

## **New Zealand: 2009 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion**

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 2009 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 23, 2009, 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 April 22, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 6, 2009, discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

NEW ZEALAND

**Staff Report for the 2009 Article IV Consultation**

Prepared by the Asia and Pacific Department  
(In consultation with other departments)

Approved by James Gordon and Martin Mühleisen

April 22, 2009

- **Discussions:** March 13–23, 2009, with Minister of Finance Bill English, the Governor of the Reserve Bank of New Zealand Alan Bollard, the Treasury Secretary John Whitehead, and other senior officials and representatives of the private sector and trade unions.
- **Team:** Mr. Brooks (head), Messrs. Cubero, Rozhkov, and Schule (all APD). Mr. Ha (OED) also participated in the meetings.
- **Mission Focus:** Policies needed to lift the economy out of recession, reduce external vulnerabilities, and preserve macroeconomic and financial stability.
- **Past Fund Advice:** For a description of policy issues discussed in the 2008 Article IV consultation, see <http://www.imf.org/external/pubs/cat/longres.cfm?sk=21976.0> and Appendix I.
- **Exchange System:** New Zealand has accepted the obligations of Article VIII, Sections 2, 3, and 4. The exchange rate 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). The de facto exchange rate arrangement is free floating.
- **Official Development Assistance:** 0.3 percent of national income for ODA in 2008/09, focused on the Pacific.

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## Executive Summary

After several years of strong growth, the New Zealand economy entered into recession in early 2008, dragged down initially by the end of the housing boom and a drought, and later by the global downturn. With sound macroeconomic policies, a flexible exchange rate, a low level of public debt, flexible labor markets, and a healthy banking sector, New Zealand is in a better position than most advanced countries to face the global storm. However, the near-term outlook is challenging. Staff expects the New Zealand economy to contract by about 2 percent in 2009, with a gradual recovery over the medium term. Risks are weighted to the downside, linked to the unprecedented uncertainties surrounding the depth and duration of the global recession.

A key vulnerability is the high level of short-term external debt, mostly owed by banks. A low probability but high impact event would be a loss of investor confidence in banks or the sovereign. This could lead to a further increase in the cost and/or reduced availability of external funding, which would require a more painful economic adjustment.

A sizable fiscal stimulus is helping support domestic demand, but staff and the authorities shared concerns about the expected deterioration of the fiscal position over the medium term. The projected increase in public debt is similar to other advanced countries. However, given New Zealand's high external debt, a credible strategy to reduce the deficit over the medium term is needed to preserve investor confidence. There is very limited scope for additional fiscal stimulus beyond that already in the pipeline.

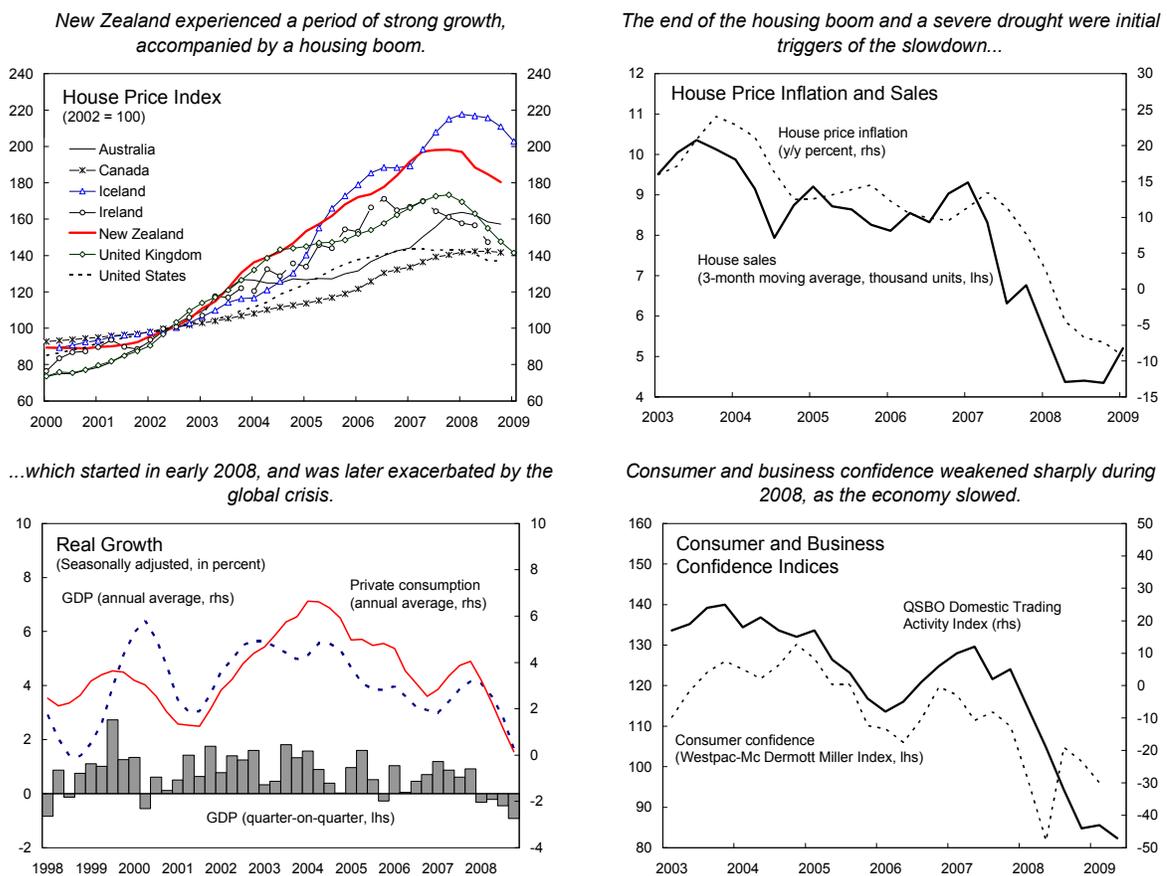
Monetary policy was appropriately eased since mid-2008 which should help support demand. Staff and the authorities agreed that, in light of the weak outlook for growth and inflation, the reduction of the official cash rate should continue.

The banking sector has weathered well the global crisis so far. Good credit ratings have allowed banks to refinance their external debt. The introduction of funding guarantees and the extension of the Reserve Bank's liquidity facilities, have supported confidence in the financial system and eased funding pressures. Nevertheless, banks' exposure to short-term external debt remains high. Banks are also vulnerable to an increase in loan defaults. Banks should be required to undertake extreme stress tests and increase their capital if needed. The key objective is to sustain banks' strong balance sheets, which is crucial for maintaining access to offshore funding.

## I. BACKGROUND

1. **After several years of strong growth, New Zealand entered a recession in early 2008 (Table 1).** As the housing boom ended in response to tight monetary policy, domestic demand fell, led by private consumption (Figure 1). In addition, agricultural exports were hit by drought in early 2008. The downturn was exacerbated later in the year by the global slowdown. The correction in commodity export prices reduced farm incomes and put further pressure on consumption. Real GDP contracted in all quarters of 2008, with a fall of 3½ percent (saar) in the fourth quarter, bringing annual growth to 1/3 percent.

