVR restrictions in October 2016, primarily affecting credit to property investors, as well as possibly weaker foreign demand and self-correction in response to declining affordability. Together with tightening in bank lending standards, growth in household credit moderated in turn, broadly in line with nominal income growth (Figures 5-7).

9. Banks continue to hold strong capital and liquidity buffers. Profitability remained strong, underpinned by net interest margins**.** Slower credit growth and strong deposit growth with stable interest rates, reduced banks' needs to fund from market sources. This lowered offshore market funding reliance, while the average maturity of such funding also increased (Figure 8).



B. Outlook

10. **Growth is expected to remain strong at around 3 percent in the medium term, while inflation should edge towards the middle of the target range.** The turn to a more expansionary fiscal policy stance should offset slowing residential investment and weaker agricultural exports due to dry weather conditions in the near term. Over time, the *KiwiBuild* program should entail an increase in residential investment (see below). With potential output growth slowing due to the slowdown of net migration, the output gap should turn positive, and upward pressures on domestic prices are expected to emerge. Inflation is projected to rise gradually toward the mid-point of the 1-3 percent target range. The current account deficit should remain below longer-term averages.

11. **Vulnerabilities from household debt are expected to decline gradually but will remain high.** While housing demand fundamentals remain robust under the baseline outlook, the soft landing in the housing market should continue, reflecting increasing supply over time from the *KiwiBuild* program (see paragraphs 31 and 32) and gradually rising domestic interest rates. The interest burden on household debt should remain low, given relatively small expected increases in interest rates over the medium term, while the household debt ratio should start decreasing in 2018.

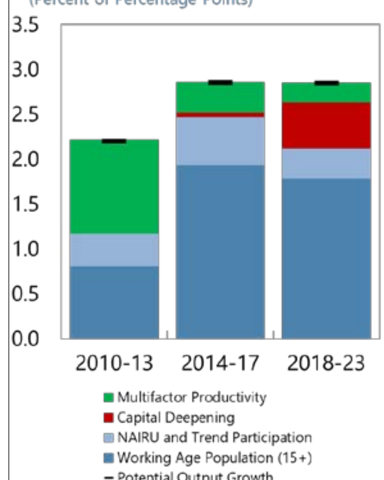
Impact of Interest Rate Changes on Housing Loans

	Baseline	Alternative	
	Dec-17		Change
Interest payment (Mil NZ$)	11,691	13,446	15.0
Implicit interest rates (percent)	6.7	7.7	1.0
DSTI (interest payment only, percent)	7.1	8.2	1.1

Sources: RBNZ and IMF staff calculations.

12. **Potential output growth is projected to slow over a 5-year horizon, mostly because of lower labor supply growth.** The latter reflects improving labor market conditions abroad and tighter visa requirements since August 2017. Capital deepening is expected to increase moderately, reflecting higher infrastructure investment in the near term, adjustment to a higher labor supply path after recent upward surprises, and incentives for cost control and adapting new technologies as capacity constraints broaden.

Growth Accounting
(Percent or Percentage Points)



Sources: Stats NZ, Authorities' data, IMF staff calculations

C. Risks

13. **Risks to growth are broadly balanced in the near term but tilted to the downside in the medium term** (Annex II). New Zealand has monetary and fiscal policy space to respond to shocks. On the upside, a stronger-than-expected performance of the global and the Australian economies would benefit New Zealand, and net migration could decrease more slowly than projected. On the downside, on the domestic side, the fiscal stimulus might be less expansionary if policy implementation is more gradual than projected. Furthermore, *KiwiBuild* could lead to shifts in housing supply from the private construction sector to the public sector rather than being a catalyst for stronger residential investment overall. On the external side, New Zealand is exposed to risks from tighter global financial conditions, structurally weak growth in advanced economies, a significant China slowdown, and a retreat from cross-border

integration. Household debt remains high under the baseline outlook and would amplify the impact of large downside shocks, notwithstanding recent improvements in bank's credit portfolio and risk structure after macroprudential policy intervention. Such shocks could also trigger a disruptive housing market correction.

Authorities' Views

14. The authorities broadly concurred with staff's assessment of the outlook and risks. They expect economic growth to pick up in the near term, reflecting the expansionary fiscal policy and robust population growth. Capacity constraints will broaden from construction to other sectors, and upward pressure on inflation will increase. Wage inflation will also rise, buoyed by the announced increases in the minimum wage over the next three years. In the medium term, growth is expected to moderate toward its potential output growth rate, which itself will moderate because of the expected slowdown of net migration. The recovery from the recent adverse weather conditions will increase agricultural export growth in the short term. The authorities share staff's concerns about external downside risks. A growing concern in this regard is that trade disputes could increasingly be settled outside of the current multilateral system and result in new trade restrictions, which is likely to harm smaller economies such as New Zealand more than larger economies.

POLICY DISCUSSIONS

A. Macroeconomic and Financial Policies

Context

15. Low inflation remains a monetary policy challenge. Tradable prices have been the main source of the renewed disinflation in 2017-18, suggesting that the low inflation problem is, in part, imported, including through greater competitive pressures. But the low inflation challenge is broader. Wage and price pressures remain weak across the economy even though it is broadly at full employment according to several indicators and the output gap has been closed for some time.

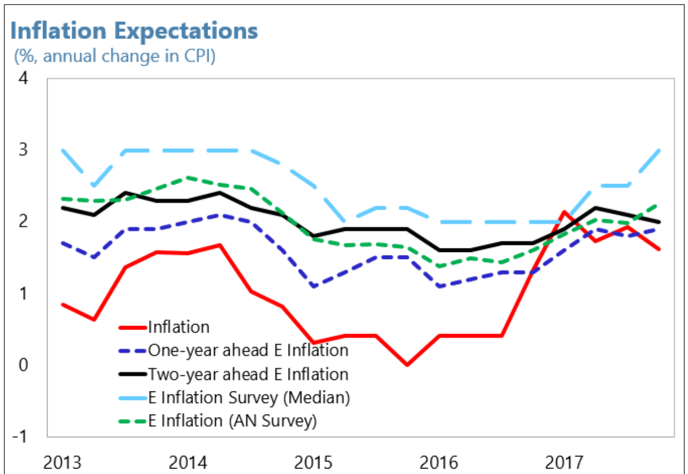
16. The solid expansion has helped to maintain a strong fiscal position but has also come with rapidly increasing infrastructure and other spending needs (Figure 4). Revenue growth has again surprised on the upside in the current fiscal year. The central government's spending plans for the next four years are more expansionary than in the previous budget and relative to the last Article IV consultation, driven by higher social, housing and regional spending (Annex III). In the near term, this spending will result in smaller budget surpluses, but in the outer years, the additional spending increases are financed by the cancellation of personal income tax cuts that had been slated to start in FY2019/20. Net debt is forecast to decrease below 20 percent of GDP by FY2022/23, two years later than previously anticipated.

17. Macroprudential policies have contributed to reducing risks to financial stability. After three rounds of tightening of LVR restrictions (Annex IV), the share of outstanding residential mortgages with LVRs above 80 percent declined to under 8 percent by September 2017, from

21 percent in September 2013 prior to the imposition of LVR restrictions. Bank and household balance sheets have become more resilient with this decline. The RBNZ relaxed the LVR restrictions marginally as of January 1, 2018 and signaled possible further easing.

Staff's Views

18. The current monetary policy stance is appropriately expansionary. A continued accomodative monetary policy stance has already contributed to stabilizing inflation expectations, and it will help the cyclical relationship between economic slack and prices to reemerge after a long period of downward pressure on prices from tradables deflation and strong labor supply growth. It will also lower risks to demand from currency overvaluation. The policy setting is robust to current uncertainties. A precautionary further easing would raise risks of a steeper tightening if inflationary pressures emerged sooner than expected, given that the economy appears to have been operating close to capacity for some time. On the other hand, a premature tightening could result in renewed currency appreciation and prolong price setting below the mid-point of the target range, given persistently low inflation in recent years, and lower the credibility of the flexible inflation targeting framework.



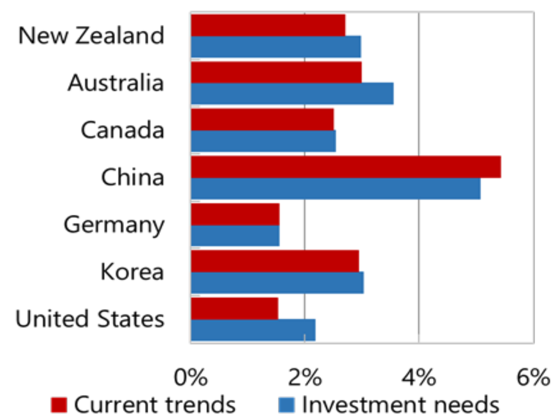
Sources: Haver Analytics and IMF staff calculations.

19. There is scope to tilt the balance from budget discipline to meeting increased spending needs from strong economic and population growth. Compared to the time of the 2017 Article IV Consultation, the updated baseline expenditure path already incorporates new growth-friendly measures (Annex III) and higher infrastructure spending (see Box 3), although gaps likely remain for the latter. At the same time, governments have been committed to budget discipline and the medium-term debt anchor. The balance between budget discipline and meeting spending needs reflects strong domestic preferences for maintaining low net debt ratios. While the authorities' prudent fiscal management is commendable, there is, at a minimum, no need for faster debt reduction beyond that outlined in the FY2018/19 budget (consistent with the fiscal DSA in Annex V). Stronger structural revenue, such as that from higher-than-expected population growth, should thus be used to increase spending on infrastructure and other measures that would strengthen the economy's growth potential.

Box 3. New Zealand's Infrastructure Gap and Fiscal Policy[1]

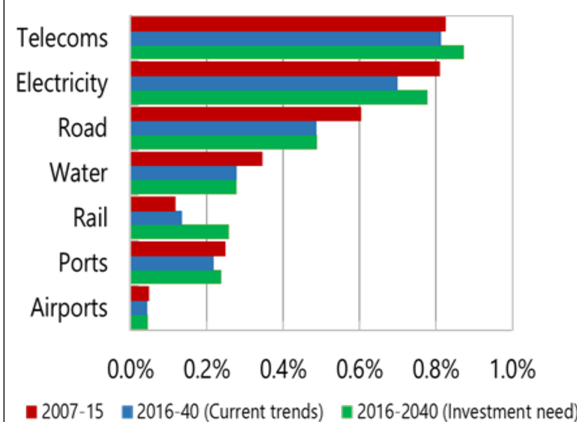
New Zealand has increased spending on infrastructure, but gaps remain. The concerted effort aims to address the infrastructure gaps that the government perceives in New Zealand. According to analysis published by the Global Infrastructure Hub, New Zealand is facing an annual shortfall of almost 0.3 percent of GDP on infrastructure investment in transportation, telecommunications, electricity and water services, translating into a cumulative gap of 9.5 percent of GDP by 2040.[2]

New Zealand versus Comparators
(Percent of GDP, per year)



Source: *Global Infrastructure Outlook*, Oxford Economics.

Infrastructure Components for New Zealand
(Percent of GDP, per year)



Source: *Global Infrastructure Outlook*, Oxford Economics.

Real GDP Gains from Closing the Gap
(Percent of GDP, deviation from baseline)

Real GDP as of:	2022	2050
Benchmark	0.1-0.2	0.6-0.8
Regional Focus, based on:		
Population Share	0.1-0.2	0.7-0.8
Population Share plus 25 percent	0.1-0.2	0.7-0.9

Note: Ranges of outcomes result from different types of deficit and tax financing.
Source: IMF staff calculations.

There are benefits to closing New Zealand's infrastructure investment gap. Estimated long-term gains (from an IMF DSGE model) range from 0.6 to 0.8 percent of real GDP. Gains are higher with deficit financing. Tax financing (PIT and/or GST) would offset almost one quarter of the long-term gains.

Additional focus of infrastructure spending in the regions outside of the main urban areas would have added benefits. Regions in need of development usually have higher output elasticities of public capital, although they also experience less efficient implementation of public investment. Under an illustrative set of assumptions, real GDP could be an additional 0.1 percent higher in the long term, as the regions benefit more from new unique local facilities and better connectivity with the rest of the country, even with an efficiency loss.[3] This additional focus is consistent with the increased emphasis on regional development because of the new *Provincial Growth Fund*.

[1] See the accompanying Selected Issues Paper, Muir, 2018, "Infrastructure Investment in New Zealand: Gaps and Multiplier Effects."

[2] The Global Infrastructure Hub is a new initiative of the G-20. Its prime output is the quantification of infrastructure investment gaps for over 50 countries, including New Zealand.

[3] These estimates are based on literature for Italy and Spain that correlates infrastructure investment undertaken in underdeveloped regions with better returns (up to 30 percent higher) but weaker efficiency (up to 10 percent lower). See, for example, for Italy, Bonaglia and others (2000) and Percoco (2004), or Marquez and others (2011) for Spain.

20. The expected fiscal policy stance balances the macroeconomic policy mix in the near and medium term. The higher spending is expected to translate into a positive fiscal impulse in the near term. This impulse is not expected to result in substantial upward price pressure since some of the higher spending will also increase potential output. While this will complement the accommodative monetary policy stance, which might be less effective on the domestic spending side, given the cooling housing market, it could potentially further weaken the external position. At the same, the slightly contractionary fiscal stance in the medium term—involving expected increases of about ½ percent of GDP in the cyclically-adjusted primary balance—is consistent with growth moderating to trend under current baseline projections. It would also contribute to moderating the upward pressure on the currency.

21. Further relaxation of LVR restrictions would not be helpful under the baseline outlook. With household debt vulnerabilities remaining high, the modest cooling of the housing market under the baseline projection does not call for an easing of macroprudential policies. While further easing is unlikely to reignite a housing boom with the new housing supply measures, there is also no clear need for further easing to prevent, together with other macroeconomic policies, a destabilizing market correction under the baseline.

Authorities' Views

22. The authorities noted that monetary policy will be accommodative for a considerable period of time. Inflation expectations remain well anchored, and RBNZ officials are confident that, under current monetary conditions, inflation will increase gradually to the 2 percent midpoint of the target range. With such a stance, monetary policy would also contribute to maximize sustainable employment at this moment.

23. The authorities emphasized that their fiscal plans accommodate the growing demands for government services and infrastructure from rapid population growth. The FY2018/19 Budget increased spending on infrastructure, housing, health, regional development, and education. Going forward, the authorities are focused on the *Budget Responsibility Rules*, which commit to reducing net public debt to around 20 percent of GDP by FY2021/2022 – two years later than in the previous (FY2017/18) budget, but still preserving fiscal space and keeping expenditures near its recent historical average of 30 percent of GDP.

24. The authorities concurred that macroprudential policies have contained risks to financial stability from a booming housing market. While they noted staff's view that high household debt ratios argued against further easing of LVRs, on balance the Reserve Bank considered tighter credit standards and a calmer housing market justified the small easing they enacted recently. They noted, however, that the macroprudential framework would be reconsidered in Phase Two of the Review of the Reserve Bank Act and that, in the meantime, any further easing would be gradual and contingent on the outlook.

B. Review of Reserve Bank Act

Context

25. Phase One of the Review of the Reserve Bank Act has resulted in updates of the monetary policy framework. The updates add a "maximum sustainable employment" objective alongside price stability to the main monetary policy objectives and put a monetary policy committee in charge of decision-making. Once the committee is established, overarching monetary policy objectives would be established by the Minister of Finance, based on a (regular) review of the monetary policy goals led by the RBNZ, instead of being agreed upon in a *Policy Targets Agreement* (PTA) between the Minister and the RBNZ Governor. In the March 2018 *PTA,* the employment objective has already been operationalized through a qualitative description.

26. The forthcoming Phase Two of the Review will consider financial stability and other policies. The backdrop to this phase is the perception that the RBNZ's current regulatory and supervisory powers, including on the macro-prudential side, are far-reaching but without sufficiently clear overarching objectives set by elected officials. The powers are primarily based on the RBNZ's responsibility for keeping the financial system sound and efficient under the Reserve Bank Act.

Staff's Views

27. The revisions to the monetary policy framework under Phase One of the Review represents a welcome, useful update of governance elements, while maintaining the successful flexible inflation targeting regime. The formalization of an employment objective recognizes the fact that, *de facto*, modern flexible inflation targeting already involves employment stabilization.[1] The operationalization through a qualitative objective avoids undue risks to operational monetary policy independence and should be maintained in the forthcoming legislative changes. The periodic reset of overarching monetary policy objectives upon recommendations after a review led by the RBNZ should further enhance the transparency and accountability of the framework.

28. Phase Two of the Review should give priority to key areas in need of reform. The clarification of the RBNZ's financial policy mandate and objectives will be ambitious in scope. Last year's Financial Sector Assessment Program (FSAP) identified an urgent need for strengthening the macroprudential framework, including by broadening the toolkit to include a debt-to-income (DTI) or debt-service-to-income (DSTI) instrument, and the supervisory pillar of New Zealand's three-pillar approach to banking regulation (Annex VI). Related reforms should be prioritized in the deliberations, implementation, and addition of resources.

[1] See the accompanying Selected Issues Paper, Jakab, 2018, "Revamping Inflation Targeting in New Zealand 30 Years after its Inception."

Authorities' Views

29. The authorities considered Phase One of the Review of the Reserve Bank Act to be an update of the governance framework for the successful flexible inflation targeting regime. The employment objective recognizes that monetary policy has some role to play in macroeconomic stabilization. The authorities agreed that the employment objective should be operationalized through a qualitative description, following the style in the current *PTA*. The authorities noted that a committee structure was their preferred structured for decision making under delegated authority, instead of having all statutory responsibility falling on the governor.

30. Phase Two of the Review of the Reserve Bank Act is an opportunity to reconsider the financial policy mandate of the RBNZ. While the Reserve Bank Act assigns the RBNZ responsibility for promoting the maintenance of a sound and efficient financial system, the authorities are of the view that these objectives may not be sufficiently specific to provide for robust accountability under a delegated mandate. Among the possible options to be considered was the development of a Risk Statement by the government, which, akin to the overarching monetary policy objectives, could frame the RBNZ's financial policy mandate. A committee structure for decision making in financial policy is also under consideration.

C. Managing Housing Market Imbalances

Context

31. The new government's housing policy agenda focuses on direct supply initiatives, tax policy changes, and restrictions on home ownership by nonresidents. Addressing declining housing affordability has become a policy priority (Box 4).

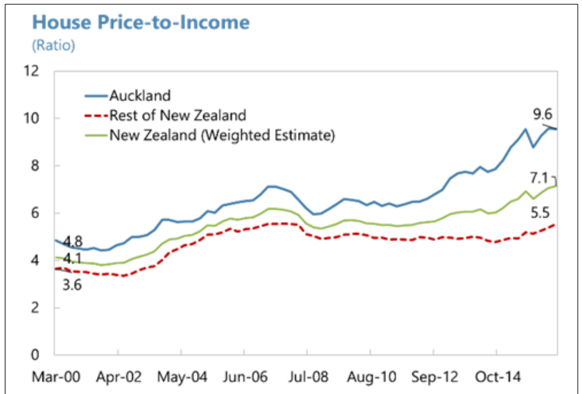
- ***Supply initiatives***. Under the *KiwiBuild* program, the government plans to build 100,000 affordable houses over 10 years (about one third of average annual residential building authorizations) for first-time homebuyers. After initial financing of NZ$2 billion, the program would be sustained through the sales of completed houses.

- ***Addressing other supply constraints.*** Besides the *KiwiBuild* program, the *Urban Growth Agenda* aims to increase the availability of developable land and the supply response to higher house prices by addressing regulatory, planning and other policy constraints, including the underfunding of locally-provided infrastructure.

- ***Tax policy changes.*** To dampen property speculation, more residential property sales will be subject to capital gains taxes, as the related bright-line test has been extended from a two-year to a five-year holding period. Residential properties other than main home acquired after March 29, 2018 will be subject to capital gain taxes if disposed of within five years of acquisition. The government also proposed to limit negative gearing from rental properties, such that the deductibility of net losses from property investment (and interest costs) from other taxable

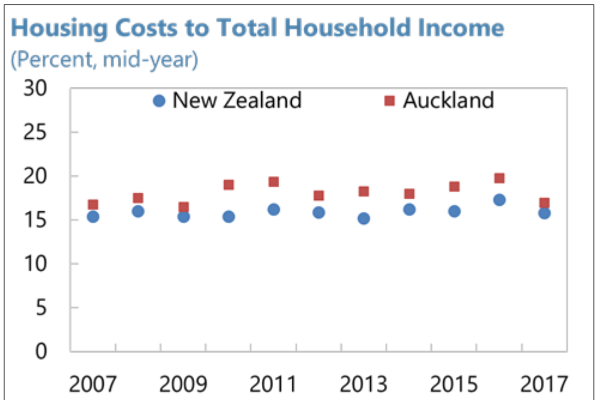
Box 4. Tracking Housing Affordability in New Zealand[1]

Housing affordability is a pressing concern in major cities. The house-price-to-income ratio has risen more rapidly in Auckland, resulting in a widening wedge with the rest of the nation. The decline in home ownership from more than 70 percent over 1990-97 to 63 percent in June 2017 suggests a deterioration in affordability.

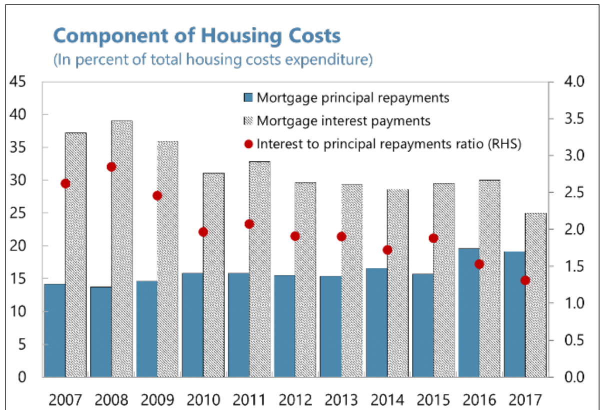


Source: RBNZ, Financial Stability Review (November 2016).

Housing cost indicators suggest that affordability in general may not have worsened considerably. Housing costs remain below 20 percent of household income. The ratio in 2016 marginally exceeded the previous peak in 2011 but has since declined in 2017. Historically low interest rate levels have largely offset the higher cost from the higher required principal repayments for larger housing loans.

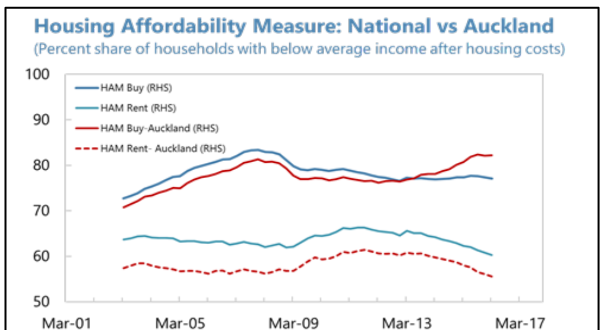


Source: NZ Statistics.



Sources: NZ Statistics; and IMF staff calculation.

Affordability has worsened for Auckland first-home buyers and is better for renters. A new housing affordability measure compiled by the government examines household incomes, subtracting the cost of buying or renting and compares that to a 2013 benchmark to track affordability over time. The share of potential first home-buyer households with below average income after housing costs increased to 82 percent in 2016Q1 in Auckland, compared to 77 percent at the national level. In contrast, the housing rental market has so far acted as a safety valve for those cannot afford home ownership.



Sources: Ministry of Business, Innovation & Employment; NZ Statistics; and OECD.
Note: Housing affordability measure (HAM) compares the income after housing costs of renters and potential first home buyers to income after housing costs for the average New Zealand household in June 2013.

The central group subject to the housing affordability problem is new entrants to the labor market with little of the savings needed for home ownership. Our analysis suggests that at the prevailing median house price level and median household income, the estimated debt-service-to-income ratio would exceed the affordable threshold of 30 percent. It would also take at least 4 years of saving one-third of household income for a 20 percent deposit in order to be eligible for a mortgage.

[1] See the accompanying Selected Issues Paper, Wong, 2018, "Housing Affordability in New Zealand and Policy Response."

income would be eliminated. A Tax Working Group is considering possible additional reform, including a broader capital gains tax on real estate investment and land tax reform.

- ***Restrictions on nonresidents' real estate purchases.*** A proposed ban in a draft amendment to the *Overseas Investment Act* is scheduled for a parliamentary vote as early as late June 2018. Under the amendment, all residential land would be re-classified as "sensitive land," which would require approval for foreign buyers under tighter qualifying criteria.

Staff's Views

32. The housing policy agenda appropriately focuses on closing key gaps on the supply side and in the tax system. While demand-side drivers have stabilized, they remain robust, and improved housing affordability ultimately requires a stronger housing supply response. These measures are complementary, and the success of the housing policy agenda will depend on well-coordinated progress on all fronts. While the large scale of the *KiwiBuild* program can provide the certainty needed to redirect builders' incentives toward lower-price housing and adopt new, more cost-effective building technology, the direct market intervention by the government also comes with risks to the budget and risks of crowding out private housing supply and market distortions more broadly. The Tax Working Group should also consider raising land taxes, which are efficient and would increase the recurrent cost of holding land, thereby encouraging its (re)development.

33. A ban of residential real estate purchases by nonresidents is unlikely to improve housing affordability significantly. The proposed draft amendment to the *Overseas Investment Act* would be a capital flow management measure (CFM) under the IMF's Institutional View (IV) on capital flows, as it would introduce discrimination based on residency and thus limit capital flows by its design. Its use would not be in line with the IV. While macroeconomic and macroprudential policy settings are broadly appropriate, available data suggest that foreign buyers appear to have played a minor role in New Zealand's residential real estate markets recently. And in its current design, the CFM is unlikely to be temporary or targeted. The broad housing policy agenda above, if fully implemented, would address most of the potential problems associated with foreign buyers on a non-discriminatory basis.

Authorities' Views

34. The authorities concurred that restoring housing affordability required a focus on strengthening supply and lowering tax distortions. They noted that measures to intensify competition in land markets via the *Urban Growth Agenda* would not be sufficient. Direct intervention, through the *KiwiBuild* program, was also required. On tax policy, while the extension of the bright-line test to five years for capital gains taxation on non-primary residences is now in place, a wider set of reforms are being considered to the tax treatment of residential real estate investment. This includes ring-fencing negative gearing on investment properties. The Tax Working Group has been directed to consider whether a system of taxing capital gains or land (not applying to the family home or the land under it), or other housing tax measures, would improve the tax system.

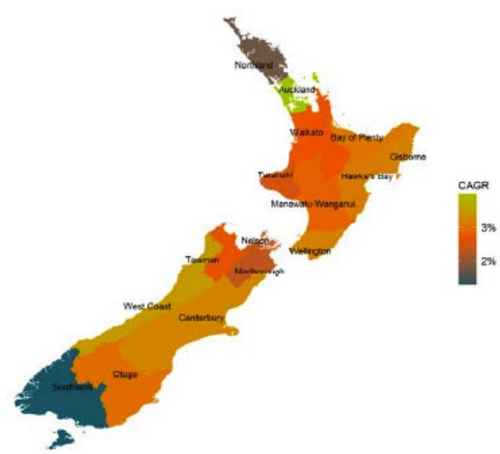
35. The authorities disagreed with the assessment that a ban on residential real estate purchases by nonresidents, if implemented, would be a CFM under the IV. They emphasized that the ban must be assessed holistically, taking into account the broader social, economic and political context. Declining housing affordability and greater inequality have become a major concern, which has lowered approval of globalization and immigration in New Zealand. Given the central role that home ownership plays in New Zealanders' sense of wellbeing, the government has taken steps to ensure that housing prices will be shaped by domestic market forces. If the government had not committed to extend its domestic screening regime for sensitive New Zealand assets to residential land, it would not have been able to secure the public's support for additional international trade agreements. The authorities noted that the proposed screening regime will allow nonresidents to obtain consent to acquire residential land where they are committed to reside and become tax residents, in New Zealand; where their investment will increase housing supply; or where they will develop the land for other purposes (such as commercial premises). They also think that the new regime will help ensure that foreign direct investment flows into the productive economy rather than unproductive speculation. Finally, the authorities do not consider this measure to be a CFM; it will only have a limited effect on aggregate capital flows or the balance of payments, and it will have no material impact on the broader direction of or the openness of New Zealand's economy.

D. Supporting Higher and More Inclusive Growth

Context

36. New Zealand's strong expansion has not resulted in strong per capita income growth, highlighting long-standing structural weaknesses.[2] The lack of capital deepening in the current expansion has been of concern, as New Zealand risks missing out on new technologies embodied in capital. Total factor productivity growth, while steady, has been relatively low in comparison with peers. Moreover, after a period of rapid population growth, there is evidence of a persistent infrastructure gap. Regionally, much of the growth has been centered in the large urban areas—Auckland, Wellington and Christchurch—with less progress in the regions. However, New

Compound Annual Growth Rate – Average Annual Household Income, 2007-2017



Source: Ministry of Business, Innovation and Employment.

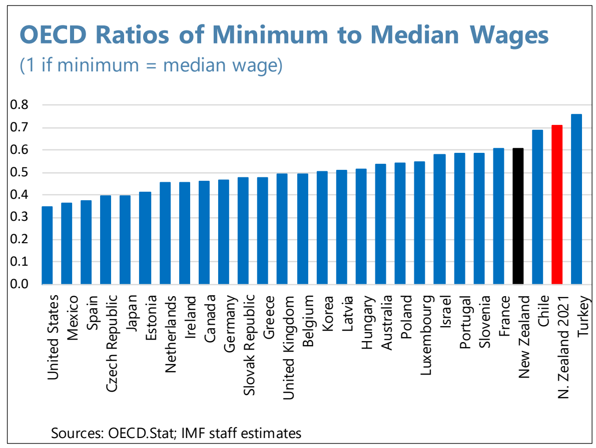
[2] See the accompanying Selected Issues Paper, Nakatani, 2018, "Productivity and Profitability in New Zealand: The Role of Leverage, R&D and Investment."

Zealand's structural policy settings are close to or mark best practice among OECD economies and it remains an attractive destination for skilled migrants (see Figure 9).

Staff's Views

37. The government's structural policy agenda seeks to support productive, sustainable, and inclusive growth. The initial emphasis has been on minimum wages; productivity, including research and development (R&D) and education; tax reform; regional development; and trade policy. While the FY2018/19 budget has provided clarity on many elements of the agenda, parts are still under development.

- ***The proposed minimum wage increases out to 2020 could help ease income inequality.*** But, as a result, New Zealand will have the second-highest minimum-to-median wage ratio in the OECD. In the current strong growth environment, the negative impact of higher minimum wages on employment growth, international competitiveness, and labor productivity are likely to be minimal, although there are risks that these impacts might turn out to be larger in a downturn.



- ***Free tertiary-level education and training for at least one year could boost human capital.*** Given its potential fiscal cost, the program could include greater targeting based on needs, possibly beyond the current time horizon.

- ***The agenda appropriately focuses on lifting R&D spending in New Zealand to 2 percent of GDP.*** An R&D tax credit, if well designed, would be an efficient instrument to support R&D spending in the business sector.

- ***Tax reform could play an important role in shifting incentives toward broader business investment.*** Estimates of marginal effective tax rates published by the Tax Working Group suggest that investment in residential real estate is effectively tax-favored compared to other investment. In contrast, introducing progressive corporate income taxation is unlikely to be helpful, considering the relatively small size of businesses in New Zealand. New companies and startups can be supported more effectively through other instruments, such as R&D tax credits or grants. Maintaining broad tax bases will support corporate investment and productivity more generally.

- ***The new Provincial Growth Fund should ensure project selection that helps regions to benefit from income gains more in line with the major urban centers.*** It can also be an appropriate tool to relieve pressures on the major urban areas by encouraging movement of population into the regions (see Box 3).

38. New Zealand's continued support of open trade and the multilateral trade framework is welcome. As one of the initial signatories of *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (CP-TPP), New Zealand will benefit from increased market access and new growth opportunities. Foreign direct investment complements the productivity benefits of international trade, and New Zealand would benefit from an improvement of the current policy regime. Restrictions under the *Overseas Investment Act* could be clarified, while the administrative burden associated with direct investment approvals could be reduced.

Authorities' Views

39. The authorities emphasized that the structural policy agenda focused on making the economy and economic growth productive, sustainable and inclusive. The agenda is still under development. Nonetheless, important first steps had been made. Reducing income and geographical inequality has been the motivation for the increase in the minimum wage, the equivalent of a free year of tertiary education (university or vocational), and the establishment of the three-year *Provincial Growth Fund* for regional development. The commitment to increase R&D spending to 2 percent of GDP, which includes a new tax incentive in addition to the current grant system was a first step in a broader agenda to support higher productivity. Finally, the government continues to pursue deeper economic integration through international trade, with the signing of the *CP-TPP* an important step in this agenda.

STAFF APPRAISAL

40. Context. New Zealand's economic expansion remains solid. Growth moderated toward trend recently after buoyant rates in 2014-16, and demand fundamentals continue to be strong: financial conditions are supportive, the terms of trade are close to historic highs, and net migration is still high. The external position in 2017 was assessed to be moderately weaker than implied by fundamentals and policy settings, while internal macroeconomic imbalances narrowed, although progress on the inflation front remains tentative.

41. Outlook and risks. The economic outlook is favorable, as growth is expected to remain at around 3 percent in the near term. While housing demand fundamentals remain robust, the soft landing in the housing market should continue, given gradually increasing supply. Risks to growth are broadly balanced in the near term, although some downside risks remain a concern in the medium term. Near-term upside risks are stronger-than-expected net migration or global growth, while more gradual government spending and a weaker demand stimulus is a downside risk. There are external downside risks in both the near and medium term of tighter global financial conditions, structurally low growth in advanced economies, a significant slowdown in China, and more protectionist and inward-looking policies. Household debt remains high under the baseline outlook and would amplify the impact of large downside shocks, notwithstanding recent improvements in its risk structure, and, possibly, also trigger a disruptive housing market correction.

42. Current macroeconomic policy settings are broadly appropriate. The monetary policy stance is sufficiently expansionary to address current, below-target inflation and lowers risks to demand from currency overvaluation. The strong fiscal position provides space to accommodate the needs from strong economic and population growth. With the country's strong fiscal position, there is no need for faster debt reduction beyond that outlined in the FY2018/19 budget. Stronger structural revenues, such as from higher-than-expected population growth, should be used to increase spending on infrastructure and other measures that would raise potential output.

43. Macroprudential policies have contributed to reducing risks to financial stability and should continue to mitigate risks from high household debt. Bank and household balance sheets have become more resilient with a lower share of loans with high LVRs. With household debt still elevated, further relaxation of LVR restrictions would not be appropriate under the baseline outlook.

44. The Review of the Reserve Bank Act is timely and has already led to an update of the governance framework after substantial evolution of New Zealand's flexible inflation targeting monetary policy regime. Phase One of the review is well advanced. In the latest *Policy Targets Agreement*, the employment objective has already been operationalized through a qualitative description, which is consistent with operational monetary policy independence and should be maintained as the updated framework is legislated and fully implemented. Phase Two of the Review, focused on financial stability and other policies, is expected to be ambitious in scope. While this phase is an opportunity to better define the mandate and objectives for the RBNZ in this domain, emphasis should be given to priority areas in need of reform, especially those suggested in the 2017 FSAP, such as the macroprudential toolkit and the supervisory pillar.

45. The ambitious housing policy agenda appropriately focuses on strengthening supply and lowering tax distortions. This focus will help in restoring broad-based housing affordability. The different workstreams under the agenda, including the *KiwiBuild* program and the *Urban Growth Agenda* are complementary, and the success of the agenda will depend on well-coordinated progress across the public sector. A ban of residential real estate purchases by nonresidents is unlikely to have a significant impact on housing affordability and the proposed CFM should be reconsidered. The broad housing policy agenda above, if fully implemented, would address most of the potential problems associated with foreign buyers on a non-discriminatory basis.

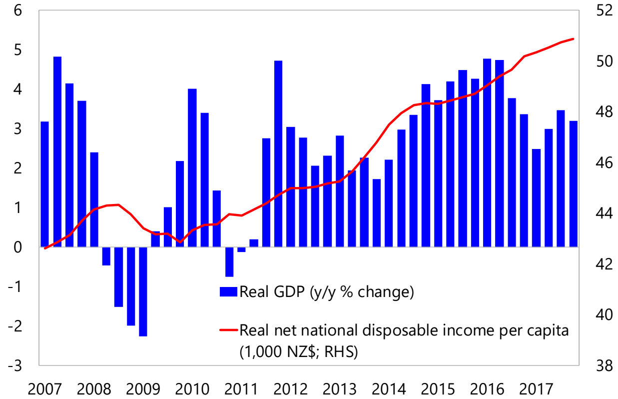
46. The government's structural policy agenda seeks to support productive, sustainable, and inclusive growth. Many elements of the agenda are still under development, and decisive reform progress would yield faster benefits. In particular, an R&D tax credit, if well designed, could be an efficient instrument to support innovation in the business sector, while tax reform could play an important role in shifting incentives toward broader business investment. New Zealand's continued support of open trade and the multilateral trade framework is welcome. Foreign direct investment complements the productivity benefits of international trade and it would benefit from a clarification of the restrictions in New Zealand's *Overseas Investment Act* and a reduction in the related administrative burden.

47. It is expected that the next Article IV Consultation with New Zealand will be held on the standard 12-month cycle.

Figure 1. Growth Starting to Pick Up Again

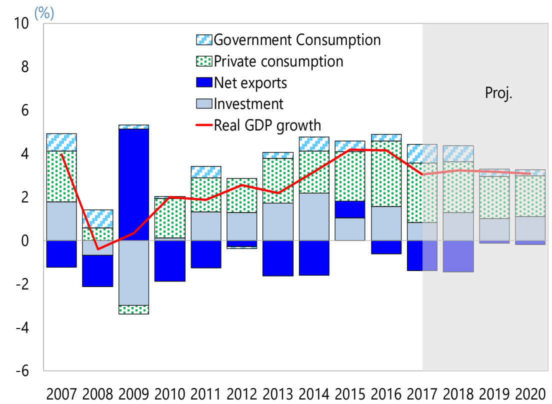
Economic growth continues to strengthen...

Growth Performance



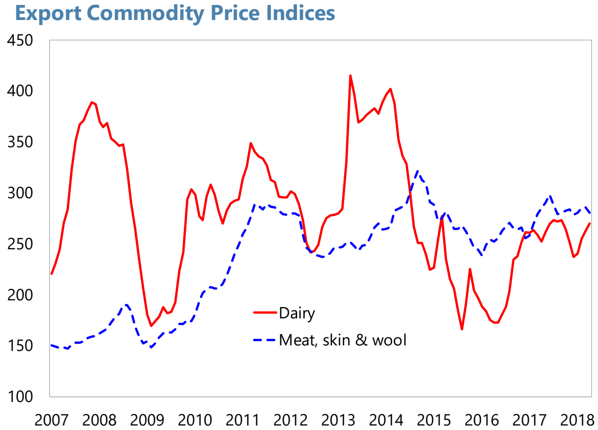
... supported by buoyant domestic demand ...