Figure 1. Macroeconomic Developments

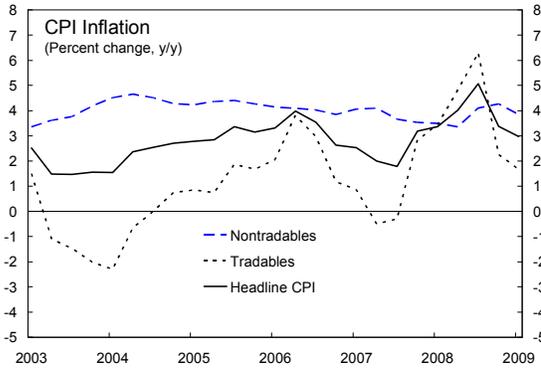


Sources: Reserve Bank of New Zealand, REINZ, Statistics New Zealand; Haver Analytics; and Fund staff calculations.

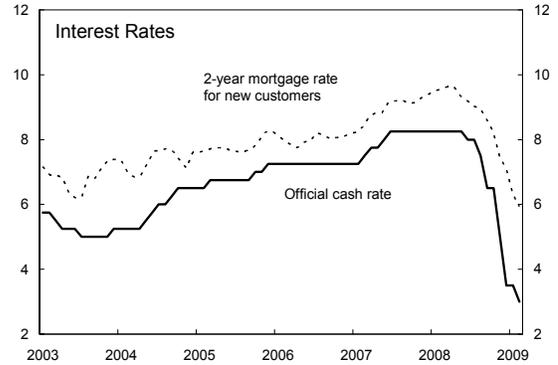
2. **CPI inflation has eased sharply since peaking in September 2008.** Driven by high oil and food prices, annual CPI inflation rose to 5 percent in the third quarter (Figure 2). Since then, weak economic activity and a sharp decline in oil prices resulted in a significant easing of inflation pressures. Annual CPI inflation fell to 3 percent in the March 2009 quarter, within the Reserve Bank's target band of 1 to 3 percent. The labor market remained relatively resilient, but started to slow in late 2008, with unemployment rising to 4¾ percent (text figures).

Figure 2. Monetary and Financial Conditions

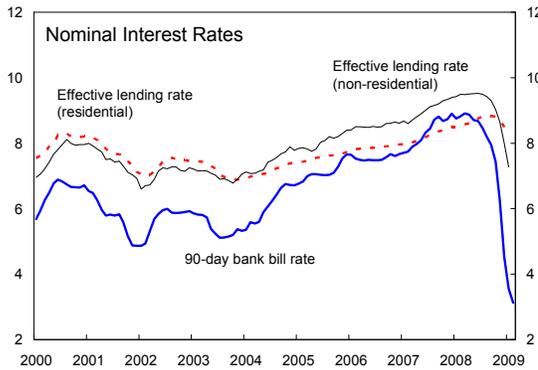
*Inflation peaked in September 2008, but since then inflationary pressures have eased...*



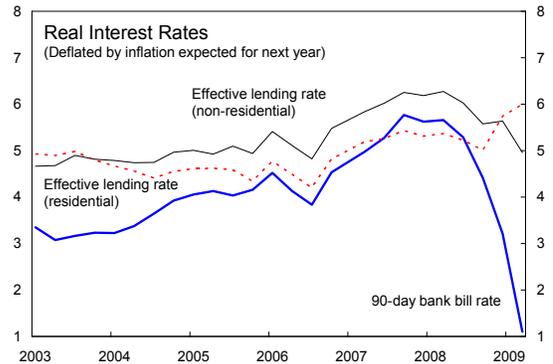
*...and the RBNZ loosened monetary policy, cutting the official rate by a total of 525 basis points.*



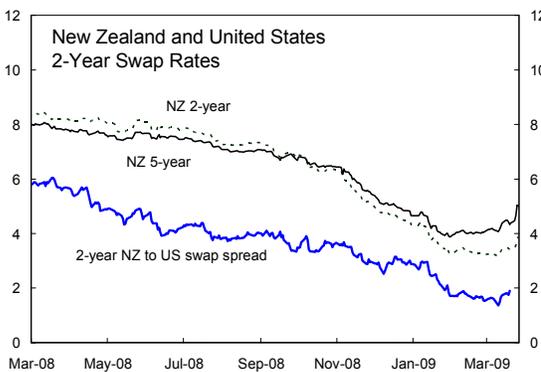
*Effective lending rates fell, but not as much as the Official Cash Rate and the bank bill rate...*



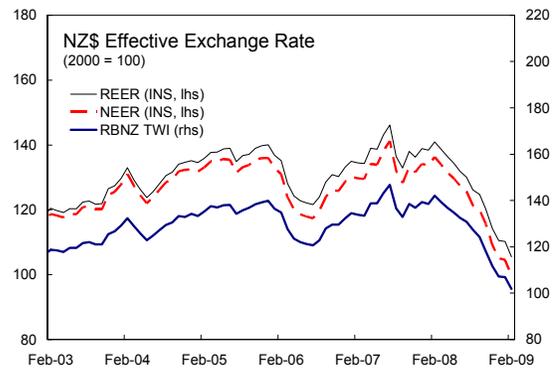
*...and falling inflation kept real effective lending rates at a high level.*



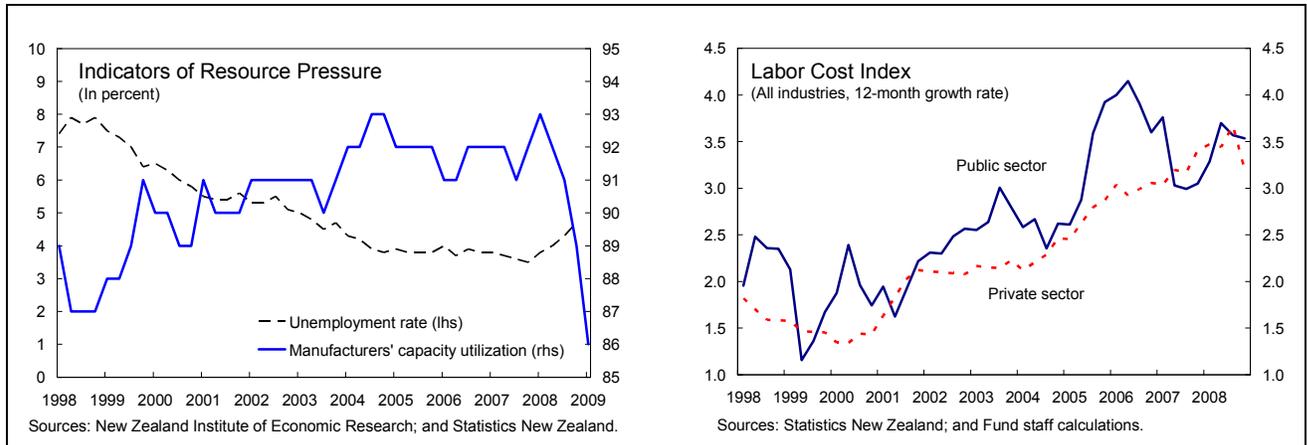
*Swap rates have come down from the peak in early 2008.*