Contribution to Growth



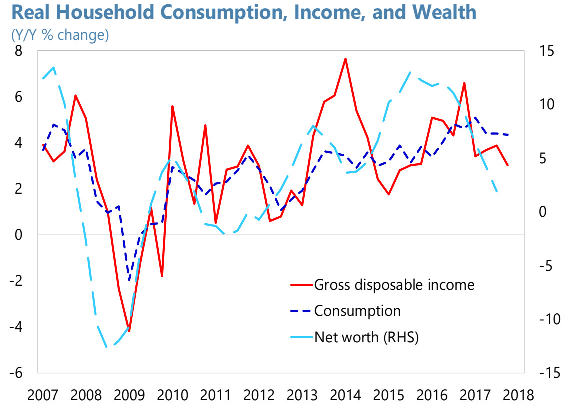
and relatively strong agricultural commodity prices.

Export Commodity Price Indices



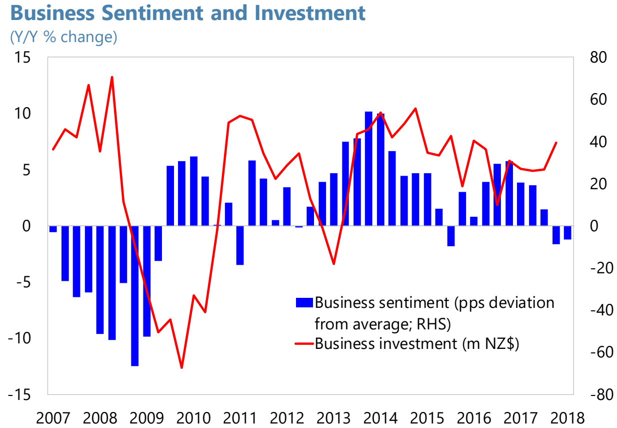
Consumption and net income are more stable ...

Real Household Consumption, Income, and Wealth



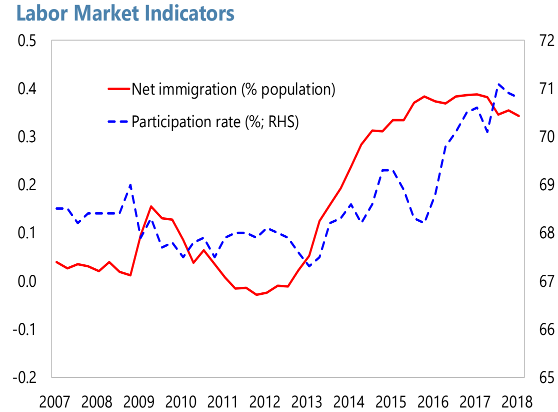
... while business investment has been lackluster ...

Business Sentiment and Investment



... despite rising labor participation and historically strong net immigration.

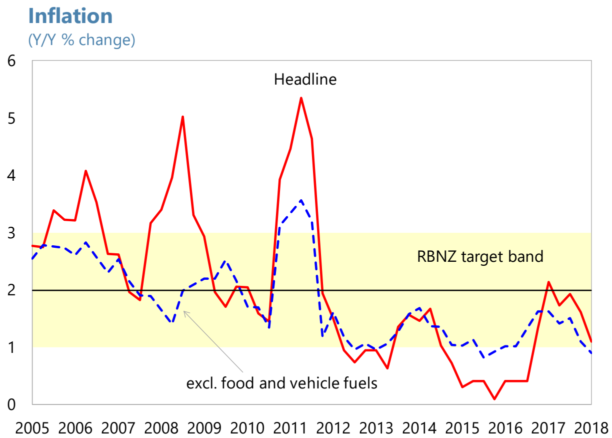
Labor Market Indicators



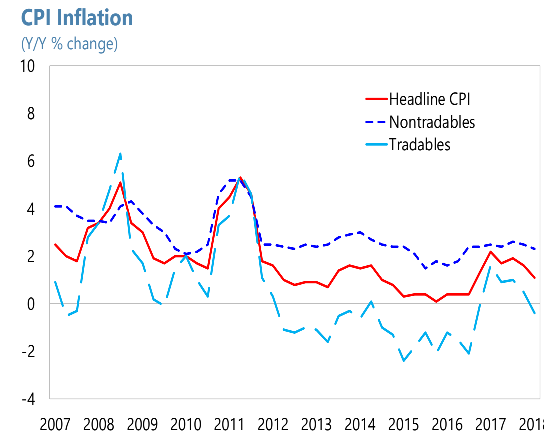
Sources: Haver Analytics; Statistics New Zealand; and IMF staff calculations.

Figure 2. Monetary Policy Still Faces Weak Inflation, Despite Lower Unemployment

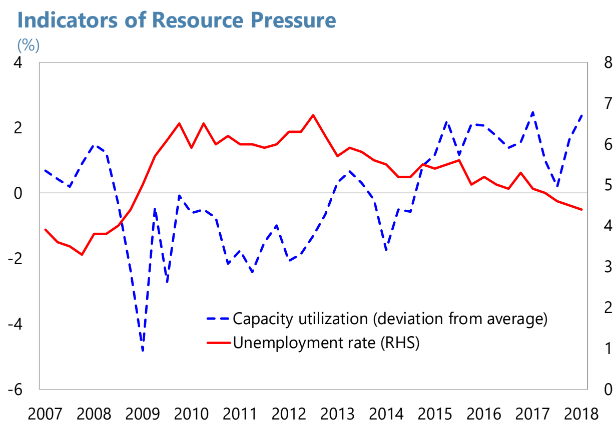
Core inflation continues in the lower half of the target band …



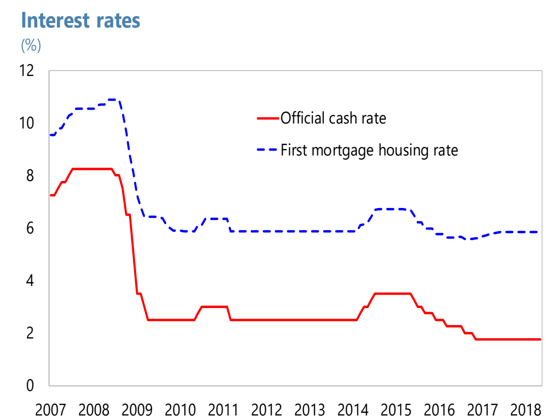
… primarily because of weak tradables inflation.



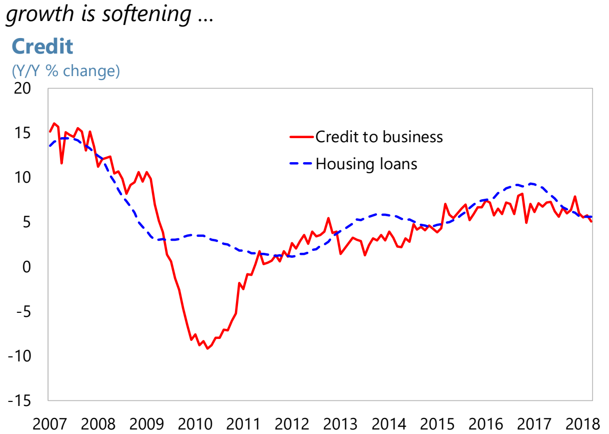
Capacity utilization is high and unemployment is declining.



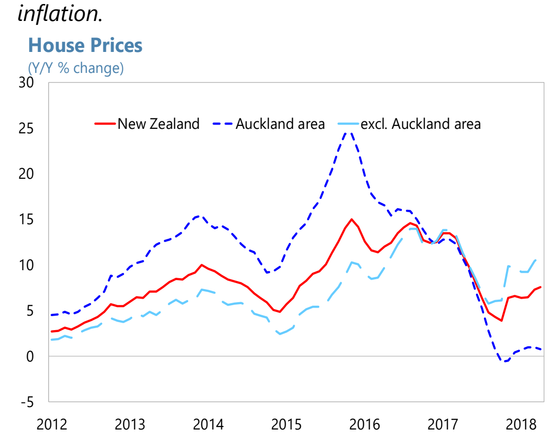
The mortgage and RBNZ policy rates remain stable …



… while business credit growth is still firm. Housing credit growth is softening …



…and is a contributing factor to easing house price inflation.

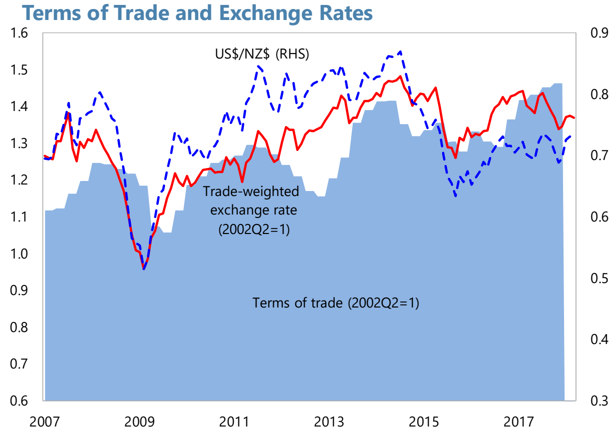


Sources: Reserve Bank of New Zealand; Haver Analytics; CoreLogic; and IMF staff calculations.

Figure 3. External Sector Remains Stronger and Stable

The terms of trade and real exchange rate remain stronger …

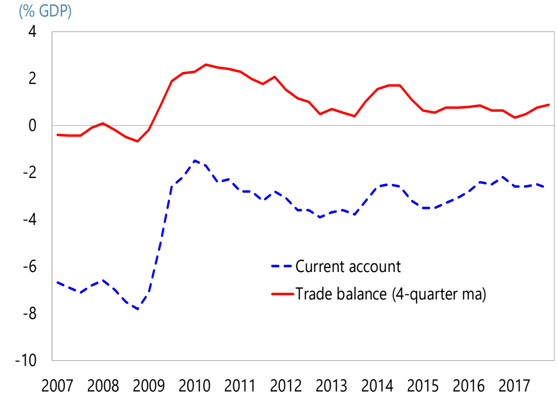
Terms of Trade and Exchange Rates



… and the current account balance is stable …

Current Account

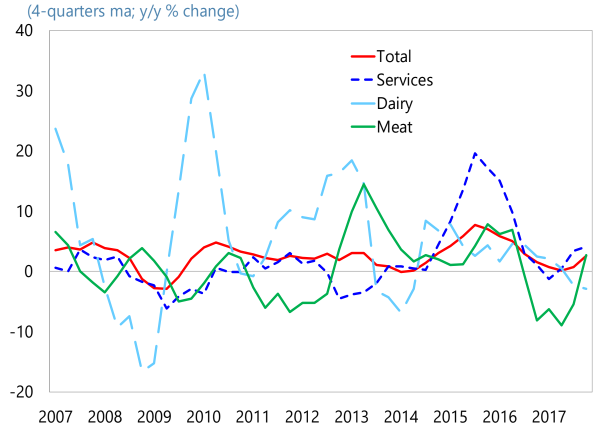
(% GDP)



… even as export growth has moderated …

Export Volume

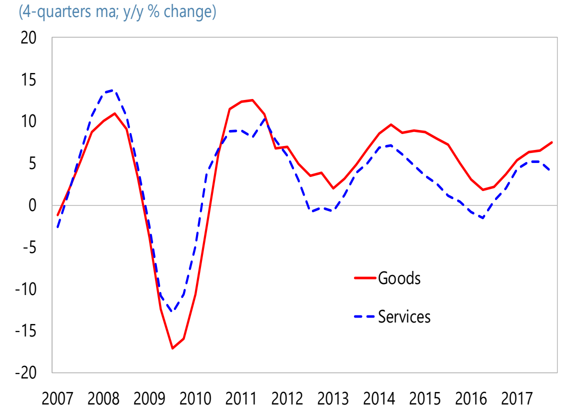
(4-quarters ma; y/y % change)



… and import volume growth has risen.

Import Volume

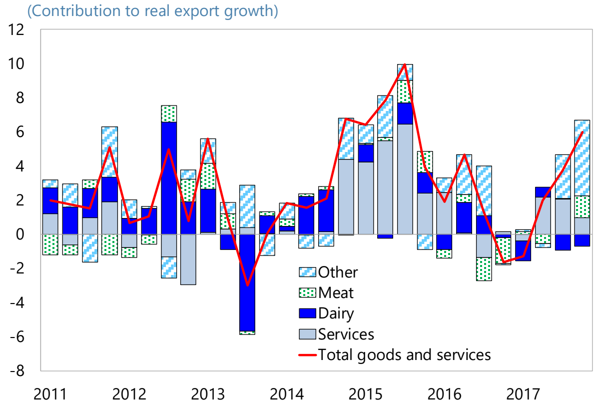
(4-quarters ma; y/y % change)



Services' contribution to export growth remains strong …

Export Composition

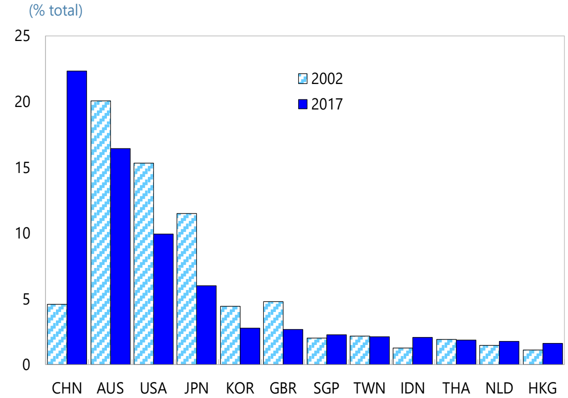
(Contribution to real export growth)



… while China has become the largest export destination.

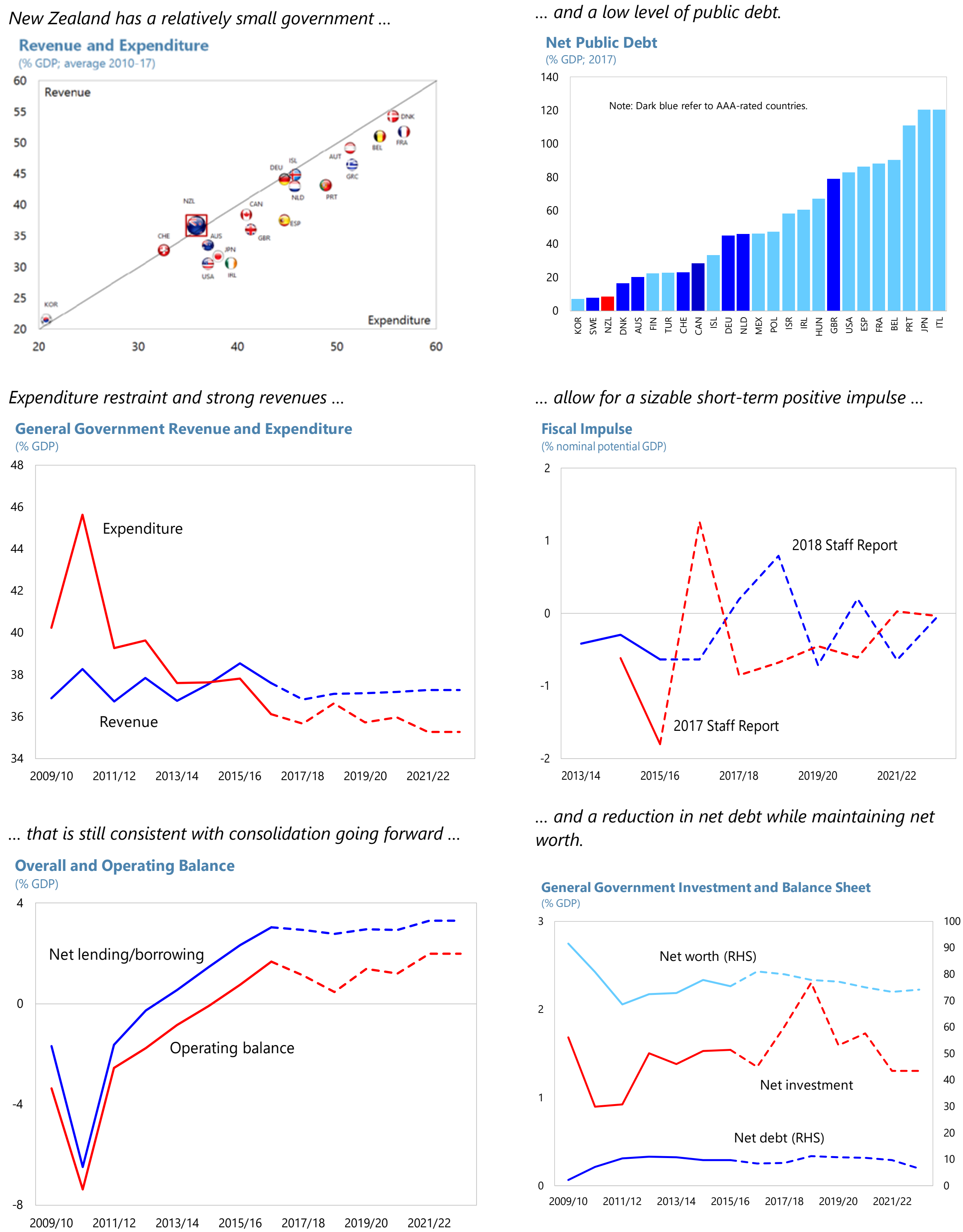
Exports by Destination

(% total)



Sources: Reserve Bank of New Zealand; Haver Analytics; and IMF staff calculations.

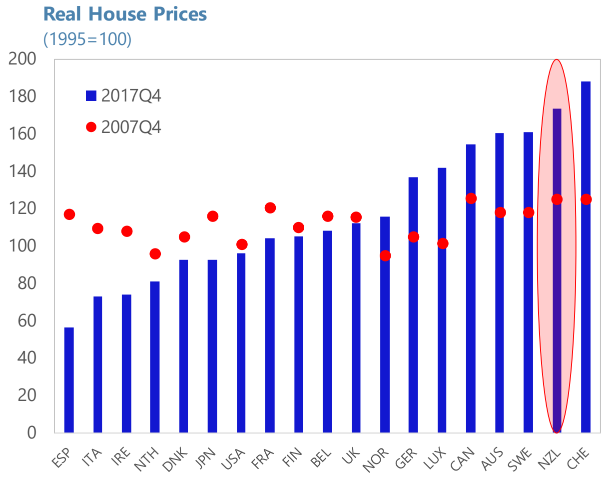
Figure 4. The Fiscal Position Remains Strong, Notwithstanding Higher Spending



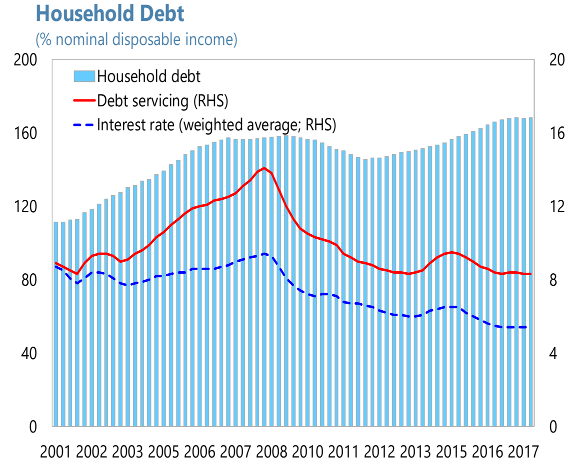
Sources: Treasury, *Budget 2018* and *2017 Half-Year Economic and Fiscal Update*; and IMF staff calculations.

Figure 5. Household Debt and Housing Remain a Concern, but with Signs of Improvement

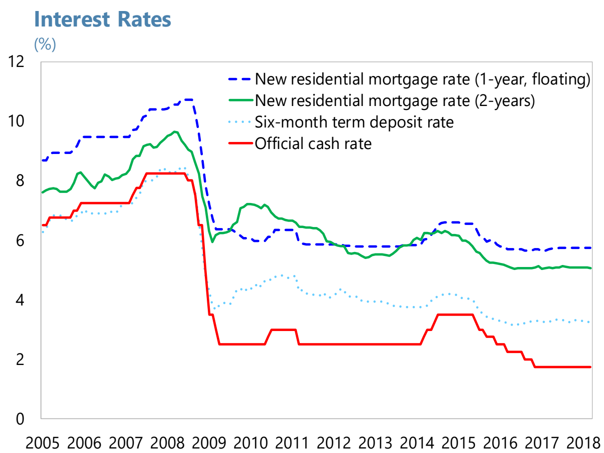
Low interest rates have led to higher house prices …



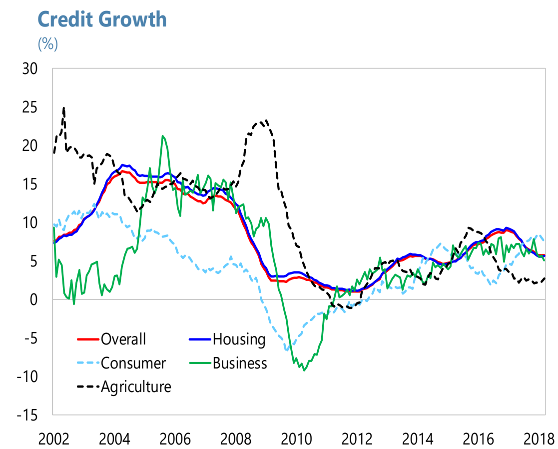
… and higher (but stabilizing) household indebtedness.



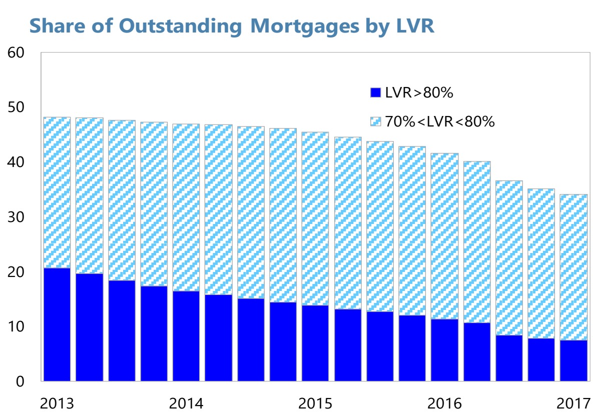
Marginally higher mortgage rates since early 2017 …



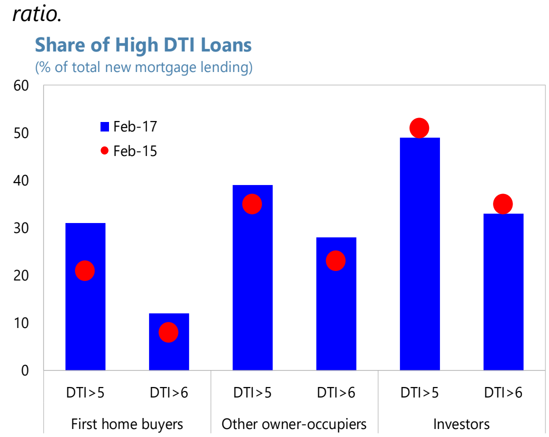
… and moderating housing credit growth reflect tighter LVR caps.



The share of high loan-to-value mortgages has fallen …



…but some loans have an elevated debt to income ratio.



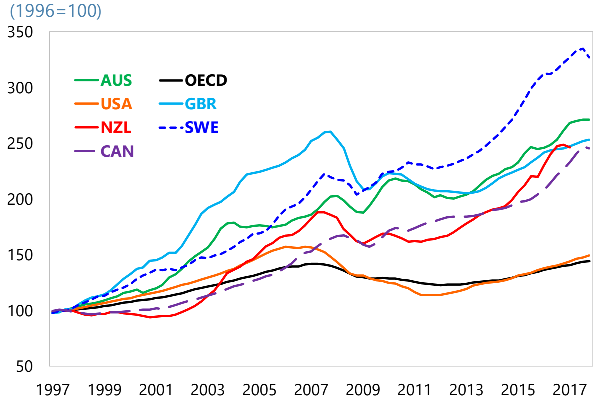
Sources: Reserve Bank of New Zealand; and Haver Analytics.

Figure 6. The Housing Market is Cooling

House price increases are still well above the OECD average …

Real House Prices vs OECD

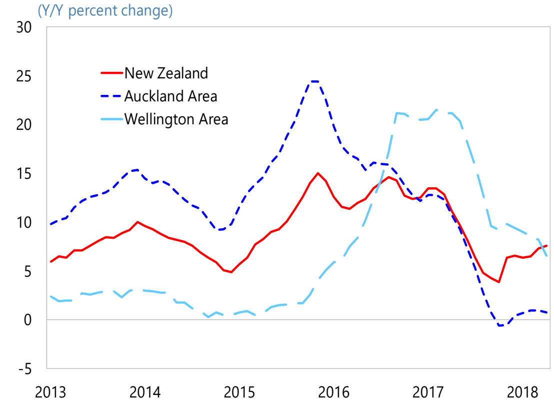
(1996=100)



… with substantial regional differences.

Residential House Prices: Regional Differences

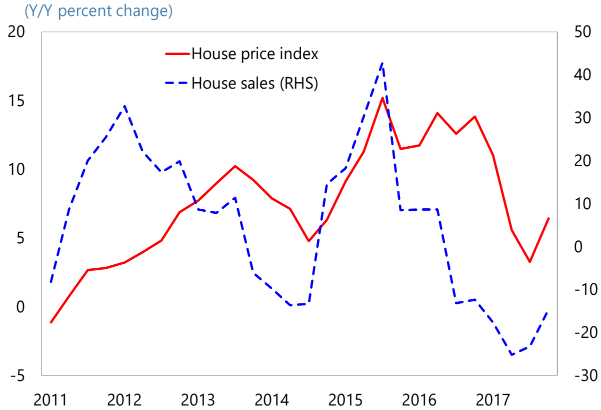
(Y/Y percent change)



Sales continued to decline as prices weaken …

House prices and sales

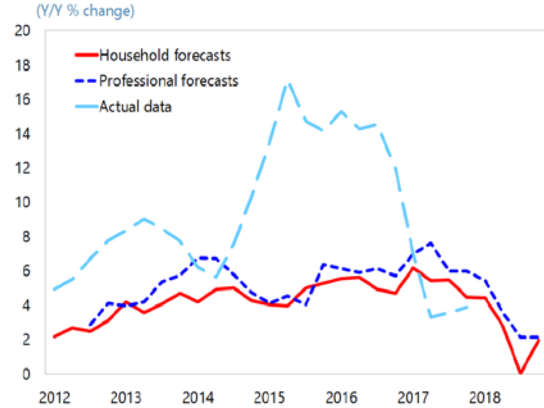
(Y/Y percent change)



… and expected house price increases declined.

House Price Expectations

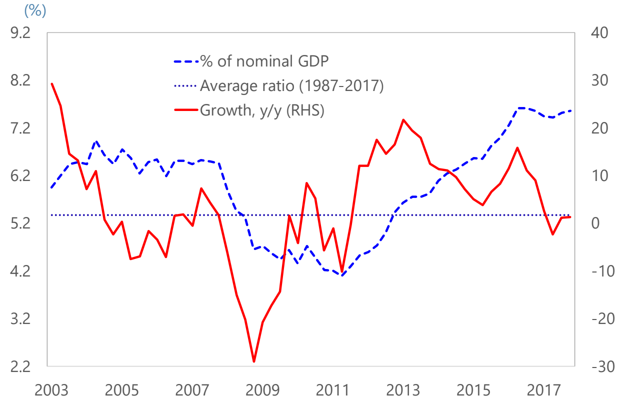
(Y/Y % change)



Residential investment growth has been subdued …

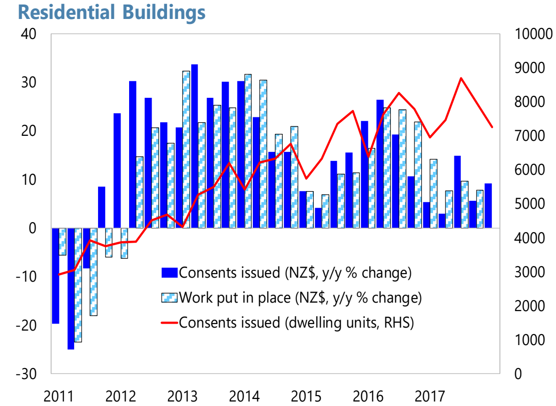
Residential Investment

(%)



… amid lower levels of new construction in the pipeline.

Residential Buildings

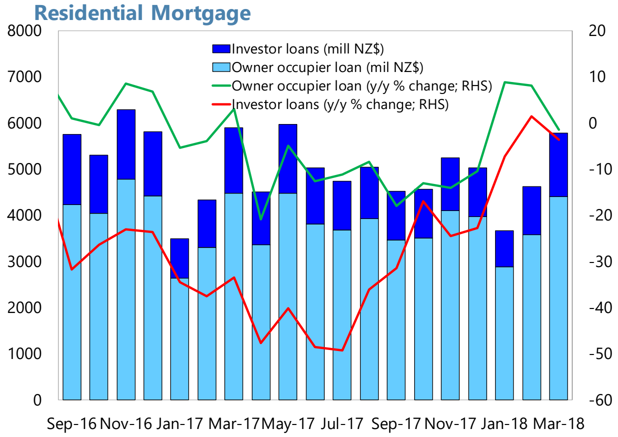


Sources: Reserve Bank of New Zealand; OECD; QV via Corelogic; Haver Analytics; and IMF staff calculations.

Figure 7. Households' Balance Sheets Risks Have Started to Improve

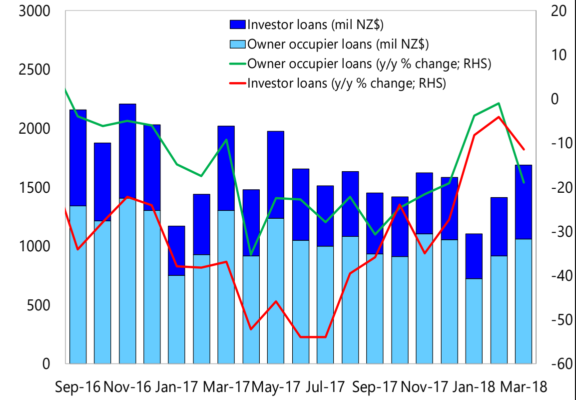
As banks tightened lending standards, loans to investors …

Residential Mortgage



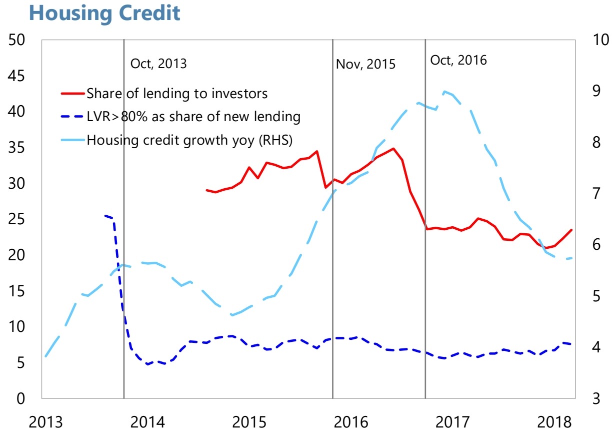
… and interest-only loans have declined substantially.

Residential Mortgage - Interest Only



Tightened macro-prudential measures helped ease credit growth to housing sector …

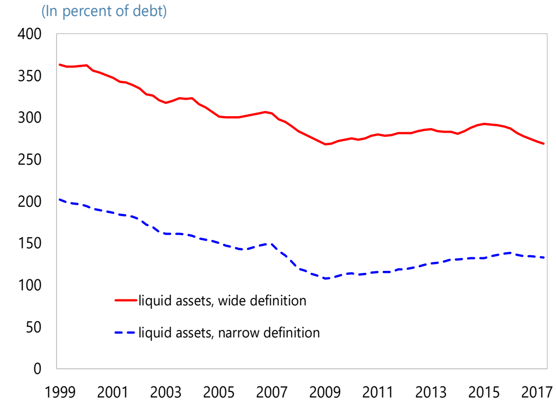
Housing Credit



… and household debt remained broadly covered by liquid assets.

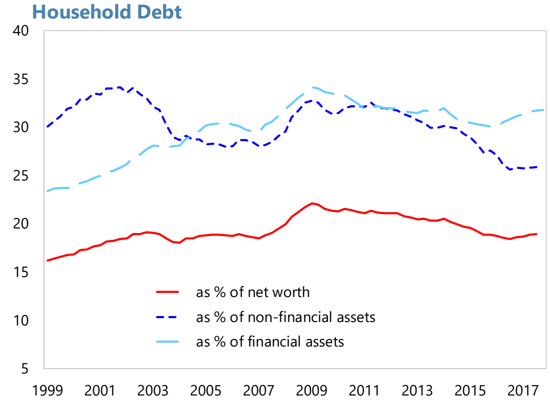
Household Liquidity

(In percent of debt)



Financial leverage has risen …

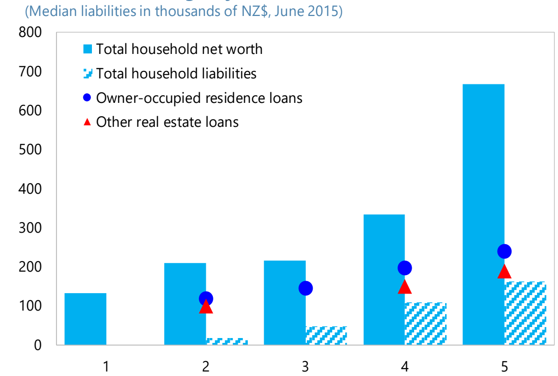
Household Debt



… with high and rising debt to income ratios.

Household Leverage by Income Quintile 1/

(Median liabilities in thousands of NZ$, June 2015)



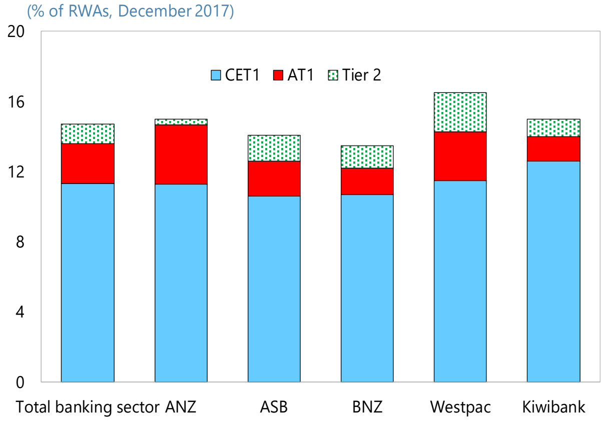
Sources: Reserve Bank of New Zealand; Statistics New Zealand; Haver Analytics; and IMF staff calculations.
1/ Some estimates are not publicly available for confidentiality and quality reasons.

Figure 8. The Banking Sector Is Strong

Banks remain well capitalized …

Capital Ratios

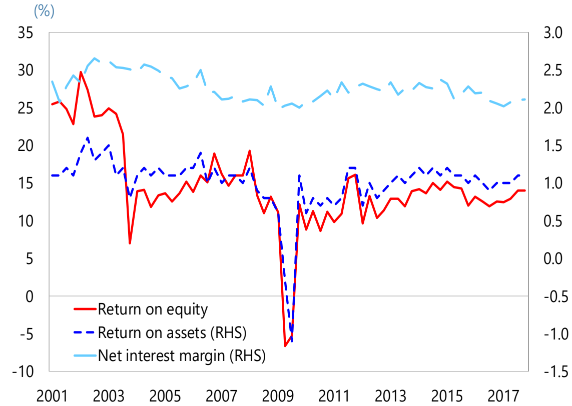
(% of RWAs, December 2017)



… and highly profitable.

Profitability

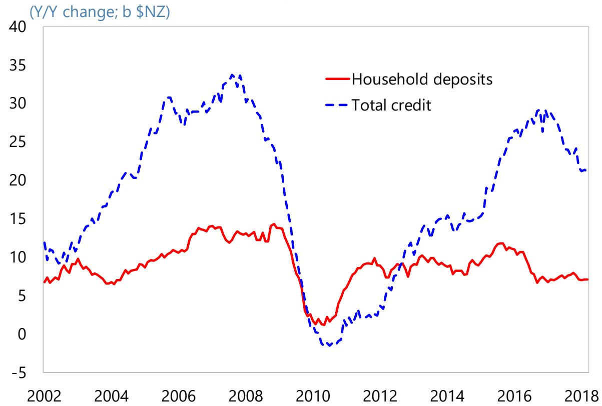
(%)



Credit growth has slowed while still exceeding deposit growth.

Credit and Household Deposits

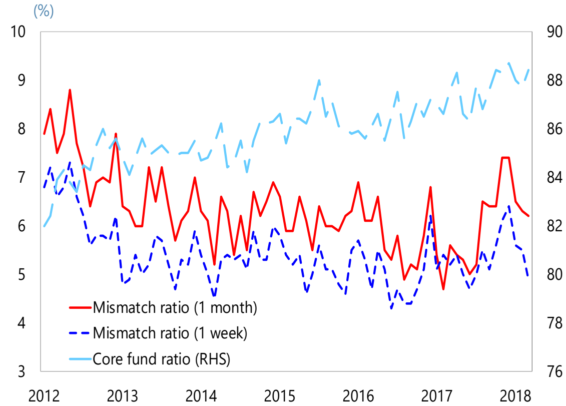
(Y/Y change; b $NZ)



Liquidity and core funding ratios have improved …

Liquidity and Core Funding

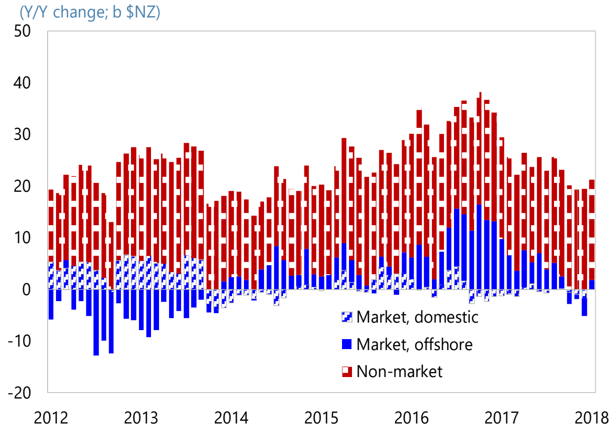
(%)



… with lower funding needs.

Total Funding

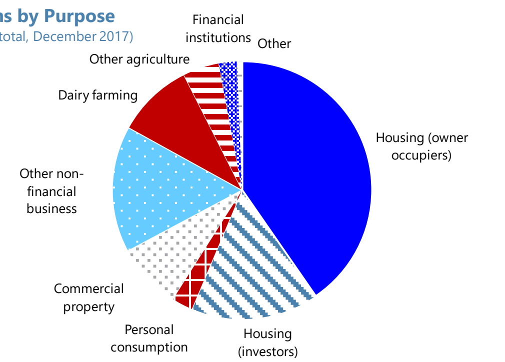
(Y/Y change; b $NZ)



Over one-half of loans are exposed to the housing sector.