*The exchange rate depreciated sharply from the levels that the authorities called "unjustifiably high".*

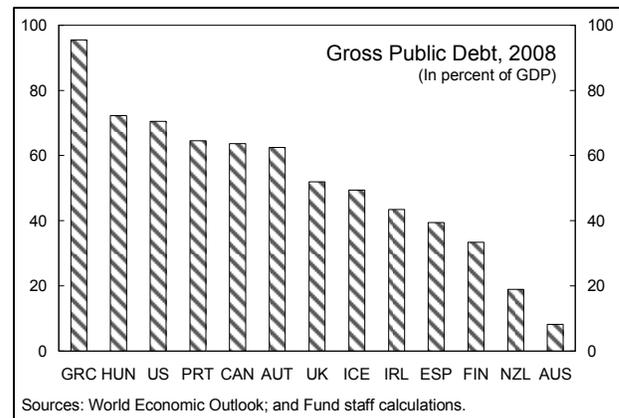


Sources: International Financial Statistics; Reserve Bank of New Zealand; Statistics New Zealand; Bloomberg.



3. **As the economy contracted and inflation pressures eased, monetary policy was loosened and the exchange rate depreciated sharply.** The Reserve Bank cut the official cash rate by 525 basis points since July 2008 to 3 percent, and the nominal exchange rate depreciated by 25 percent in trade-weighted terms between December 2007 and March 2009. This did not have a material adverse impact on balance sheets, as most external debt is denominated in New Zealand dollars or hedged. In fact, banks' offshore funding needs have been eased by the depreciation of the exchange rate, as foreign currency borrowing now provides more New Zealand dollars than a year ago.

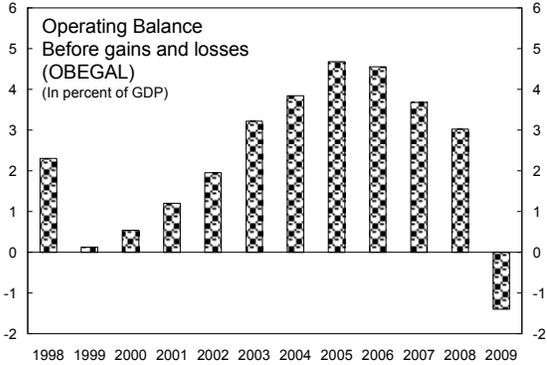
4. **The fiscal position remained strong, but the outlook has deteriorated.** The surplus<sup>1</sup> was 3 percent of GDP in 2007/08, the government's net financial assets are positive, and gross public debt is low by international standards (text figure). However, a deficit of 1½ percent of GDP is expected for 2008/09 (Table 2 and Figure 3). Part of the deterioration was a result of the economic downturn, as the increase in tax revenues in recent years was partly driven by cyclical factors, such as rising commodity and house prices. Another part was driven by measures introduced last year—namely personal income tax cuts staggered over three years and expenditure increases.



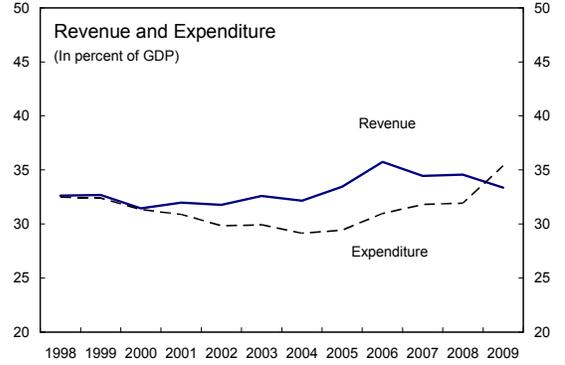
<sup>1</sup> Operating balance before gains and losses (OBEGAL).

Figure 3. Fiscal Position

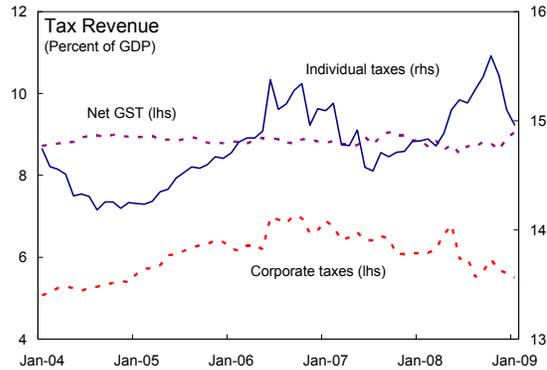
The budget is projected to move into deficit in the current fiscal year...



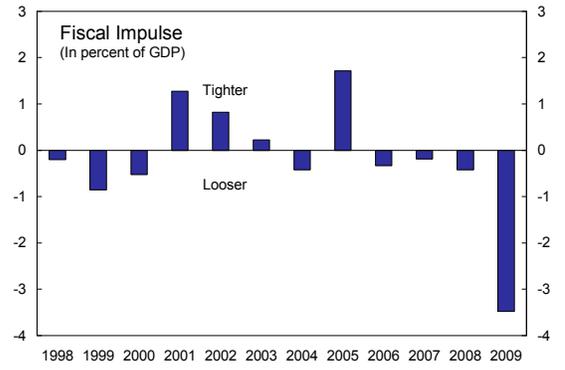
...as a result of income tax cuts, new spending initiatives, and a worsened growth outlook.



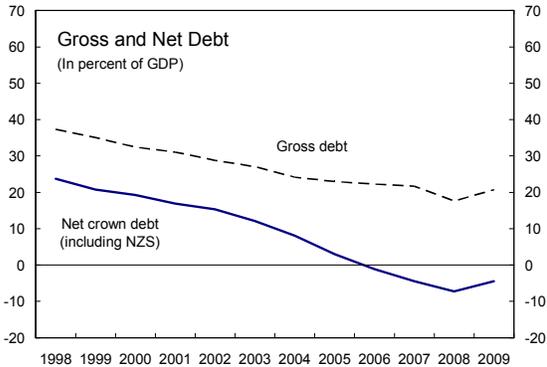
Tax receipts from individuals and corporates fell in 2008 as the economy slowed...



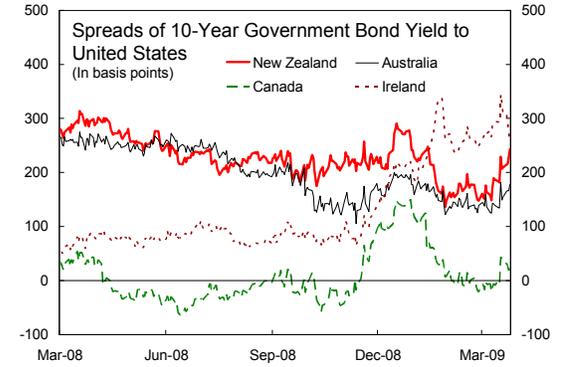
...and the fiscal impulse is projected to increase sharply in 2008/09.