Loans by Purpose

(% of total, December 2017)



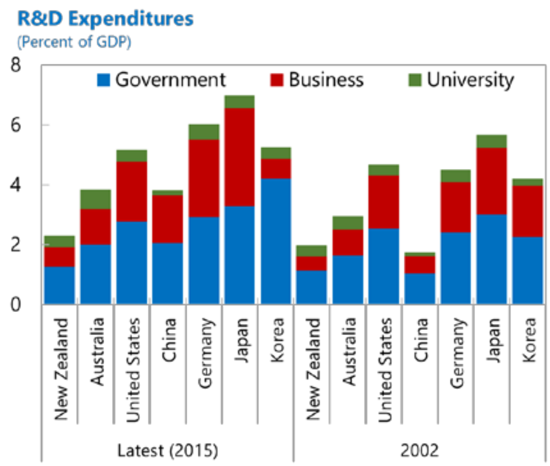
Source: Reserve Bank of New Zealand.

Figure 9. There Are Some Gaps in the Macro-Structural Position

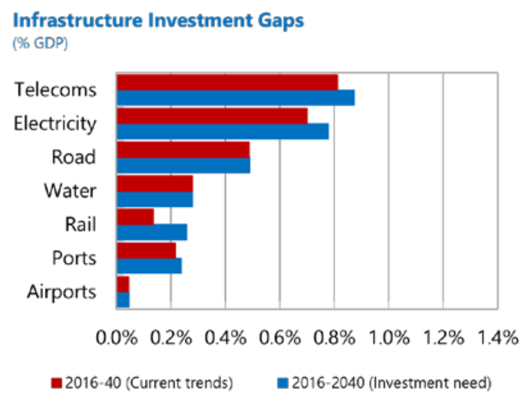
New Zealand has registered the lowest productivity growth rates among its peers, having deteriorated post-GFC …

… although it has a favorable economic and regulatory environment.

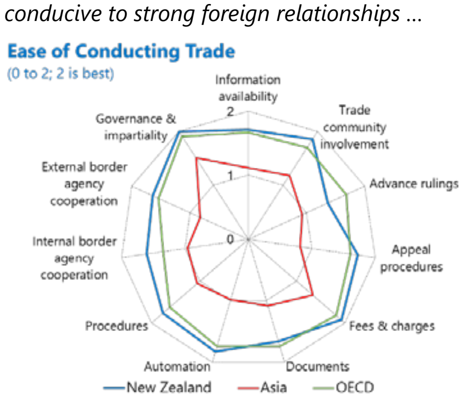
It lags behind in terms of R&D spending, with little improvement over time …



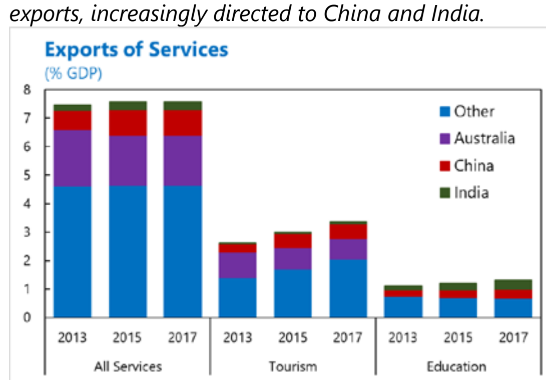
… and could augment its productivity growth by closing investment gaps in basic infrastructure.



This would complement a trade environment which is already highly conducive to strong foreign relationships …



… and expanding tourism and education services exports, increasingly directed to China and India.



Sources: OECD.Stat; World Economic Forum, *The Global Competitiveness Report 2017-2018;* OECD Main Science and Technology Indicators; Oxford Economics and G-20 Global Infrastructure Hub, *Global Infrastructure Outlook*; OECD Trade Facilitation Indicators, StatsNZ; and IMF staff calculations.

Table 1. New Zealand: Main Economic Indicators, 2013-2023
(Annual percent change, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Est.	Projections					
NATIONAL ACCOUNTS											
Real GDP (production)	2.2	3.6	3.5	4.0	2.9	3.1	3.2	3.1	2.9	2.7	2.6
Real GDP (expenditure)	2.2	3.2	4.2	4.2	3.0	3.2	3.2	3.1	2.9	2.7	2.6
Domestic demand	3.7	4.5	3.2	4.7	4.0	4.9	3.1	3.1	2.8	2.6	2.4
Private consumption	3.5	3.2	3.8	5.0	4.5	3.8	3.1	3.0	2.7	2.4	2.4
Public consumption	1.4	3.3	2.7	1.7	4.7	3.9	1.8	1.5	1.5	1.5	1.5
Investment	6.6	11.2	2.8	6.3	3.3	4.3	4.0	4.3	4.1	3.6	3.1
Public	7.0	6.5	6.1	-2.9	-0.3	9.0	2.0	1.5	1.5	1.2	1.2
Private	8.2	10.6	3.7	9.7	4.4	3.7	4.6	5.1	4.9	4.2	3.6
Private business	3.9	11.1	2.5	8.6	6.4	4.8	5.2	5.1	4.8	4.2	3.8
Dwelling	17.7	9.8	6.0	11.8	0.6	1.4	3.3	5.3	5.2	4.2	3.3
Inventories (contribution to growth, percent)	-0.2	0.4	-0.3	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	-1.6	-1.6	0.8	-0.6	-1.4	-1.5	-0.1	-0.2	-0.1	-0.1	0.0
Real gross domestic income	4.4	5.2	2.0	4.6	4.3	4.5	3.2	3.1	2.9	2.7	2.7
Investment (percent of GDP)	21.9	22.7	23.1	23.7	23.8	24.3	24.6	25.0	25.4	25.6	25.8
Public	5.6	5.7	5.9	5.5	5.3	5.6	5.6	5.5	5.4	5.4	5.3
Private	16.3	17.1	17.2	18.2	18.5	18.7	19.1	19.5	20.0	20.3	20.5
Savings (gross, percent of GDP)	19.0	19.5	20.0	21.4	21.0	21.6	21.8	22.0	22.4	22.6	22.8
Public	3.3	4.0	4.1	1.2	1.4	0.8	0.9	1.3	1.6	2.0	2.0
Private	15.8	15.4	16.1	20.2	19.6	20.8	20.8	20.7	20.8	20.6	20.8
Potential output	2.4	2.6	2.8	3.0	3.0	3.0	3.0	2.9	2.8	2.7	2.7
Output gap (percent of potential)	-2.4	-1.6	-0.9	0.1	0.0	0.1	0.3	0.4	0.6	0.5	0.4
LABOR MARKET											
Employment	1.5	3.5	2.2	4.6	4.1	2.8	1.8	1.4	1.3	1.3	1.4
Unemployment (percent of labor force)	5.8	5.4	5.4	5.1	4.7	4.5	4.5	4.4	4.3	4.3	4.4
Wages (nominal percent change)	2.4	2.5	2.3	1.9	2.1	2.9	2.1	2.5	2.5	2.4	2.6
PRICES											
Terms of trade index (goods, % change)	8.5	5.6	-5.0	1.2	6.6	2.1	-0.6	0.1	0.0	0.2	0.5
Consumer prices (avg, % change)	1.1	1.2	0.3	0.6	1.9	1.4	1.7	1.9	2.0	2.0	2.0
GDP deflator (avg, % change)	3.2	1.9	0.8	1.9	3.6	2.7	2.0	2.0	2.0	2.1	2.0
MACRO-FINANCIAL											
Official cash rate (policy rate, percent, avg)	2.5	3.1	3.2	2.2	1.8	1.8	1.8	2.1	2.4	2.9	3.0
Credit to the private sector (percent change)	5.1	4.5	8.4	7.3	4.9	5.1	5.3	5.1	5.0	5.0	4.7
House prices (percent change, avg)	9.0	6.5	11.6	13.0	6.4	4.5	4.5	4.2	4.0	4.0	4.0
Interest payments (percent of disposable income)	8.4	9.0	9.3	8.5	8.4	8.6	8.8	9.1	9.3	9.5	9.8
Household savings (percent of disposable income)	3.3	2.1	2.0	2.2	2.4	2.6	2.8	3.0	3.1	3.3	3.5
Household debt (percent of disposable income)	151	155	161	167	168	166	165	163	161	160	159
GENERAL GOVERNMENT (percent of GDP) 1/											
Revenue	37.3	37.2	37.7	37.6	37.2	37.0	37.1	37.2	37.2	37.3	37.3
Expenditure	38.5	37.7	37.3	36.4	35.8	36.2	36.1	35.9	35.6	35.3	35.3
Net lending/borrowing	-1.3	-0.5	0.3	1.2	1.4	0.8	0.9	1.3	1.6	2.0	2.0
Operating balance	0.2	1.0	1.9	2.7	3.0	2.9	2.9	3.0	3.1	3.3	3.3
Cyclically adjusted balance	0.4	0.7	1.2	1.9	2.3	1.8	1.8	2.1	2.3	2.7	2.7
Gross debt	34.6	34.2	34.3	33.5	31.7	30.0	29.0	28.1	27.6	26.2	23.0
Net debt	11.0	10.4	9.8	9.1	8.6	10.0	11.0	10.8	10.2	8.1	4.9
Net worth	87.5	89.1	90.7	93.0	86.0	75.9	74.7	73.4	71.5	71.2	72.1
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-3.2	-3.2	-3.1	-2.3	-2.7	-2.6	-2.9	-3.0	-3.0	-3.0	-3.0
Export volume	0.8	3.1	7.0	1.5	2.6	2.7	3.9	4.0	4.3	4.3	4.1
Import volume	6.2	7.9	3.8	3.3	6.6	6.7	3.6	3.8	3.8	3.7	3.5
Net international investment position (percent of GDP)	-64.4	-65.3	-61.3	-59.3	-54.8	-54.3	-54.5	-54.8	-55.2	-55.7	-56.2
Gross official reserves (bn US$)	16.5	15.8	14.3	18.2	20.3	...	...	...	...	...	...
MEMORANDUM ITEMS											
Nominal GDP (bn NZ$)	228	241	251	266	283	300	316	332	349	366	383
Percent change	5.5	5.5	4.4	6.0	6.6	5.9	5.2	5.2	5.0	4.8	4.7
Nominal GDP per capita (US$)	41,776	43,876	37,825	39,050	41,591	44,508	46,340	48,413	50,598	52,854	54,985
Real gross national disposable income per capita (NZ$)	46,491	47,896	48,204	49,851	50,560	51,808	52,176	52,741	53,365	53,916	54,538
Percent change	3.2	3.0	0.6	3.4	1.4	2.5	0.7	1.1	1.2	1.0	1.2
Population (million)	4.4	4.5	4.6	4.6	4.7	4.8	4.9	5.0	5.1	5.2	5.3
US$/NZ$ (average level)	0.821	0.831	0.700	0.697	0.711	...	...	...	...	...	...
Nominal effective exchange rate	112.3	116.6	111.2	112.0	113.3	...	...	...	...	...	...
Real effective exchange rate	111.5	115.2	109.3	109.6	111.0	...	...	...	...	...	...

Sources: Authorities' data and IMF staff estimates and projections.

1/ Calendar year.

Table 2. New Zealand: Fiscal Accounts, 2012/13-2022/23 1/
(In percent of GDP, unless otherwise indicated)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
						Est.			Projections		
GENERAL GOVERNMENT 2/											
Revenue	**37.9**	**36.8**	**37.6**	**37.7**	**37.6**	**36.8**	**37.1**	**37.1**	**37.2**	**37.3**	**37.3**
Tax revenue	30.5	29.6	30.7	30.9	31.1	30.8	31.1	31.3	31.5	31.7	31.7
Direct taxes	19.5	18.9	19.7	19.8	20.1	19.9	20.1	20.5	20.7	21.0	21.0
Individual and withholding	12.4	12.0	12.5	12.4	12.4	12.4	12.6	12.7	12.8	13.0	13.0
Corporate	5.1	4.9	5.2	5.3	5.6	5.5	5.6	5.7	5.8	5.9	5.9
Property	2.1	2.0	2.0	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Indirect taxes	11.0	10.7	11.0	11.1	11.0	10.9	10.9	10.9	10.8	10.8	10.8
Of which: GST	7.4	7.2	7.4	7.5	7.5	7.5	7.6	7.6	7.6	7.6	7.6
Non-tax revenue	7.3	7.2	6.9	6.7	6.5	6.0	6.0	5.8	5.7	5.6	5.6
Expenditure	**39.6**	**37.6**	**37.6**	**36.9**	**35.9**	**35.7**	**36.6**	**35.7**	**36.0**	**35.3**	**35.3**
Expense	38.1	36.2	36.1	35.4	34.6	33.9	34.3	34.1	34.3	34.0	34.0
Employee expenses	9.7	9.3	9.3	9.2	8.9	9.0	8.8	8.5	8.3	8.0	8.0
Other operating expenses (excl. depreciation)	5.5	5.3	5.3	5.2	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Social benefits	15.2	14.4	14.3	14.0	13.7	13.7	14.2	14.1	14.1	14.1	14.1
Other transfers	3.8	3.6	3.5	3.4	3.3	2.2	2.1	2.1	2.1	2.0	2.0
Interest	2.0	1.7	1.8	1.6	1.5	1.7	1.6	1.5	1.6	1.5	1.5
Other	2.0	1.9	1.9	1.9	1.8	2.0	2.2	2.5	2.9	3.1	3.1
Net acquisition of nonfinancial assets	1.5	1.4	1.5	1.5	1.3	1.8	2.3	1.6	1.7	1.3	1.3
Of which: Gross fixed capital formation	3.2	3.0	3.3	3.2	3.0	3.4	3.6	2.7	3.3	2.7	2.7
Operating balance	-0.3	0.5	1.5	2.3	3.0	2.9	2.8	3.0	2.9	3.3	3.3
Primary balance	0.2	0.9	1.7	2.4	3.2	2.8	2.1	2.9	2.8	3.5	3.5
Net lending (+)/borrowing (-)	**-1.8**	**-0.8**	**-0.1**	**0.7**	**1.7**	**1.1**	**0.5**	**1.4**	**1.2**	**2.0**	**2.0**
GENERAL GOVERNMENT BALANCE SHEET 2/											
Liabilities	**67.1**	**62.5**	**62.5**	**64.4**	**61.6**	**58.9**	**56.3**	**54.6**	**52.0**	**51.2**	**47.0**
Gross debt	35.1	34.2	34.2	34.3	32.7	30.7	29.3	28.8	27.4	27.8	24.6
Other liabilities 3/	32.0	28.3	28.3	30.2	29.0	28.3	27.1	25.8	24.6	23.4	22.4
Assets	**139.6**	**135.4**	**140.4**	**139.9**	**142.8**	**139.0**	**134.3**	**131.8**	**127.0**	**124.5**	**121.0**
Financial assets	61.5	58.8	62.8	62.3	64.7	64.2	60.5	60.4	57.2	56.8	55.0
Debt relevant	24.0	23.3	24.4	24.5	24.2	21.9	18.1	17.8	16.7	18.1	18.1
Other	37.5	35.5	38.4	37.8	40.5	42.3	42.4	42.6	40.5	38.6	36.9
Nonfinancial assets	78.0	76.6	77.6	77.6	78.1	74.8	73.7	71.4	69.8	67.8	66.1
Net financial worth	**-5.6**	**-3.7**	**0.3**	**-2.2**	**3.1**	**5.2**	**4.2**	**5.8**	**5.3**	**5.5**	**8.0**
Net debt 4/	**11.1**	**10.9**	**9.8**	**9.8**	**8.4**	**8.8**	**11.2**	**10.9**	**10.7**	**9.7**	**6.5**
Central government	8.0	7.8	6.5	6.2	4.8	5.3	7.7	7.6	7.4	6.4	3.3
Local government	3.1	3.0	3.3	3.6	3.6	3.5	3.5	3.4	3.3	3.3	3.2
Net worth	**72.4**	**72.9**	**77.9**	**75.4**	**81.1**	**80.0**	**77.9**	**77.3**	**75.0**	**73.3**	**74.1**
Central government	26.0	27.8	32.9	31.1	37.6	39.0	38.3	39.3	38.5	38.1	40.0
Local government	46.4	45.1	45.0	44.4	43.5	41.1	39.6	37.9	36.5	35.2	34.1
MEMORANDUM ITEMS											
Cyclically adjusted balance (percent of potential GDP)	-0.7	-0.1	0.2	0.9	1.6	1.3	0.6	1.4	1.1	1.9	1.9
Fiscal impulse (change in CAB; in percent of potential GDP)	-0.9	-0.6	-0.3	-0.8	-0.7	0.3	0.7	-0.8	0.2	-0.7	-0.1
Change in real revenue (percent)	4.0	3.5	5.1	5.1	4.8	3.1	3.9	3.7	3.1	3.1	2.6
Change in real primary expenditure (percent)	1.6	1.5	2.9	3.2	2.2	4.1	6.2	1.2	3.7	1.1	2.6
New Zealand Superannuation Fund											
Budget transfers (+ = receipts)	0.0	0.0	0.0	0.0	0.0	0.2	0.3	0.5	0.6	0.7	0.7
Net assets	10.3	10.9	12.1	11.5	12.6	13.1	13.3	13.5	13.8	14.1	14.1
Contributed capital	6.8	6.3	6.1	5.8	5.4	5.2	5.3	5.5	5.9	6.3	6.7
Central government											
Revenue	34.6	33.5	34.2	34.3	34.3	33.7	34.0	34.0	34.1	34.2	34.2
Expenditure	35.7	34.0	33.9	33.5	32.5	32.5	33.4	32.5	32.8	32.1	32.1
Net lending (+)/borrowing (-)	-1.1	-0.5	0.3	0.9	1.7	1.2	0.6	1.5	1.3	2.1	2.1
Local government											
Revenue	4.1	3.9	4.0	4.0	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Expenditure	4.7	4.2	4.3	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Net lending (+)/borrowing (-)	-0.5	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
GDP (in billion NZ$)	219	237	245	258	274	293	307	324	340	357	374

Sources: Authorities' data and IMF staff estimates and projections.

1/ The fiscal year runs from July to June.
2/ Accrual basis; GFS. Comprises Core Crown (excludes RBNZ), Crown entities, and local governments. Includes New Zealand Superannuation Fund.
3/ "Other liabilities" include government pension liabilities, and the Accident Compensation Corporation (ACC) liabilities (roughly 85 percent funded by assets, and projected to be fully funded by 2019/2020).
4/ "Net debt" is gross debt less debt-relevant financial assets - cash and equivalents, marketable securities, etc. (often held to cover pension liabilities).