Public debt is low, but is starting to increase as the fiscal position deteriorates.



The spreads on New Zealand government debt have fallen from recent peaks, but remain elevated.



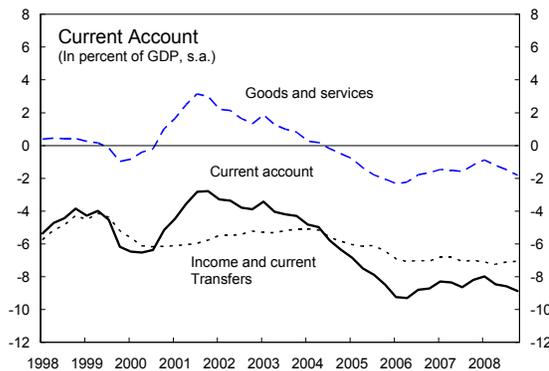
Note: Fiscal years ending June 30.

Sources: The New Zealand Treasury; SNZ; and Fund staff calculations and projections.

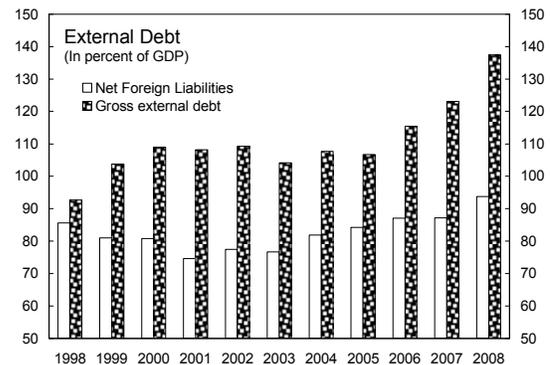
5. **The current account deficit widened to almost 9 percent of GDP in 2008.** High oil prices and the lagged effect of an appreciated exchange rate contributed to strong import growth, despite the slowdown in consumption (Table 3 and Figure 4). Unlike in many Asian countries, export volumes have held up because of the low share of medium- and high-tech manufacturing exports. Private capital inflows continued to finance the deficit, and net foreign liabilities increased to 94 percent of GDP.

Figure 4. External Developments

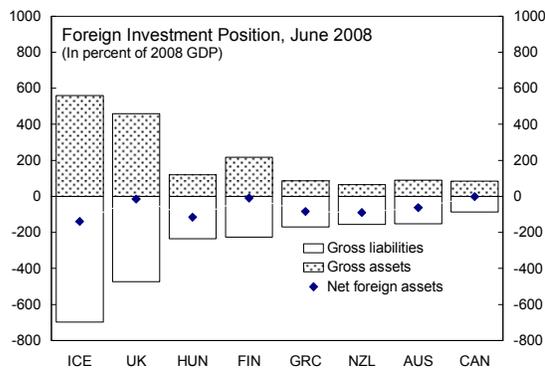
*High oil prices and the lagged effect of an appreciated exchange rate lifted the current account deficit.*



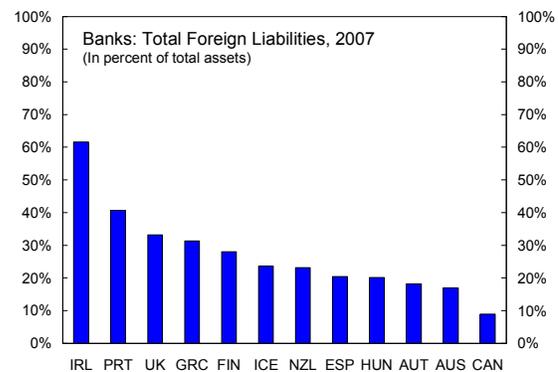
*Private capital inflows continued to finance the deficit, increasing net foreign liabilities to 94 percent of GDP.*



*While net foreign liabilities are high, gross liabilities are lower than in many other developed countries...*



*...and banks' foreign liabilities are comparable to other OECD countries.*

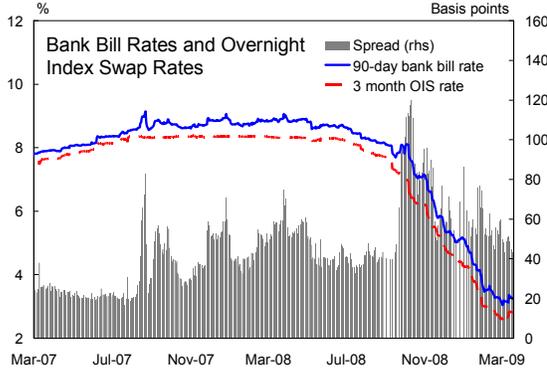


Sources: Reserve Bank of New Zealand, REINZ, Statistics New Zealand; International Financial Statistics; and Fund staff calculations.

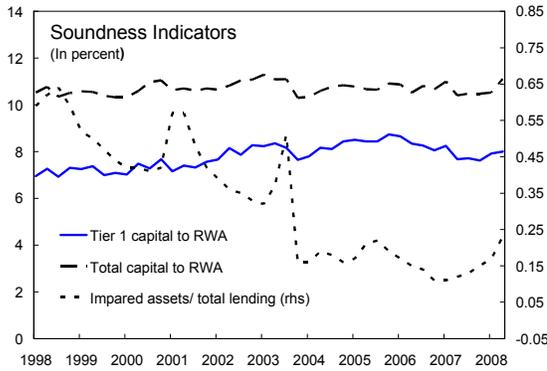
6. **The banking sector has weathered well the global crisis so far.** It remains profitable, with aggregate capital well above the regulatory minimum (Figure 5). Impaired assets have increased noticeably over recent months, but are low by international standards ( $\frac{1}{4}$  percent of total loans), and are covered by provisions. Regulations restricted banks' use of securitization, which limited the fallout from the financial turmoil. However, banks' short-term external debt remains high and most of their assets are with the household sector, whose debt has risen to 160 percent of disposable income. Nonbank financial institutions have been hard hit by the housing downturn, but their assets account for only 5 percent of system-wide assets.

Figure 5. Banking Sector Developments

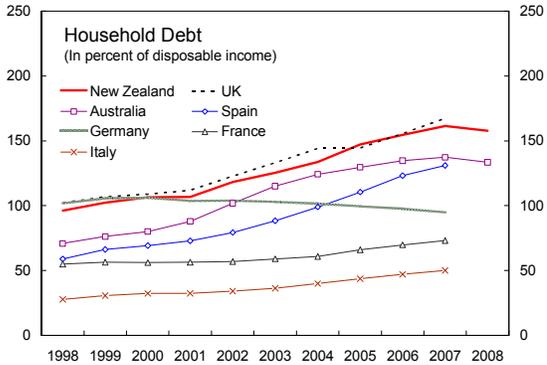
90-day interest rates have fallen sharply, offsetting the widening of the spread.