Table 3. New Zealand: Balance of Payments, 2013-2023
(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Est.			Projections			
BALANCE OF PAYMENTS											
(% GDP)											
Current account	-3.2	-3.2	-3.1	-2.3	-2.7	-2.6	-2.9	-3.0	-3.0	-3.0	-3.0
Balance on goods and services	1.0	1.1	0.6	0.7	0.8	0.7	0.9	0.9	0.9	1.0	1.1
Exports of goods and services	28.4	28.2	27.8	26.2	27.0	26.9	26.5	26.2	26.1	26.2	26.4
Exports of goods	21.3	21.0	19.6	18.2	19.0	18.8	18.7	18.8	19.0	19.4	19.7
Exports of services	7.2	7.2	8.2	8.1	8.0	8.1	7.8	7.5	7.1	6.9	6.7
Imports of goods and services	27.5	27.2	27.2	25.6	26.2	26.1	25.6	25.3	25.3	25.3	25.3
Imports of goods	20.7	20.6	20.5	19.1	19.7	19.8	19.5	19.3	19.2	19.2	19.2
Imports of services	6.8	6.6	6.7	6.5	6.4	6.3	6.1	6.0	6.0	6.1	6.1
Primary income, net	-3.9	-4.0	-3.6	-2.7	-3.3	-3.7	-4.0	-4.0	-3.8	-3.7	-3.7
Inflows	3.1	3.0	3.1	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Outflows	6.9	7.0	6.6	5.9	6.5	6.9	7.2	7.2	7.0	7.0	6.9
Secondary income, net	-0.2	-0.2	-0.1	-0.1	-0.2	0.4	0.2	0.1	0.0	-0.2	-0.4
Inflows	0.5	0.7	0.8	0.8	0.8	1.1	1.0	1.0	1.0	0.9	0.9
Outflows	0.7	0.9	0.9	0.9	0.9	0.7	0.7	0.9	1.0	1.2	1.3
Capital and financial account											
Capital account, net	0.0	0.0	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account, net	0.3	-1.8	0.5	-3.0	-1.2	-2.6	-2.9	-3.0	-3.0	-3.0	-3.0
Direct investment	-0.7	-1.0	0.1	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Equity	-0.2	-1.8	-1.3	-0.8	-1.8	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Debt	-0.5	0.8	1.4	-0.7	0.3	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Portfolio investment	1.0	0.3	-1.3	-2.2	1.6	-0.9	-1.1	-1.1	-1.1	-1.1	-1.1
Equity	0.8	0.5	-0.7	1.2	0.5	1.0	0.8	0.8	0.8	0.7	0.7
Debt	0.2	-0.2	-0.6	-3.5	1.1	-1.9	-1.9	-1.9	-1.9	-1.9	-1.8
Financial derivatives	-0.5	0.4	0.9	-0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	1.0	-1.3	1.4	-0.9	-2.6	-0.9	-0.9	-0.9	-0.9	-0.9	-0.8
Reserve assets	-0.5	-0.2	-0.6	1.7	0.9	…	…	…	…	…	…
Net errors and omissions	3.5	1.4	3.5	-1.2	1.5	0.0	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET											
Net international investment position	-64.4	-65.3	-61.3	-59.3	-54.8	-54.3	-54.5	-54.8	-55.2	-55.7	-56.2
Equity, net	-2.1	-5.2	-4.9	-4.0	-2.4	-2.2	-2.3	-2.4	-2.5	-2.6	-2.8
Assets	31.5	32.7	34.5	36.3	39.7	39.7	39.7	39.7	39.7	39.7	39.7
Liabilities	33.6	37.8	39.4	40.4	42.1	41.9	42.0	42.1	42.2	42.3	42.5
Debt, net	-71.0	-68.5	-64.9	-64.8	-62.7	-62.4	-62.5	-62.7	-63.0	-63.4	-63.7
Assets	38.2	40.8	46.3	44.5	38.8	38.8	38.8	38.8	38.8	38.8	38.8
Liabilities	109.2	109.3	111.3	109.3	101.5	101.2	101.3	101.5	101.8	102.1	102.5
External assets (gross)	78.4	81.9	89.4	90.4	88.8	88.8	88.8	88.8	88.8	88.8	88.8
Equity	31.5	32.7	34.5	36.3	39.7	39.7	39.7	39.7	39.7	39.7	39.7
Debt	38.2	40.8	46.3	44.5	38.8	38.8	38.8	38.8	38.8	38.8	38.8
External liabilities (gross)	142.8	147.1	150.7	149.7	143.5	143.1	143.3	143.6	144.0	144.5	145.0
Equity	33.6	37.8	39.4	40.4	42.1	41.9	42.0	42.1	42.2	42.3	42.5
Debt	109.2	109.3	111.3	109.3	101.5	101.2	101.3	101.5	101.8	102.1	102.5
Of which: NZ$ denominated	68.0	60.6	63.9	66.2	56.8	52.2	52.3	52.4	55.1	55.3	55.5
FX denominated	45.7	43.4	45.0	45.0	44.8	44.2	44.3	44.4	46.7	46.9	47.0
Short-term	39.8	35.7	34.8	35.5	29.7	29.6	29.6	29.7	29.7	29.8	29.9
MEMORANDUM ITEMS											
Gross official reserves (bn NZ$)	16.5	15.8	14.3	18.2	20.3	…	…	…	…	…	…
In months of prospective imports	3.7	3.6	3.8	4.1	4.5	…	…	…	…	…	…
In percent of short-term external debt	22.0	23.6	24.6	27.1	34.7	…	…	…	…	…	…

Sources: Authorities' data and IMF staff estimates and projections.

Table 4. New Zealand: Monetary and Financial Sector, 2013-2023
(In billions NZ$, otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
						Projections					
Registered Banks 1/											
Assets	...	...	...	510	526	554	583	613	644	675	707
Cash	...	...	...	1	1	1	1	1	1	1	1
Deposits (with depository institutions)	...	...	...	21	20	21	22	23	25	26	27
Debt securities (Net)	...	...	...	42	45	47	50	52	55	58	60
Loans and advances (Net)	...	...	...	406	427	449	473	498	522	548	574
NZL dollar	...	...	...	400	421	442	466	490	514	540	565
Foreign currency	...	...	...	7	8	7	7	8	8	9	9
Derivatives in an asset position	...	...	...	27	19	20	21	22	23	24	25
Other assets	...	...	...	14	14	15	16	17	18	18	19
Liabilities	...	...	...	510	526	554	583	613	644	675	707
Total equity	...	...	...	37	41	43	45	47	50	52	55
Deposits (Net)	...	...	...	307	327	347	365	384	403	422	442
NZL dollar	...	...	...	295	315	334	351	370	388	407	426
Foreign currency	...	...	...	12	12	13	13	14	15	15	16
Non residents	...	...	...	31	32	34	35	37	39	41	43
Debt securities issued (Net)	...	...	...	106	108	115	120	127	133	139	146
Borrowings (Net)	...	...	...	24	26	28	29	30	32	34	35
NZL dollar	...	...	...	12	14	15	15	16	17	18	19
Foreign currency	...	...	...	12	12	13	14	14	15	16	17
Non residents	...	...	...	22	24	26	27	28	30	31	33
Derivatives in a liability position	...	...	...	31	19	20	21	22	23	24	25
Other liabilities	...	...	...	5	5	2	3	3	3	4	4
MEMORANDUM ITEMS											
Domestic credit 2/	349	365	388	415	436	458	482	507	532	559	585
Private sector credit 2/	341	355	382	409	429	451	475	499	524	550	576
Housing loans 1/	186	195	210	229	242	252	264	275	286	297	309
Business loans 1/	81	85	90	97	103	109	117	124	132	140	149
Household deposits	120	131	145	156	167	177	186	196	205	215	225
					In percent of GDP						
Banking system assets	...	...	...	192	186	184	185	185	184	185	185
Private sector credit 2/	150	148	152	154	151	150	150	150	150	150	150
Housing loans 1/	82	81	83	86	85	84	84	83	82	81	81
Business loans 1/	35	35	36	37	36	36	37	37	38	38	39
Household deposits	53	54	58	59	59	59	59	59	59	59	59
					Percentage change						
Private sector credit 2/	4.6	4.0	7.5	7.0	4.9	5.1	5.3	5.1	5.0	5.0	4.7
Housing loans 1/	6.1	4.7	7.6	9.2	5.5	4.5	4.5	4.2	4.0	4.0	4.0
Business loans 1/	3.0	4.5	6.7	7.8	6.2	6.1	6.5	6.5	6.4	6.4	5.8
Household deposits	8.9	8.9	11.1	7.1	7.1	5.9	5.2	5.2	5.0	4.8	4.7
					In percent						
Loan-to-deposit ratio	...	...	...	135	133	132	132	132	132	132	132
Nonresident funding in total liabilities	...	...	...	10.5	10.6	10.7	10.7	10.7	10.7	10.7	10.7

Sources: RBNZ and IMF staff calculations.

1/ Registered banks. Most data starts in end-December 2016 when the Bank Balance Sheet Survey replaced the Standard Statistical Return.

2/ Depository corporations.

Table 5. New Zealand: Financial Sector Indicators, 2011-17

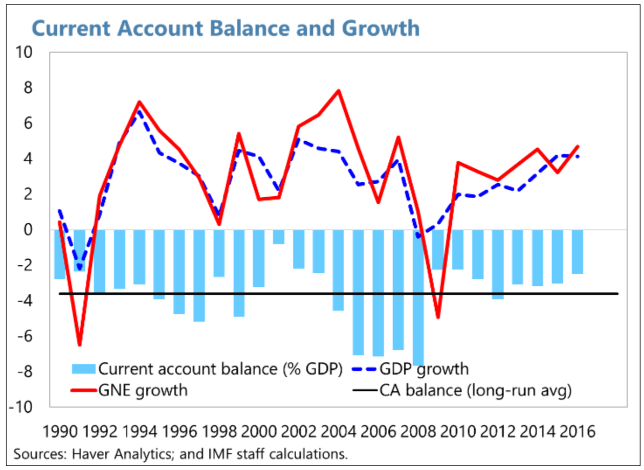
	2011	2012	2013	2014	2015	2016	2017
Interest rates (percent end-year)							
90-day bank bill rate	2.8	2.7	2.7	3.4	3.2	2.3	2.0
90-day bank bill rate, real	-1.2	1.6	1.5	2.2	2.9	1.7	0.1
Stock market index (percent change, end-year)	-1.0	24.2	16.5	17.5	13.6	8.8	22.0
Capital adequacy (in percent)							
Regulatory capital to risk-weighted assets	13.3	13.1	12.5	12.4	13.5	13.7	14.7
Tier I capital to risk-weighted assets	10.6	11.5	11.4	11.4	12.1	12.4	13.6
Common equity tier 1 to risk-weighted assets	...	...	10.6	10.8	10.8	10.7	11.4
Capital to assets	6.5	7.1	7.3	7.4	7.3	7.2	7.7
Asset quality (in percent)							
Non-performing loans to total loans	1.7	1.4	1.0	0.8	0.5	0.5	0.5
Non-performing loans net of provisions to capit	13.7	9.8	6.9	5.4	3.9	n.a.	n.a.
Non-performing loans (in millions of NZ$)	5,182	4,278	3,372	2,773	1,988	2,183	2,296
Liquidity and funding (in percent)							
Liquid assets to total assets	16.9	16.2	16.2	15.7	15.0	n.a.	n.a.
Liquid assets to short-term liabilities	25.3	23.8	23.1	22.5	21.7	n.a.	n.a.
1-month maturity mismatch	9.3	7.9	7.0	6.9	6.3	6.8	7.4
Core funding ratio	82.8	85.6	85.5	86.3	85.8	87.2	88.7
Customer deposits to total loans	69.6	70.6	72.6	73.4	73.7	71.8	n.a.
Offshore wholesale funding to total liabilities 1/	24.3	21.6	20.3	20.1	19.6	n.a.	n.a.
Asset composition (percentage share of total)							
Agricultural	15.0	15.2	14.9	14.9	15.1	14.6	14.1
Business	25.7	25.8	25.4	25.3	25.2	25.0	25.1
Households	59.2	59.1	59.7	59.8	59.8	60.4	60.7
Of which: Housing	55.2	55.1	55.8	55.8	55.9	56.7	56.9
Profit Ratios (in percent)							
Return on assets	1.2	0.9	1.1	1.1	1.0	1.0	1.1
Return on equity	16.1	11.4	13.9	14.1	12.0	12.6	14.0
Net interest margin	2.3	2.2	2.2	2.4	2.3	2.1	2.1

Sources: Data provided by the New Zealand authorities; and IMF staff estimates.
Note: Capital adequacy measures, NPLs net of provisions to capital, liquid assets, 1-month mismatch ratio, core funding ratio, and return on equity are calculated for locally incorporated banks only.
1/ Proxied by the share of foreign-currency-denominated liabilities to total liabilities.

Annex I. External Sector Assessment

With the Real Effective Exchange Rate (REER) still above its long-term average and considering the External Balance Assessment (EBA) estimates, the external position in 2017 was assessed to be moderately weaker than implied by fundamentals and policy settings, while the New Zealand dollar is moderately overvalued.

1. New Zealand has historically run a current account deficit, averaging around 3 percent of GDP over the past decade. These deficits reflect a long-standing structural savings-investment imbalance. They have resulted in a sizeable negative net international investment position (NIIP). New Zealand's NIIP amounted minus 55 percent of GDP at the end of 2017Q3.



2. New Zealand's REER was some 10 percent above its long-term average in 2017, consistent with strong terms of trade and a domestic demand-driven expansion. These factors have underpinned the strength of the New Zealand dollar during the expansion more broadly, consistent with the currency's status as a commodity currency. During 2017, the merchandise terms of trade rose strongly and reached a new high in 2017Q4 for the lifetime of the series. Nevertheless, the REER depreciated in the second half of the year, consistent with a steadily narrowing interest rate differential with other major advanced economies and the RBNZ's signaling that its policy would remain at current low levels of some time.

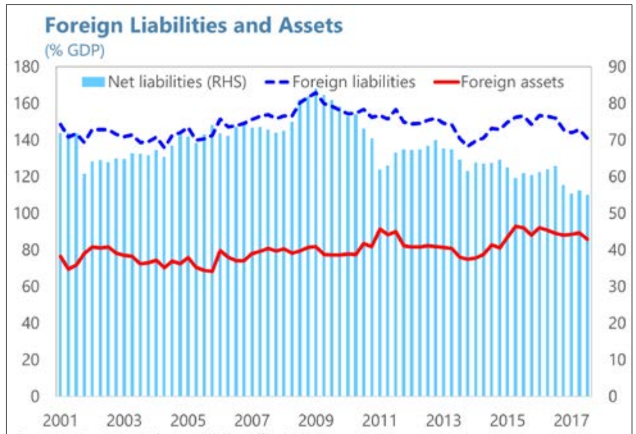
3. The EBA REER index regression also suggests that the New Zealand dollar was moderately overvalued in real effective terms in 2017. The model implies that, in real effective terms, the dollar was overvalued by 15 percent (Table 1).

EBA Exchange Rate Assessments

	2015	2016	2017
REER index regression	6%	7%	15%
Current account regression	10%	3%	4%
External sustainability	7%	5%	1%

Source: IMF EBA estimates.

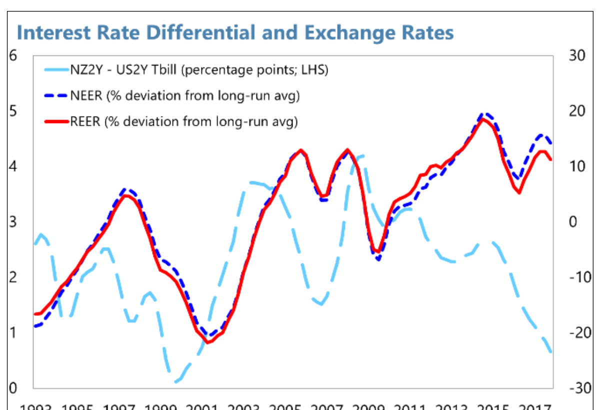
4. The EBA current account regression suggests that the current account deficit in 2017 was moderately weaker than implied by fundamentals and policy settings. The estimated cyclically-adjusted current account norm for 2017 was -0.6 percent of GDP, compared to an actual, cyclically-adjusted balance of -2.3 percent. However, in staff's view, the CA norm is closer to -1.2 percent of GDP, reflecting traditionally large investment needs due to New Zealand's size, low population density, and initial conditions. With this adjustment, the estimated current account gap is in the range of -0.3 to -1.9 percent of GDP. With an EBA-estimated elasticity of the current account-to-GDP ratio with respect to the REER of -0.25, the mid-point of the range translates into a currency overvaluation of around 4½—suggesting some currency overvaluation. Policy gaps in New Zealand currently contribute to lowering the current account gap, everything else equal, and, therefore, currency overvaluation. In the longer term, the government's planned gradual fiscal consolidation should help to narrow the current account deficit by boosting national savings.



Sources: Haver Analytics; and IMF staff calculations.

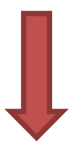
5. The NIIP level and trajectory are sustainable. The External Stability (ES) approach suggests that the NIIP would be stabilized at current levels with a CA deficit of between 2.7 percent of GDP, while the adjusted medium-term CA deficit recorded is projected at 2.9 percent. This implies that the currency is overvalued by slightly less than 1 percent. The structure of New Zealand's external balance sheet reduces the vulnerability associated with its large negative NIIP. Since external NIIP liabilities are mainly in New Zealand dollars and there is a net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector has a net foreign currency liability position but it is fully hedged.

6. Other Considerations. The New Zealand dollar has been freely floating since 1985. The central bank undertook a brief but large intervention in 2007–08 when the market for New Zealand dollars became illiquid (bid-ask spreads widened) following banking sector disruptions in the United States. The authorities are strongly committed to a floating regime, which reduces the need for reserve holding.



Sources: Haver Analytics; and IMF staff calculations.

Annex II. Risk Assessment Matrix

	Source of risks	Likelihood	Time horizon	Impact	Policies to reduce impact
				Domestic risks	
	Stronger growth because of higher dairy prices	**L**	Short term	**L** This could boost the agricultural sector (especially rural areas) and accelerate deleveraging in the sector.	Automatic adjustment through commodity currency mechanism.
	Stronger growth because of slower decrease in net migration	**M**	Short to medium term	**M** In the short term, this could ease labor shortages and upward pressure on inflation. In the medium term, potential output growth will be higher.	Monetary policy tightening to dampen short-term positive aggregate demand effects.
	Housing market downturn	**M**	Short to medium term	**H** A sharp housing market correction would lower residential investment and private consumption, given high household debt. Financial accelerator effect would amplify the downturn.	Monetary and selective macroprudential policy easing; fiscal policy stimulus; measures to facilitate mortgage debt restructuring.
				External Risks	
	Lower energy prices	**L**	Short to medium term	**L** Lower energy prices would improve the terms of trade and reduce inflation pressures.	Temporary monetary easing if lower inflation expectations are becoming embedded.
	Significant China slowdown	**L/M**	Short to medium term	**H** A hard landing in China would reduce external demand, lower exports, and lead to large commodity price declines potentially including dairy prices, which could cause, a major downturn in New Zealand, possibly triggering a hard landing in the housing market.	Combined monetary, fiscal policy easing as economy could reach the effective lower bound for monetary policy quickly; and selective macroprudential easing if the housing market correction is severe.
	Structurally weak growth in key advanced economies	**H**	Medium term	**M** Lower growth in these economies could result in lower exports and inhibit medium-term growth performance.	Temporary monetary and fiscal policy easing (especially if economy hits the effective lower bound). Structural reforms to raise productivity.
	Tighter global financial conditions	**H**	Short to medium term	**M** Depending on investor sentiment towards New Zealand, deteriorating external funding conditions for banks, and spillovers from the broader effects on global growth and commodity prices.	Monetary, selective macroprudential policy, and fiscal policy easing (especially if economy hits the effective lower bound).
	Retreat from cross-border integration	**M**	Short to medium term	**M** The negative consequences for global trade and capital flows, and global growth would lower New Zealand's external demand, with negative direct and indirect aggregate demand effects.	Combined monetary, fiscal policy easing as economy could reach the effective lower bound for monetary policy quickly; and selective macroprudential easing if housing market correction is severe.

Annex III. Recent Fiscal and Structural Policy Measures

The new coalition government has introduced new fiscal policy measures in its *100-Day Plan* upon election, the "mini-budget" incorporated within last December's *Half-Year Economic and Fiscal Update 2017* (*HYEFU 2017*) and April's *Budget and Economic Fiscal Update 2018* (*Budget 2018*). This table lists the most relevant fiscal and macrostructural policy measures for the Staff Report.