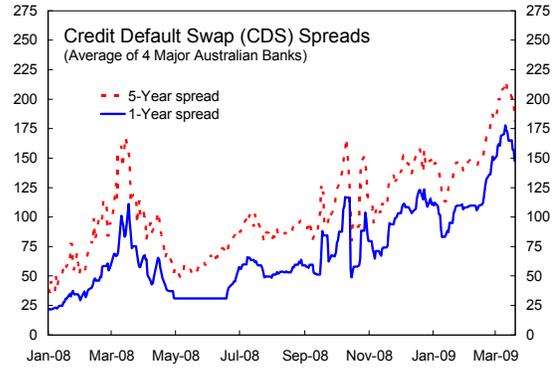
The banking sector remains sound...



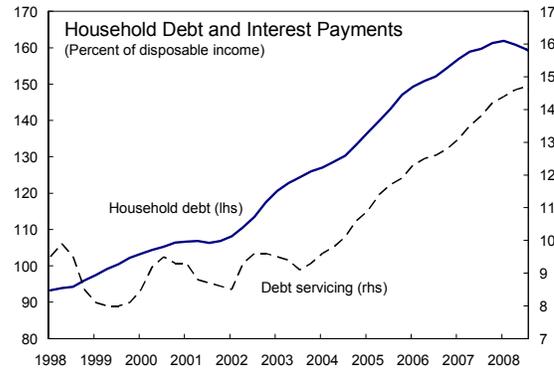
...compared with most other developed countries.



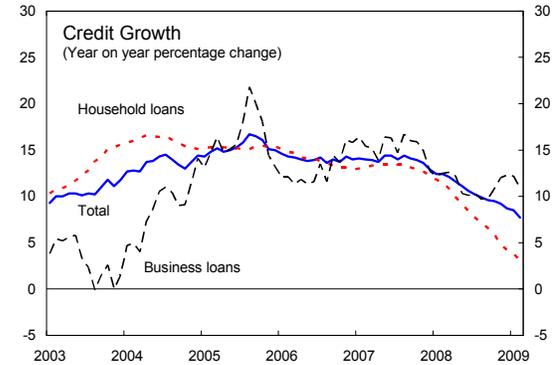
CDS spreads for major Australian banks widened.



... but banks are exposed to mortgage loans held by households that are highly indebted...



Credit growth has slowed, especially to households.



Sources: Bloomberg; Eurostat; Reserve Bank of New Zealand; and Statistics New Zealand.

## II. POLICY DISCUSSIONS

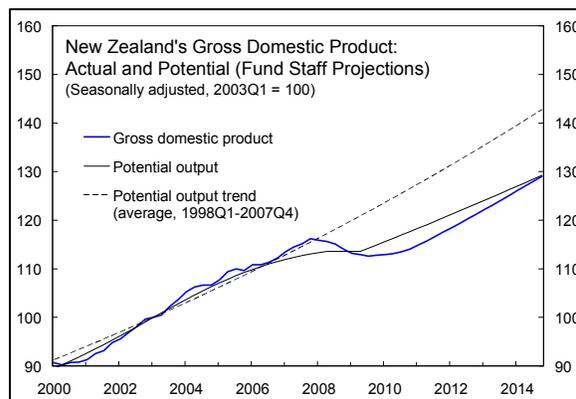
7. **Discussions focused on the policies needed to lift the economy out of recession, reduce external vulnerabilities, and preserve macroeconomic and financial stability.** In particular, the key topics included:

- choosing the appropriate degree and speed of monetary easing;
- preserving medium-term fiscal sustainability;
- maintaining stability of the financial sector;
- reducing external vulnerabilities.

### A. The Outlook

8. **Staff and the authorities agreed that the near-term outlook is weak, and that uncertainty is higher than usual.** Staff emphasized the significant deterioration in the global outlook in recent months, and the likely spillover effects that the global downturn may have on New Zealand (Box 1). Households are constrained by high debt levels, falling house and equity prices, and uncertain employment prospects. Business investment is held back by a fall in confidence, weaker profitability, and tighter credit conditions. Downside risks in the outlook are high and linked to the unprecedented uncertainties surrounding the depth and duration of the global recession. Staff expects the economy to contract by about 2 percent in 2009.

9. **In the medium term, staff projects a gradual recovery beginning in 2010** (Table 4). The uncertainty in the world financial markets will likely continue to constrain the ability to raise funding offshore, particularly at longer maturities, and may therefore limit the availability of credit for the private sector. Higher saving by households, slower credit growth, and a fall in commodity prices will put a brake on growth. The recovery is expected to be gradual and led by government expenditure and net exports, with the latter driven by the depreciation of the exchange rate and a bounce back of agricultural exports from drought. Growth is projected to rise above the potential rate of about 2½ percent by 2012. The projections assume a permanent loss of output relative to a 10-year trend that is in line with international experience (text figure).



### Box 1. New Zealand: Tail Risks to the Forecast

**The IMF's Global Integrated Monetary and Fiscal Model has been used to estimate the potential impact of a global deflationary shock on New Zealand.** The model has a number of useful features, including various nominal and real rigidities, overlapping generations and rule-of-thumb consumers, and an elaborate representation of monetary and fiscal policies.<sup>1</sup>

**In scenario 1, the global downturn deepens and becomes long-lived.** A combination of shocks to consumption and investment hit both the rest of the world and New Zealand in 2009 and 2010. In addition, lower foreign demand for New Zealand commodities put pressure on commodity prices. Given the two-country structure of the model, the shock is effectively the same across all New Zealand's trading partners. At home and abroad, policy interest rates are cut, and fiscal automatic stabilizers are allowed to work. Nonetheless, the capital stock and trend output fall below baseline; the output gap closes after five years, but the level of GDP remains below baseline.

**In scenario 2, tighter foreign financing conditions force a painful adjustment.** On top of scenario 1, foreign investors demand a 5 percentage points higher risk premium, which triggers a sharp fall in domestic demand to 10–11 percent below baseline. GDP and inflation also fall below baseline, but net exports and the current account balance improve. Reductions in policy interest rates and automatic fiscal stabilizers help cushion the downturn, but public debt increases.

Impact on New Zealand of Adverse Shocks (Percent or percentage point deviation from baseline)				
	2009	2010	2011	2012
<b>World</b>				
Real GDP	-1.0	-1.5	-1.3	-1.1
<b>New Zealand: Scenario 1</b>				
Real GDP	-1.1	-2.0	-1.9	-1.8
Inflation	-0.6	-0.9	-0.9	-0.6
Current Account/GDP	-0.8	-1.1	-0.7	-0.5
<b>New Zealand: Scenario 2</b>				
Real GDP	-3.9	-4.4	-4.3	-3.8
Domestic Demand*	-8.8	-11.1	-10.6	-9.1
Net Exports*	4.9	6.7	6.3	5.3
Current Account/GDP	5.6	4.8	4.2	4.1
REER 1/	-15.5	-9.5	-5.2	-3.6
Inflation	-0.6	-0.7	-0.4	-0.2
Nominal Policy Rate	-1.5	-2.1	-1.9	-1.7
Priv. Real Interest Rate	4.3	3.5	3.4	3.4
Fiscal Balance/GDP	-2.4	-2.8	-2.7	-2.3
Public Debt/GDP	2.7	5.4	7.1	7.8
Source: GIMF simulations.				
* Contribution to change in real GDP.				
1/ Minus = devaluation.				