Policy	Key Details	Status
	Fiscal Policy	
New Zealand Superannuation Fund	Resume funding immediately at NZ$500mn, and increase to prior announced path that was to start in FY2020/21.	Effective December 14, 2017.
Families Package	Extend parental leave; *Winter Energy Payment* for low-income families; increase *Student Benefit*; *Best Start* for under-1-year-olds; reinstate *Independent Earner Tax Credit*.	Passed December 14, 2017.
Tax Working Group (TWG)	Wide mandate to look at the whole tax system but directed to look at investor housing. PIT/GST rates and owner-occupied housing off the table.	TWG has been meeting regularly since February 2018.
	Managing Housing Market Imbalances	
KiwiBuild	Government to fund NZ$2bn over 4 years (to be recycled as units are sold) to build 100,000 affordable housing units over 10 years.	Temporary unit in MBIE, until Housing Commission established; updated funding profile from *Budget 2018*.
Ban foreign house ownership	Reclassify housing as sensitive property under *Overseas Investment Act* to prevent foreigners from purchasing.	Legislation in Parliament; may be passed by June 2018.
State-owned homes	Government to stop sell-off, and maintain ownership of remaining housing stock. Additional funding to build 6,400 new social housing units over 4 years.	Stoppage announced December, 2017; the additional funding was part of *Budget 2018*.
Healthy Homes Guarantee Bill	Set comprehensive minimum standards for rental housing.	Passed December 2017.
	Supporting Higher and More Inclusive Growth	
Minimum wage increases	NZ$15.75 to NZ$16.50 per hour on April 1, 2018; to NZ$20.00 April 1, 2021.	Announced December 22, 2017.
Tertiary education subsidy	Funding for 1 year of tertiary education or 2 years of vocational training up to NZ$12,000 for any New Zealand citizen with less than 6 months of tertiary education or 1 year of vocational training.	Effective January 1, 2018.
Regional development	Appoint a Minister of Regional Development to oversee the 3-year NZ$1bn per year *Provincial Growth Fund (PGF)*.	PGF began disbursing funds on February 23, 2018.
Carbon emissions	Reduce to net zero emissions by 2050.	Set up Interim Climate Change Committee in December, 2017.

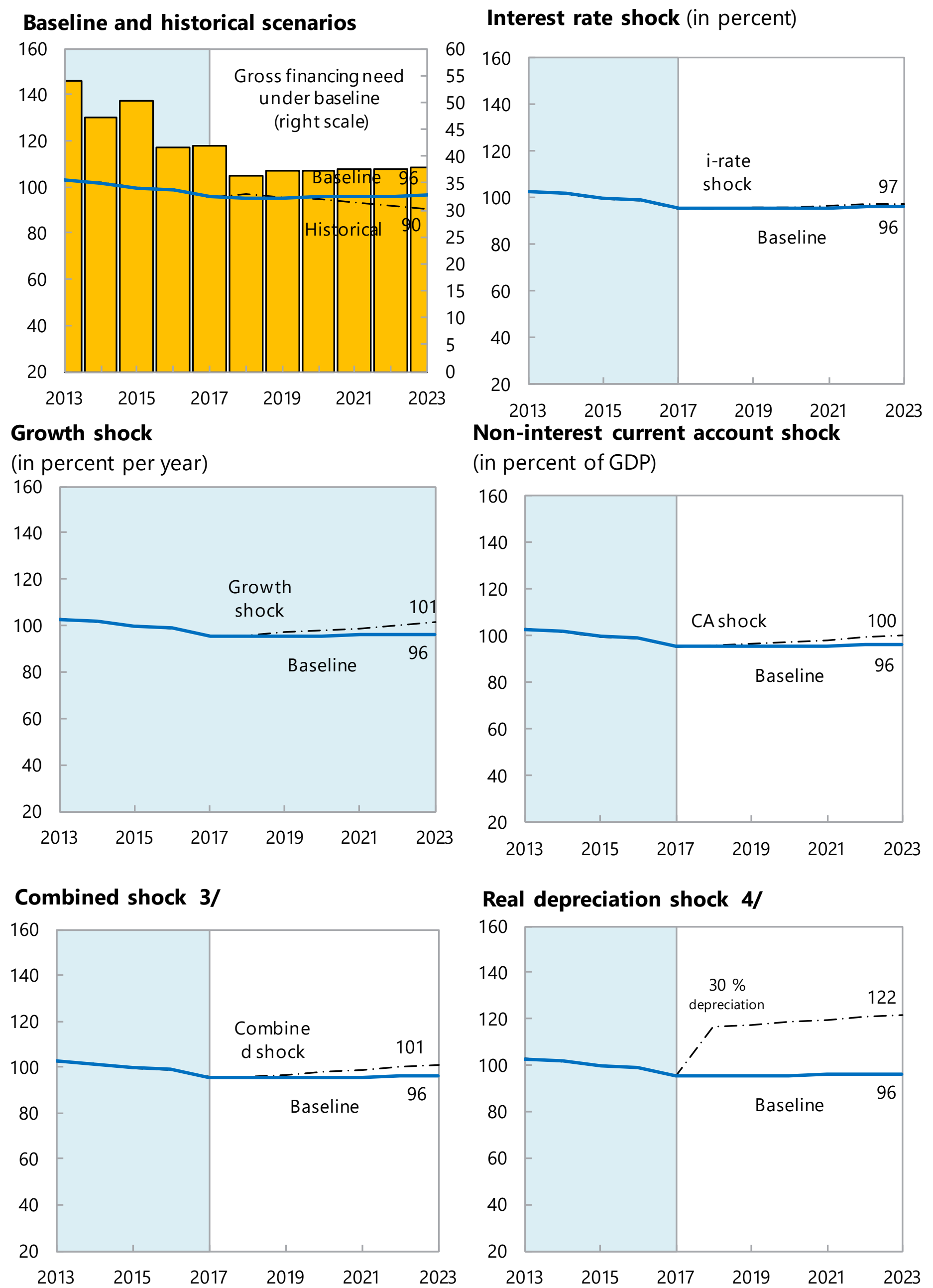
Sources: New Zealand Labour Party at http://www.labour.org.nz/100_days; government at www.beehive.govt.nz; *HYEFU 2017* at https://treasury.govt.nz/publications/budgets/budget-2017; *Budget 2018* at https://treasury.govt.nz/publications/budgets/budget-2018; IMF staff research.

Annex IV. Macroprudential Measures on Residential Loans

	Loans to owner occupiers	**Loans to investors**
October 2013	No more than 10 percent of the new commitments for new residential mortgage lending at LVRs above 80 percent	
November 2015	Auckland: 10 percent limit on total new residential mortgage loans that could be granted at LVRs above 80 percent	Auckland: 5 percent limit on total new residential mortgage loans that could be granted at LVRs above 70 percent
	Outside Auckland: 15 percent limit on total new residential mortgage loans at LVRs above 80 percent	
October 2016	10 percent limit on each bank's new residential mortgage lending to owner occupiers at LVRs above 80 percent	5 percent limit on each bank's new residential mortgage lending to property investors at LVRs above 60 percent
January 2018	**15** percent limit on each bank's new residential mortgage lending to owner occupiers at LVRs above 80 percent	5 percent limit on each bank's new residential mortgage lending to property investors at LVRs above **65** percent

Annex V. External and Fiscal DSAs

Figure 1. New Zealand: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2018.

Table 1. New Zealand: External Debt Sustainability Framework, 2011-2023

(In percent of GDP, unless otherwise indicated)

	2011	2012	2013	2014	Actual 2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
Baseline: External debt	113.0	112.1	102.7	101.6	99.7	98.8	95.5			**95.2**	**95.3**	**95.5**	**95.8**	**96.1**	**96.4**	**-2.8**
Change in external debt	-4.9	-0.9	-9.4	-1.1	-1.8	-0.9	-3.3			-0.3	0.1	0.2	0.2	0.3	0.3	
Identified external debt-creating flows (4+8+9)	-7.6	1.1	-3.6	-6.0	5.2	-1.7	-8.2			-1.3	-0.9	-0.7	-0.5	-0.1	-0.1	
Current account deficit, excluding interest payments	0.7	2.1	1.5	1.6	1.5	0.9	1.4			0.0	0.2	0.3	0.4	0.5	0.5	
Deficit in balance of goods and services	-2.1	-0.5	-1.0	-1.1	-0.6	-0.7	-0.8			-0.7	-0.9	-0.9	-0.9	-1.0	-1.1	
Exports	30.8	29.0	28.4	28.2	27.8	26.2	27.0			26.9	26.5	26.2	26.1	26.2	26.4	
Imports	28.7	28.6	27.5	27.2	27.2	25.6	26.2			26.1	25.6	25.3	25.3	25.3	25.3	
Net non-debt creating capital inflows (negative)	-0.4	0.8	-0.5	-3.4	-0.8	1.5	-4.2			-1.3	-0.9	-0.9	-0.8	-0.7	-0.7	
Automatic debt dynamics 1/	-7.9	-1.8	-4.6	-4.2	4.5	-4.1	-5.3			-0.1	-0.2	-0.1	0.0	0.2	0.2	
Contribution from nominal interest rate	2.1	1.8	1.7	1.7	1.6	1.4	1.4			2.6	2.7	2.6	2.6	2.6	2.5	
Contribution from real GDP growth	-1.9	-2.7	-2.3	-3.4	-4.1	-3.8	-2.6			-2.7	-2.8	-2.8	-2.6	-2.4	-2.4	
Contribution from price and exchange rate changes 2/	-8.1	-0.9	-4.0	-2.4	7.0	-1.7	-4.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.7	-2.0	-5.8	4.8	-7.1	0.7	4.8			1.1	1.0	0.9	0.7	0.5	0.4	
External debt-to-exports ratio (in percent)	366.9	386.4	361.1	359.7	358.8	376.5	353.5			354.5	359.6	364.3	366.2	366.4	365.0	
Gross external financing need (in billions of US dollars) 4/	87.6	99.3	100.9	93.9	88.2	77.0	84.6			80.0	87.2	93.1	99.2	105.7	112.2	
in percent of GDP	52.4	56.7	54.0	47.0	50.2	41.6	42.0	10-Year	10-Year	36.3	37.3	37.4	37.5	37.7	37.9	
Scenario with key variables at their historical averages 5/										**96.9**	**95.6**	**94.4**	**93.2**	**0.0**	**0.0**	**-6.2**
Key Macroeconomic Assumptions Underlying Baseline								Historical Average	Standard Deviation							
Nominal GDP (US dollars)	167.1	175.1	187.0	199.8	175.8	185.4	201.5			220.3	234.0	248.9	264.5	280.5	295.8	
Real GDP growth (in percent)	1.9	2.5	2.2	3.6	3.5	4.0	2.9	2.1	1.7	3.1	3.2	3.1	2.9	2.7	2.6	
Exchange rate appreciation (US dollar value of local currency, change in percent)	9.7	2.5	1.2	1.3	-15.7	-0.5	2.0	0.0	8.7	3.2	1.0	1.1	1.2	1.2	0.7	
GDP deflator (change in domestic currency)	2.9	-0.3	3.2	1.9	0.8	1.9	3.6	2.3	1.3	2.7	2.0	2.0	2.0	2.1	2.0	
GDP deflator in US dollars (change in percent)	12.9	2.2	4.5	3.2	-15.1	1.4	5.7	2.4	9.4	6.0	2.9	3.2	3.2	3.3	2.8	
Nominal external interest rate (in percent)	2.0	1.7	1.6	1.7	1.4	1.4	1.5	1.8	0.4	3.0	3.0	3.0	2.9	2.8	2.8	
Growth of exports (US dollar terms, in percent)	18.9	-1.3	4.7	6.1	-13.4	-0.4	11.8	4.1	12.5	8.7	4.9	5.2	6.0	6.4	6.2	
Growth of imports (US dollar terms, in percent)	20.3	4.2	2.8	5.7	-12.1	-0.7	11.2	4.0	14.2	9.2	4.2	5.2	6.0	6.0	5.7	
Current account balance, excluding interest payments	-0.7	-2.1	-1.5	-1.6	-1.5	-0.9	-1.4	-1.5	1.3	0.0	-0.2	-0.3	-0.4	-0.5	-0.5	
Net non-debt creating capital inflows	0.4	-0.8	0.5	3.4	0.8	-1.5	4.2	1.0	2.3	1.3	0.9	0.9	0.8	0.7	0.7	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 2. New Zealand: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP, unless otherwise indicated)

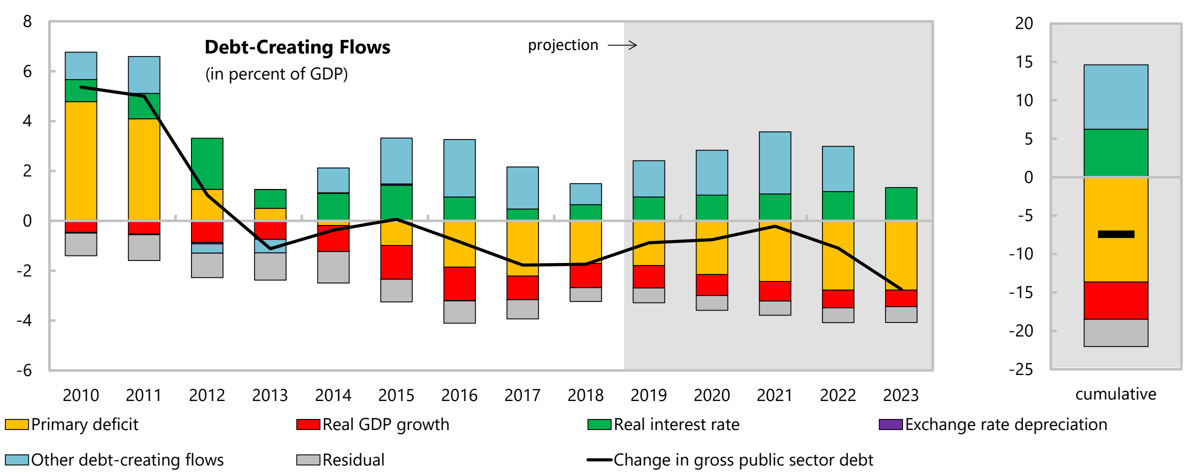
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2010-2015 [2]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	33.9	33.5	31.7	29.9	29.1	28.3	28.1	27.0	24.3
Public gross financing needs	2.5	-1.1	-1.3	3.5	3.2	3.7	3.4	3.2	3.7
Net public debt	33.9	33.5	31.7	29.9	29.1	28.3	28.1	27.0	24.3
Public debt (in percent of potential GDP)	33.3	33.5	31.6	29.9	29.0	28.3	28.2	27.1	24.3
Real GDP growth (in percent)	2.7	4.2	3.0	3.2	3.2	3.1	2.9	2.7	2.6
Inflation (GDP deflator, in percent)	2.0	1.9	3.6	3.3	2.4	2.4	2.5	2.4	2.2
Nominal GDP growth (in percent)	4.6	6.0	6.6	5.9	5.2	5.2	5.0	4.8	4.7
Effective interest rate (in percent) [4]	5.9	4.9	5.2	5.6	5.9	6.2	6.6	6.8	7.4

As of May 21, 2018		
Sovereign Spreads		
Long-term (bp) 3/		-54
5Y CDS (bp)		15
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AA	AA+
Fitch	AA	AA+

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	1.7	-0.8	-1.8	-1.7	-0.9	-0.8	-0.2	-1.1	-2.7	-7.4	
Identified debt-creating flows	2.7	0.1	-1.0	-1.2	-0.3	-0.2	0.4	-0.5	-2.1	-3.9	
Primary deficit	1.6	-1.9	-2.2	-1.7	-1.8	-2.1	-2.4	-2.8	-2.8	-13.6	0.7
Primary (noninterest) revenue and grants	36.4	36.7	36.4	36.2	36.4	36.5	36.5	36.6	36.6	218.8	
Primary (noninterest) expenditure	37.9	34.8	34.2	34.5	34.6	34.3	34.1	33.8	33.8	205.1	
Automatic debt dynamics [5]	0.4	-0.4	-0.5	-0.3	0.1	0.2	0.3	0.5	0.7	1.4	
Interest rate/growth differential [6]	0.4	-0.4	-0.5	-0.3	0.1	0.2	0.3	0.5	0.7	1.4	
Of which: real interest rate	1.2	1.0	0.5	0.7	1.0	1.0	1.1	1.2	1.3	6.2	
Of which: real GDP growth	-0.8	-1.3	-1.0	-1.0	-0.9	-0.8	-0.8	-0.7	-0.7	-4.9	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.7	2.3	1.7	0.8	1.4	1.8	2.5	1.8	0.0	8.4	
0 (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Stock-flow adjustment, incl. asset chang	0.7	2.3	1.7	0.8	1.4	1.8	2.5	1.8	0.0	8.4	
Residual, including asset changes [8]	-1.0	-0.9	-0.8	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-3.5	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

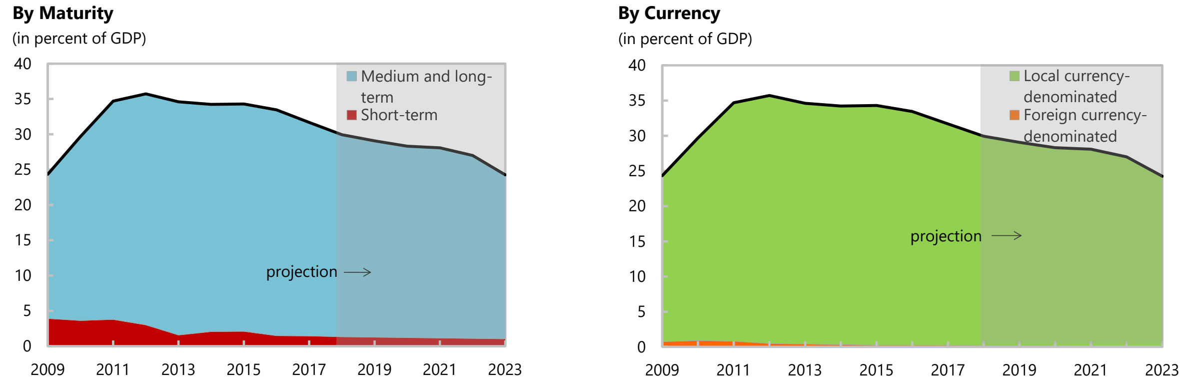
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

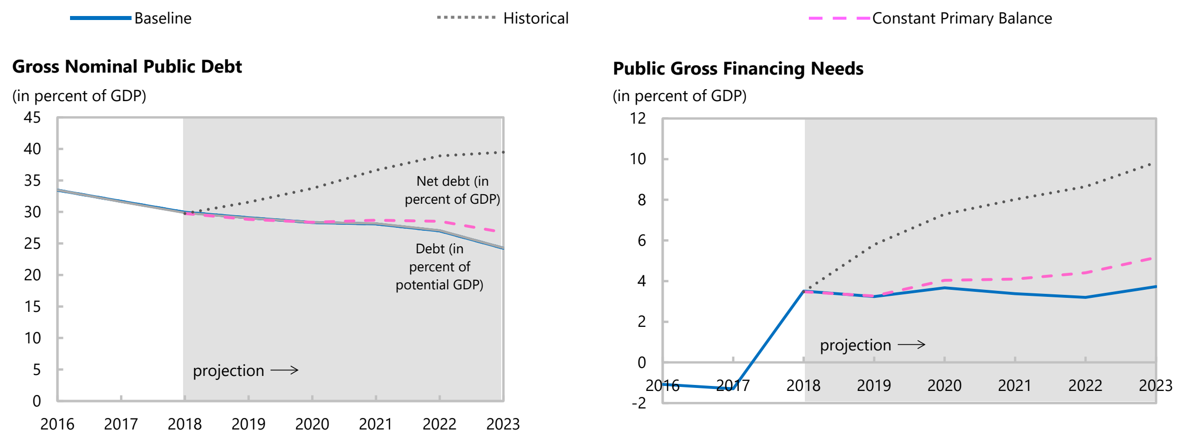
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 3. New Zealand: Public DSA – Composition of Public Debt and Alternative Scenarios



Alternative Scenarios



Underlying Assumptions

(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.2	3.2	3.1	2.9	2.7	2.6
Inflation	3.3	2.4	2.4	2.5	2.4	2.2
Primary Balance	1.7	1.8	2.1	2.4	2.8	2.8
Effective interest rate	5.6	5.9	6.2	6.6	6.8	7.4
Constant Primary Balance Scenario						
Real GDP growth	3.2	3.2	3.1	2.9	2.7	2.6
Inflation	3.3	2.4	2.4	2.5	2.4	2.2
Primary Balance	1.7	1.7	1.7	1.7	1.7	1.7
Effective interest rate	5.6	5.9	6.2	6.5	6.7	7.1

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.2	2.3	2.3	2.3	2.3	2.3
Inflation	3.3	2.4	2.4	2.5	2.4	2.2
Primary Balance	1.7	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	5.6	5.9	5.9	5.8	5.7	5.9

Source: IMF staff.