<sup>1</sup> For a complete description of the model, see Kumhof and Laxton (2009).

10. **The risks to the outlook are tilted to the downside.** A low probability but high impact event would be a loss of investor confidence in banks and the sovereign, which would require a painful economic adjustment. So far, banks' sound financial positions have allowed them to refinance significant amounts of short-term offshore debt. However, it is possible that the full impact of the global turmoil on capital flows is yet to be felt.<sup>2</sup> A loss of investor confidence could lead to a further increase in the cost and/or reduced availability of banks' external funding. On the upside, a stronger-than-expected recovery in Asia and Australia, which account for about half of New Zealand's exports, could boost export incomes and result in higher-than-forecast growth.

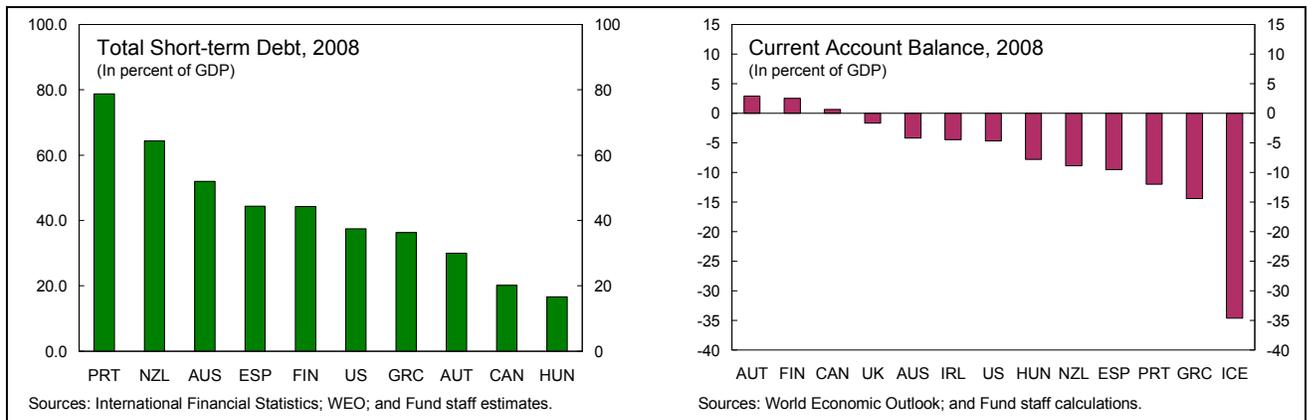
<sup>2</sup> *World Economic Outlook*, April 2009.

11. **The authorities project a somewhat stronger recovery.** The authorities noted that a number of factors differentiate New Zealand favorably from many other countries, including the absence of a banking crisis and a flexible exchange rate. They therefore believed that recession is likely to lead to a smaller permanent output loss than in other advanced economies.

## B. Fiscal Policy

12. **A significant fiscal stimulus is underway.** The policy measures taken in 2008 provide a cumulative stimulus of around 3 percent of GDP by 2009/10, which will help cushion the near-term impact on the economy of the global downturn. The combined effect of the policy decisions and the weaker outlook for commodity prices and growth, however, is a sharp worsening of the fiscal projections over the next 4–5 years.

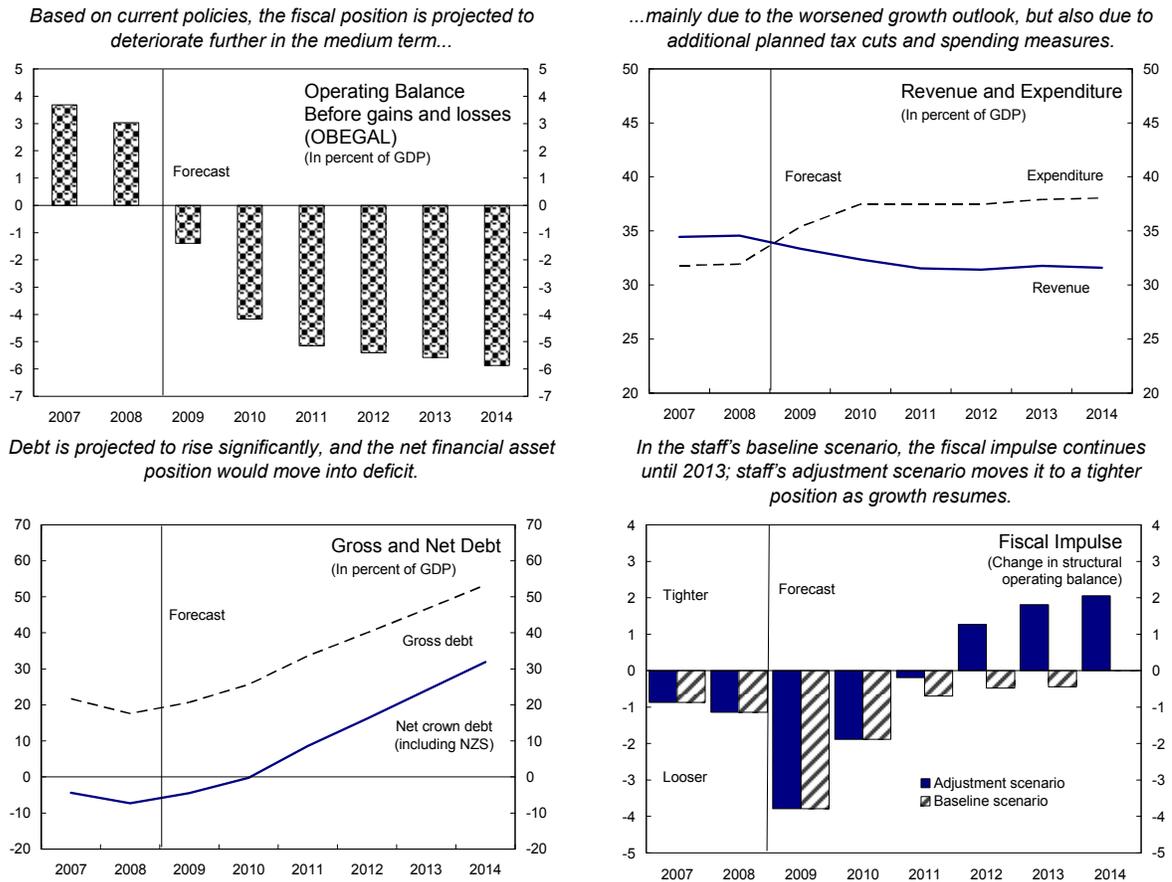
13. **Staff and the authorities shared concerns about the expected deterioration of the fiscal position over the medium term.** Staff projects that, without changes to current policies, the deficit would reach almost 6 percent of GDP by 2013/14, with gross public debt of more than 50 percent of GDP by 2014 (Figure 6). In a scenario with lower economic growth, the fiscal position would deteriorate even further.<sup>3</sup> While this increase in debt is broadly in line with that forecast for other advanced countries,<sup>4</sup> New Zealand's sizable short-term external debt (65 percent of GDP) and large current account deficit (9 percent of GDP) constrain fiscal policy's room for maneuver (text figures). A further deterioration in the near-term fiscal outlook could generate a market backlash and raise borrowing costs, undermining the effectiveness of the sizable fiscal and monetary stimulus already in train. Thus, there is very limited scope for additional fiscal stimulus beyond the sizable stimulus already in the pipeline.