Annex VI. New Zealand 2017 FSAP: Follow-Up on Key Recommendations

Recommendation	Time Frame	Update and Implementation
Financial Stability and Financial Sector Resilience		
Increase RBNZ resources for the supervision and regulation of banks, insurance companies, and FMIs.	ST	In process. RBNZ is working on bringing on board four additional staff.
Strengthen cooperation and collaboration arrangements with Australian authorities.	ST	In process. Ongoing work especially on insurance side. Completed a hypothetical bank crisis simulation exercise.
Clarify responsibilities of the Treasury and RBNZ on financial sector issues to reinforce the role of RBNZ as prudential regulator and supervisor.	ST	Terms of reference for Phase Two of the Review of the Reserve Bank Act include this item.
Issue enforceable standards on key risks, governance, risk management, and controls to make RBNZ's supervisory expectations more transparent and support supervisory preventive action.	ST	No progress yet.
Review and extend the enforcement regime to promote preventive action and enhance sanctions powers, including by eliminating ministerial consent for directions, and making compliance with RBNZ policy documents evidence of prudent practice.	MT	Included in the Review of the Reserve Bank Act.
Initiate on-site programs to test the foundation of the three-pillar approach and directors' attestations, and increase supervisory engagement with institutions in order to require appropriate action.	ST	In process. A team has been formed to undertake cross-cutting review.
Refine FMA supervision by a) direct monitoring of aspects of asset management relevant to financial stability; b) ensuring quality of Financial Markets Supervisors; and c) enhancing insurance intermediary and conduct regulation and supervision.	I	In process. A review of New Zealand's insurance contract law has been initiated. MBIE is preparing an issues paper which is planned for release and public consultation in mid-2018.
Expand the FMA's regulatory perimeter to include licensing and supervision of custodians and appropriate oversight of wholesale asset managers.	ST	In preparation. Need further work to understand and complete a thematic review on licensed firm management and custody management.
Adopt and implement proposed FMI legislation on regulation, oversight, and enforcement powers.	I	In process. The drafting of the Financial Services Legislation Amendment Bill is almost completed.
Adopt the PFMI through detailed requirements in secondary legislation; change the frequency of FMI self-assessments in the proposed regime from three to two years; and enhance compliance of the designated FMIs with PFMI requirements.	ST	No progress yet.
Ensure that designated nonfinancial businesses and professions are subject to AML/CFT requirements, particularly company service providers, lawyers, and accountants.	MT	In process. The AML/CFT Amendment Act 2017 puts in place Phase 2 of AML/CFT laws which extend the current AML/CFT Act to cover more businesses. The law will come into effect in stages for different sectors, including for lawyers, conveyancers; and business that

Recommendation	Time Frame	Update and Implementation
		provide trust and company services from July 1, 2018; accountants from October 1, 2018; and real estate agents from January 1, 2019.
Expand data collection and modeling efforts to develop structural models for credit risk in commercial real estate (CRE) and corporate portfolios.	MT	No progress yet.
Macroprudential Framework		
Strengthen arrangements for macroprudential policy by increasing communication efforts; by increasing the transparency of the process to adjust the framework; and by maintaining an accountability framework that does not jeopardize the integrity and independence of the macroprudential decision-making process.	C	Will be considered in Phase Two of the Review of the Reserve Bank of New Zealand Act.
Introduce DTI measures in the macroprudential toolkit.	I	In process. The RBNZ conducted a public consultation in June-August 2017 on the possible addition of serviceability restrictions to the macroprudential toolkit. Likely be considered in Phase Two of the Review of the Reserve Bank of New Zealand Act.
Implement DTI measures if the changes to the LVR do not reduce the risks in the housing sector.	I	The authorities do not need to pursue this recommendation as housing risks have currently receded somewhat.
Increase capital buffer requirements to reflect the concentration of the financial sector in four banks.	I	No progress yet. A review of the capital adequacy requirement for locally incorporated registered banks is underway. To be completed in the second or third quarter of 2018.
Crisis Readiness, Management, and Resolution		
Strengthen domestic crisis management arrangements by reaching ex ante agreement on roles, responsibilities, and processes; prepositioning, mobilization, logistics, and communications plans; and testing through simulation exercises.	MT	Terms of Reference for Phase Two of the Review of the Reserve Bank of New Zealand Act include this recommendation.
Reconsider the merits of deposit insurance, or in the absence of policy support, introduce a limited depositor preference to provide legal certainty for the *de minimis* exemption in OBR.	MT	Terms of Reference for Phase Two of the Review of the Reserve Bank of New Zealand Act include this recommendation.
Revise the RBNZ Act to provide greater clarity and certainty in resolution, by inserting objectives in resolution including protection of depositors and the public interest and requiring accountability reporting against these objectives; by clarifying that the RBNZ is the sole resolution authority, and inserting an express requirement for ministerial consent for resolutions with fiscal or systemic implications only.	MT	Terms of Reference for Phase Two of the Review of the Reserve Bank of New Zealand Act includes this recommendation.
C = continuous; I (immediate) = within one year; ST (short-term) = 1–3 years; MT (medium-term) = 3–5 years.		
Sources: IMF (2017), *New Zealand, Financial Sector Assessment Program—Financial System Stability Assessment*; and New Zealand authorities.		

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 5, 2018

Prepared By

Asia and Pacific Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of April 30, 2018)

Membership Status: Joined: August 31, 1961; Article VIII

General Resources Account:	SDR Million	Percent Quota
Quota	1,252.10	100.00
Fund Holdings of Currency	1,118.43	89.32
Reserve position in Fund	133.76	10.68
Lending to the Fund	35.98	
New Arrangements to Borrow		

	SDR Million	Percent Allocation
SDR Department:		
Net cumulative allocation	853.76	100.00
Holdings	781.34	91.52

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to Fund [1/]

	Forthcoming				
	2018	2019	2020	2011	2022
Principal					
Charges/Interest	0.47	0.65	0.65	0.65	0.65
Total	**0.47**	**0.65**	**0.65**	**0.65**	**0.65**

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Arrangement:

New Zealand accepted the obligations of Article VIII on August 5, 1982. The New Zealand dollar has floated independently since March 1985 and the de facto exchange rate arrangement is free floating. New Zealand maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions, other than restrictions notified to the Fund in accordance with Decision No. 144-(52/51).

Article IV Consultation:

New Zealand is on the 12-month consultation cycle. The 2017 Article IV consultation was concluded by the Executive Board on May 3, 2017.

FSAP Participation and ROSCs:

New Zealand has participated in two FSAPs to date.

- The FSSA from the 2003 FSAP mission and the Detailed Assessments of Observance of IOSCO Objectives and Principles of Securities Regulation and FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism were published under Country Reports No. 04/126, No. 04/417, and No. 05/284, respectively.
- New Zealand participated again in 2016, with one FSAP mission in August 2016 and another FSAP mission in November 2017. The FSSA was discussed by the Executive Board at the time of the discussion of the Staff Report for the 2017 Article IV Consultation with New Zealand.

Technical Assistance: None

STATISTICAL ISSUES

(As of May 2018)

I. Assessment of Data Adequacy for Surveillance
General. Data provision is adequate for surveillance. The authorities are continuing to enhance data quality and expand the range of data available, and are making progress towards subscribing to the IMF's Special Data Dissemination Standard (SDDS).
Real Sector. GDP is compiled with a contemporary base year (components of GDP are linked annually) and benchmark period which was recently updated to reflect enterprise and household surveys for 2016. The authorities compile quarterly estimates of GDP based on appropriate indicators. New Zealand produces a quarterly consumer price index which has national coverage and a contemporary weight reference period (2015/2016).
Fiscal Sector. Stats NZ provides annual data (operating statement, balance sheet, government expenses by function, taxation revenue and non-financial assets reconciliation) on the general government and its central and local government subsectors following the Government Finance Statistics Manual 2001 (GFSM 2001) recommendations from 2009 onwards on a fiscal year (July-June) basis. It is published roughly five months following the fiscal year end, preceded by data on a provisional basis at the time of the budget (usually in May). It replaced the publication of data only on the central and local government subsectors on December 5, 2016 The Treasury also provides data on a timely basis for the central government that complies with New Zealand equivalents of the GAAP Public Sector Public Benefit Entity (PBE) Standards from 2005 onwards. They are provided on a monthly basis (with a one-month lag), with an annual statement published within 4 months of the fiscal year end. The impact of moving from NZ IFRS International Financial Reporting Standards) to PBE Standards on July 1, 2014 was not significant, due to a strong degree of convergence between the two suites of standards. The provided data enable adequate assessment of the impact of fiscal policy measures on New Zealand's economic performance.
Monetary and Financial Sectors. The Reserve Bank of New Zealand (RBNZ) publishes monthly and quarterly data on a broad range of financial variables. RBNZ has been working with registered banks to develop a new registered bank balance sheet collection system as a replacement to the Standard Statistical Return (SSR). Data based on the new reporting system were first disseminated in April 2017, with historical data compiled only from December 2016. Exceptions are key series, such as broad money and credit to the private sector which historical data are provided prior to December 2016. The RBNZ subsequently introduced improvements to its managed funds survey and began disseminating data for insurance corporations. The RBNZ will conduct a review of the statistical reporting of non-bank entities to better align the data with the with the registered banks reports and to provide more

coherent and comparable statistics meeting international standards. The release of historical data under the new reporting structure would be highly desirable for surveillance and analytical purposes. As RBNZ currently does not submit the full set of Standardized Report Forms (SRFs) to STA. Monetary data have not been reported to STA for publication in *International Financial* Statistics since 2011. The RBNZ has requested IMF consultation to finalize the development of SRFs based on the new data collection systems.
Financial Sector Surveillance: New Zealand currently does not report Financial Soundness Indicators (FSIs) for dissemination on the Fund website. The authorities should develop an action plan to submit the FSI data and metadata to the IMF for posting.
External Sector. Stats NZ provides timely information on the balance of payments and the international investment position (IIP) on a quarterly frequency since 2000. An expanded lending and debt statistic was introduced in 2012. The new series complements the existing IIP and international financial assets and liabilities measures of New Zealand's international balance sheet position, with a time series of external lending and debt in total and by sector, and the ownership relationship between the New Zealand-resident party and the non-resident counterparty of external lending and debt positions. This follows the IMF's external debt methodology in excluding values for financial derivative asset and liability positions. RBNZ provides monthly data on official international reserves. New Zealand's reporting of international reserves has been modified for March 2000 data onwards to conform to the standards required by the IMF for the purpose of subscription to the SDDS. Stats NZ also participates in the coordinated direct and portfolio investment surveys of the STA.

Table of Common Indicators Required for Surveillance

(As of May 23, 2018)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	5/18/18	5/18/18	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/18	5/14/18	M	M	M
Reserve/Base Money	4/18	5/14/18	M	M	M
Broad Money	4/18	5/14/18	M	M	M
Central Bank Balance Sheet	4/18	5/14/18	M	M	M
Consolidated Balance Sheet of the Banking System	4/18	5/14/18	M	M	M
Interest Rates[2]	5/18/18	5/18/18	D	D	D
Consumer Price Index	Q12018	4/19/18	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2016/17	5/17/18	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[4]	2016/17	5/17/18	A	A	A
External Current Account Balance	Q4 2017	3/14/18	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2017	3/14/18	Q	Q	Q
GDP/GNP	Q4 2017	3/14/18	Q	Q	Q
Gross External Debt	Q4 2017	3/14/18	Q	Q	Q
International Investment Position[5]	Q4 2017	3/14/18	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic non-bank financing.
[4] Including currency and maturity composition.
[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by Grant Johnston, Alternate Executive Director for New Zealand
June 25, 2018

The authorities broadly agree with the outlook presented in the staff report.

Economic growth in New Zealand has generally been in the range of 3 to 4 percent over the last three years, with key drivers including strong migration inflows, low interest rates and historically-high terms of trade. Employment growth has been strong and labor force participation is near a record-high 71 percent. However, wage and price pressures remain subdued and consumer price inflation is low. Low interest rates and high net inward migration have helped fuel demand for housing, with price-to-income ratios among the highest in the world.

The authorities' forecasts are for growth to average around 3 percent over the next few years, with the economy operating broadly at, or above, capacity. While some of the recent growth drivers will moderate, a lift in government spending and robust trading-partner growth are expected to provide support to the economy. The pace of employment growth is expected to be more than sufficient to employ new entrants to the labor market, despite high population growth, and unemployment is forecast to decline further towards 4 percent. Growth is expected to add to capacity pressures in the economy, contributing to inflation rising to the target mid-point of 2 percent. The current account deficit is forecast to widen slightly, to around 3 percent of GDP, but consistent with a stable net international investment position. These forecasts are subject to a number of upside and downside risks, with growing trade protectionism an important downside risk.

Fiscal policy

A key anchor for fiscal policy is the Government's intention to reduce net core Crown debt to 20 percent of GDP by 2021/22, subject to any significant shocks to the economy. Successive governments have considered a low level of public debt to be an important buffer given New Zealand's exposure to external shocks and natural disasters, and its relatively high private and external indebtedness. The Government has also committed to keeping core expenditure within the recent historical range of spending—around 30 percent of GDP.

The fiscal outlook remains strong. The new Government's first Budget, in May, increased operating and capital expenditure above their previous tracks but also showed a lift in expected tax revenue. Forecasts for the next four years show increasing operating and cash balances, and a declining debt ratio, consistent with the Government's net debt objective. Fiscal policy is forecast to be stimulatory in the current fiscal year and the next, but contractionary after that. Increased spending has been directed to priority areas including meeting the needs of a growing population—particularly through the health and education systems—promoting economic development, taking action on child poverty and protecting New Zealand's natural resources. The Government is increasing investment in social and transport infrastructure, and is gradually resuming contributions to the New Zealand Superannuation Fund, which prefunds a portion of future public pension costs. A Tax Working Group of external experts is looking at the structure, fairness and balance of New Zealand's tax system and will make its final recommendations early next year.

Monetary and financial sector policies

Consumer price inflation remains below the 2 percent mid-point target, due in part to recent low food and import price inflation, and subdued wage pressures. The RBNZ has signalled that its policy rate will remain at 1.75 percent for some time to come. Ongoing stimulatory monetary policy is expected to result in increasing capacity pressures and consumer price inflation rising gradually to the 2 percent target. The RBNZ has also stated that the direction of its next move is equally balanced, up or down.

The monetary policy framework in New Zealand is being amended to add employment outcomes alongside price stability as a dual mandate for the RBNZ, and to create a formal committee to take monetary policy decisions. Legislation to effect these changes has yet to be introduced. In the interim, however, the Policy Targets Agreement with the Minister of Finance directs the Governor to "contribute to supporting maximum sustainable employment within the economy," which builds on the flexibility the RBNZ has been using for some time.

A broader review of the RBNZ's almost 30-year-old legislation is also underway. Key topics include: the institutional arrangements for prudential regulation and supervision; objectives, objective setting processes, and alignment with government policy and risk appetite; and role clarity for the Minister of Finance, Board and Governor, including the allocation and co-ordination of powers, functions, and tools. This review is likely to consider a number of the recommendations made in last year's FSSA, which the authorities are continuing to work through.

Structural policy

The Government has embarked on a broad program of structural reforms with an overall theme of building a productive, sustainable and inclusive economy. This includes initiatives to support skills, innovation, regional development and trade, alongside policies to improve family income support, raise the minimum wage and transition to a low-emission economy.

In the skills area, the Government has begun to remove financial barriers to post-school education and training. The first year of study at a university, polytechnic or other tertiary provider is now fees-free, as is the first two years of industry training. The intention is to extend this to further years of study and training in the future. In the innovation space, the recent Budget contained a proposal for a new R&D tax incentive that would give eligible businesses 12.5 cents back for every dollar they spend on R&D. This is a contribution to the Government's goal of lifting national investment in R&D from 1.3 percent to 2 percent of GDP within 10 years.

The Budget also formally established the $1 billion per year Provincial Growth Fund to support growth in regional New Zealand. The Fund aims to enhance economic development opportunities, create sustainable jobs, lift the productivity potential of regions, and help meet New Zealand's climate change targets. Investments are already planned in tree-planting and regional rail projects. New Zealand is a CPTPP member and is involved in several free trade negotiations, including those with the Pacific Alliance and as part of RCEP. Negotiations on a free trade agreement are due to begin soon with the EU—collectively New Zealand's third-largest trade partner.

Housing market

New Zealand maintains a high degree of capital account openness and welcomes productive foreign investment that adds to the economy. However, it also faces challenges from declining home ownership and rapidly-increasing house prices. Home ownership plays an important role in New Zealanders' sense of wellbeing and security, and high house prices have fuelled concerns about globalization and increasing inequality around the world.

Addressing these challenges involves both supply-side and demand-side policies. In particular, the KiwiBuild program aims to deliver 100,000 affordable homes over 10 years for first home buyers through a combination of building on underutilized public land, purchasing or underwriting private developments off plan, and large-scale developments. A variety of housing-related tax measures have been introduced or are under consideration.

The Government has also introduced legislation to generally prevent most overseas persons from acquiring residential land, except where that investment boosts New Zealand's housing supply, will result in a conversion of the use of that land (such as setting up a business), or the buyer is committed to living, and paying taxes, in New Zealand. This measure will ensure that house prices are shaped by New Zealanders and those that are committed to living in New Zealand, as they cannot be outbid by non-residents. As a demand-side policy—to complement supply-side measures—it will make some homes more affordable for buyers at some points in the property-market cycle. It will also help ensure that a greater proportion of foreign investment flows into the productive economy—where the benefits of free capital flows are greatest—rather than housing speculation. Furthermore, the Government considers foreign capital will be better harnessed to reduce New Zealand's housing shortage through the incentives included in the new policy to support the supply of new housing, particularly large scale residential developments of at least twenty dwellings.

The Government is committed to maintaining New Zealand as an open, outward-looking trading nation, with public support for liberal policy settings not just around trade but also more broadly across society. Its view is that, without the introduction of the proposed screening regime for residential land, public support for trade agreements like the recently-signed CPTPP would not be forthcoming and New Zealand would be unable to commit to the types of bilateral and multilateral trade deals that underpin a significant portion of the domestic economy. Such agreements are much more important to the long-term strength and resilience of New Zealand's economy and the wellbeing of its citizens than the introduction of a screening regime for residential property. The Government considers that incorporating this broader perspective would improve the Fund's advice.

Finally, as there is no intention to manage aggregate capital flows, and it will have no material impact on the balance of payments, the authorities do not consider the policy on overseas purchases to be a capital flow management measure. The authorities also note that while foreign buyers may have played a smaller role in the housing market in 2017 (as noted in the staff report) their impact was likely to have been higher in the preceding years and, if this measure was not brought in, could be significant again in the future.