<sup>3</sup> See the accompanying Selected Issues paper.

<sup>4</sup> The *World Economic Outlook*, April 2009, forecasts an increase in gross public debt from 2008 to 2014 of about 22 percent of GDP for the Euro area, and 35–40 percent of GDP for Japan, the United Kingdom, and the United States.

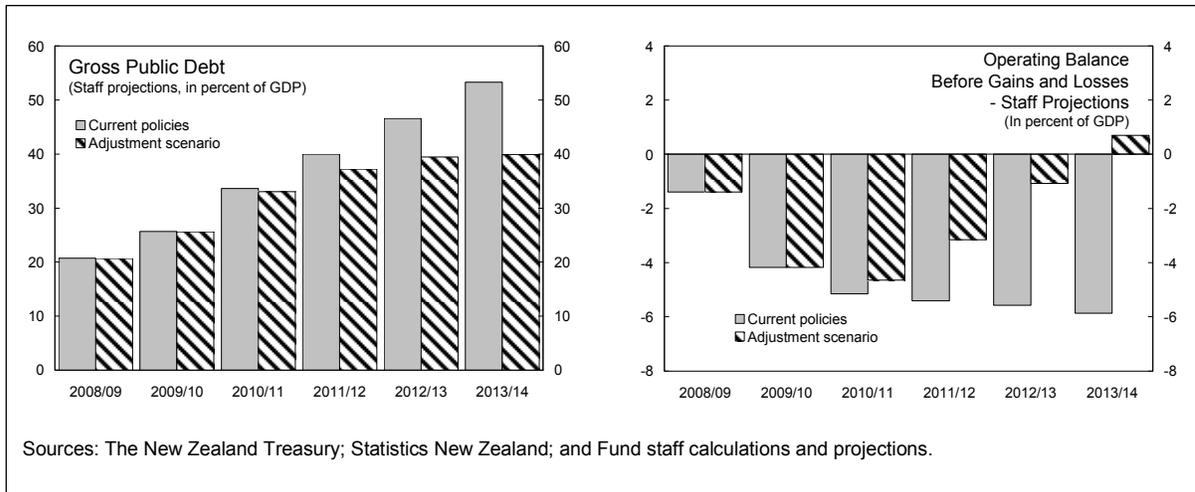
Figure 6. Fiscal Outlook (Fund Staff Projections)



Note: Fiscal years ending June 30.

Sources: The New Zealand Treasury; Statistics New Zealand; and Fund staff calculations and projections.

14. **Staff emphasized that preserving investor confidence will require a credible strategy to reduce the deficit over the medium term.** Staff advised that concrete measures be laid out in the May 2009 budget to stabilize gross public debt in the medium term and bring it back to around the current level in the longer term. The bulk of measures to be taken for medium-term fiscal consolidation should aim to have an impact in 2010/11 and beyond, when growth is projected to recover. While the focus should be on the expenditure side given the increase in spending in recent years, the size of the required adjustment is large, and revenue measures will likely also be needed to close the gap. Options for expenditure reduction include cutting low priority programs—preferably those with the least impact on demand in the near term—and improving ‘value for money’ in public sector services. Options for increasing revenue over the medium-term should aim at minimizing the impact on long-term growth. Even with consolidation, the fiscal stance would likely remain expansionary through 2010–11, because of already-budgeted personal tax cuts and spending increases (text figures).



15. **The authorities stressed their firm commitment not to allow debt to rise to levels that would undermine investor confidence.** They emphasized that the projected increase in debt over the medium term is outside the range that the government considers prudent. The authorities are already taking steps to eliminate existing unfunded commitments and stop the growth of employment in government administration. Further measures will be laid out in the May 2009 budget.

16. **The mission encouraged the authorities to prepare contingency plans in case the economic and fiscal outlook deteriorates further.** Staff noted that, given the uncertainty about the economic outlook, medium-term projections should be based on conservative revenue assumptions. If the outlook worsens, the authorities should allow the automatic stabilizers to operate, but put in place offsetting measures that would reduce the deficit in the medium term.

17. **Over the long term, key budgetary risks are the growing healthcare costs and public pension outlays.** These risks should be addressed before the demographic pressures intensify.

### C. Monetary Policy

18. **The economic slowdown and tight monetary policy earlier in the cycle have helped to ease inflationary pressures.** The output gap has turned negative and staff projects headline inflation to fall to less than 1 percent (y/y) by December 2009, before slowly returning to the middle of the 1–3 percent target band in the medium term.

19. **Staff noted that the substantial easing of monetary policy since mid-2008 has been appropriate.** The sizable reduction in the official cash rate over the last few months has largely, though not fully, been passed through to rates for new borrowing. The monetary stimulus already in train should help support demand. The depreciation of the exchange rate has also cushioned the fall in export prices and volumes, and helped ease banks' offshore funding pressures. Staff welcomed the outcome of the parliamentary inquiry into the

monetary policy framework (Box 2). The authorities felt that the inflation targeting regime remained appropriate, and has been helpful in reducing the likelihood of deflation.

20. **Given the weak outlook for growth and inflation, the Reserve Bank should continue to reduce the official cash rate.** Credit growth is slowing, and credit standards have been tightened. Also, increased spreads on bank borrowing (especially for 2–5 year terms) and lower inflation expectations have partially offset the impact of the lower cash rate on real lending rates. Moreover, households with fixed rate mortgages will benefit from lower interest rates only with a lag.

21. **The mission agreed with the authorities that further easing of monetary policy should proceed in smaller steps.** The authorities noted, and staff agreed, that interest rates should be set so that New Zealand remains competitive in international capital markets, because of the country's high short-term external debt. Reducing the official cash rate to zero could lead to significant capital outflows and a sharp depreciation of the exchange rate. The authorities saw no immediate need for quantitative easing, given that monetary policy remains effective in New Zealand. Nonetheless, the staff suggested that the authorities consider alternative easing instruments and their potential efficacy in the unlikely event that such measures are needed.

#### **D. Financial Sector**

22. **Steps taken in the second half of 2008 have helped to improve confidence in the banking system.** The introduction of retail and wholesale funding guarantees, and the extension of the Reserve Bank's liquidity facilities, have helped maintain banks' access to funding and supported confidence in the financial system (Appendix II). Moreover, new funding arrangements with parent banks have helped fill the gap left by the limited access to medium-term funding.

23. **Staff stressed the importance of contingency planning for the worst-case scenarios.** A sharp rise in unemployment could seriously affect the quality of mortgage books, while farmers are highly indebted and exposed to a fall in commodity prices. Staff analysis suggests that banks' capital is resilient to an increase in the default rate to 5–6 percent of total loans.<sup>5</sup> Nevertheless, given the downside risks in the outlook, banks should be required to conduct extreme stress tests to assess their vulnerability to a sharp jump in unemployment, a large drop in house prices, and a significant increase in funding costs. Banks' capital is well above the regulatory minimum of 8 percent. However, if these extreme stress tests were to point to the need for one or more banks to increase provisioning and raise capital, this should be done early, as it would be more difficult to raise capital if banks come under stress. The key objective is to sustain banks' strong balance sheets, which is crucial for maintaining access to offshore funding.

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<sup>5</sup> See the accompanying Selected Issues paper.

### **Box 2. New Zealand: Review of the Monetary Policy Framework**

**A parliamentary inquiry into the monetary policy framework was undertaken in 2007/08 because of concerns about an overvalued exchange rate.** Some submissions to the inquiry pointed to the adverse impact on export competitiveness from high policy interest rates driving up the exchange rate and argued for a more flexible approach to monetary policy or an exchange rate target.

**The inflation-targeting framework has become more flexible since it was introduced in 1990.** Initially a 12 month rate of inflation of 0–2 percent was targeted, but this was changed progressively to “1–3 percent on average over the medium term.” In addition, since 1999 the Reserve Bank has been required to “seek to avoid unnecessary instability in output, the exchange rate or interest rates.”

**The inquiry recommended no further significant changes to the framework.** The inquiry found that the case for modifying the inflation target, such as a adopting a wider target range, could have costs in terms of credibility in the commitment to price stability, without the promise of significant benefit. It also dismissed arguments for targeting the exchange rate as it would take away monetary policy independence and lose a buffer to shocks.

**The government’s response to the inquiry noted that while the monetary policy framework was in line with international best practice, it could be developed further.** In particular, it could take account of asset price cycles and general imbalances in the economy.

24. **The authorities reiterated their commitment to continued monitoring and stress testing of banks’ capital position.** They noted that banks are now required to conduct regular stress tests under Basel II. The Reserve Bank is currently reviewing banks’ capital adequacy associated with agricultural lending.

25. **Staff supported the Reserve Bank’s proposed prudential liquidity rules for banks.** The rules would strengthen the disclosure requirements for liquidity risk and require banks to maintain robust liquidity positions.<sup>6</sup> Over time, the new rules should help reduce banks’ dependence on short-term offshore funding.

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<sup>6</sup> These include limits on a bank’s mismatch positions over one week and one month, and a minimum “core funding” ratio of 70 percent. The latter is defined as a ratio of “core funding” (shareholders’ equity, wholesale and retail funding with residual maturity more than one year, and 80 percent of retail funding with residual maturity less than one year) to total assets.

26. **Staff welcomed other measures taken to strengthen the supervision of the financial sector.** The decision to make the Reserve Bank the regulator of nonbank financial institutions, and the regulator and supervisor of the insurance sector should improve investor confidence, and strengthen the resilience of the non-bank financial sector. Staff also welcomed the ongoing collaboration with the Australian authorities on banking supervision, regulation, and crisis preparedness.

### **E. External Stability**

27. **The staff considered that the sharp fall of the exchange rate brought the currency broadly in line with fundamentals** (Box 3). The depreciation was driven by the beginning of the loosening cycle by the Reserve Bank and the fall in commodity prices. The authorities stressed that they remain committed to a free floating exchange rate regime, with only limited interventions by the Reserve Bank.

28. **The depreciation, combined with the global financial turmoil and the domestic recession, should lead to a narrowing of the current account deficit.** More limited access to offshore funding and higher private savings will push the current account deficit to lower levels (Box 4). The trade balance is expected to improve, with imports restrained by the weakness in private consumption and investment, and by the lower exchange rate. At the same time, exports should recover from the drought, and benefit from the depreciated currency.

29. **Continued disruptions in global markets might hamper access to balance-of-payments financing.** In this context, the government's wholesale funding guarantee and increased term funding from Australian parent banks have provided important cushions. If in the event of a large shock these prove insufficient, official foreign exchange reserves, the government's offshore borrowing capacity, and some use of the swap facility with the U.S. Federal Reserve should limit the extent of a disruptive adjustment. This underlines the need to maintain fiscal sustainability. The mission encouraged the authorities to facilitate the expansion of term funding from Australian parent banks to their New Zealand subsidiaries.

### Box 3. New Zealand: New Zealand's Equilibrium Real Effective Exchange Rate

Staff estimates suggest that the New Zealand dollar is broadly in line with fundamentals. These estimates are based on the macroeconomic balance (MB) approach, the equilibrium real exchange rate (ERER) approach, and the external sustainability (ES) approach.

The MB estimates suggest that the equilibrium current account deficit is around 5 percent of GDP, reflecting relatively high population growth. Staff's projected current account deficit is in line with the norm. This implies little deviation of the exchange rate from equilibrium.

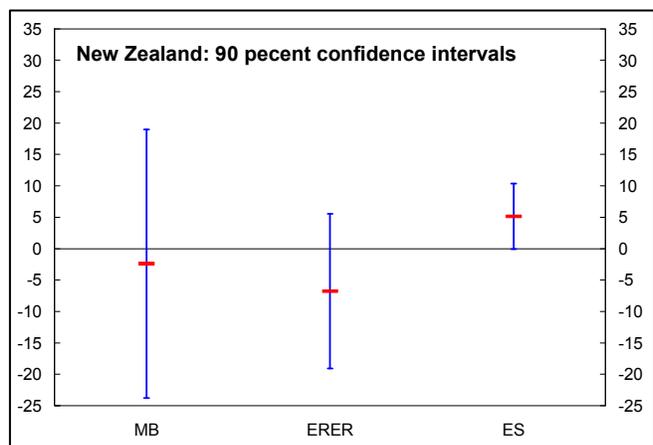
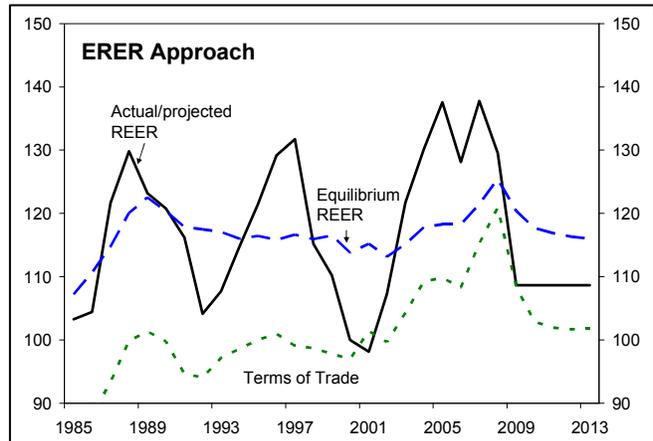
The ERER estimates suggest a small undervaluation. The model attempts to explain the REER on the basis of the terms of trade, relative productivity, and relative government consumption. Using the March 2009 level of 109 for the REER as the base, the equation suggests an undervaluation of about 7 percent in 2013, assuming a further weakening of the terms of trade over the medium-term.

The ES approach implies an overvaluation of 5 percent, if we assume that net foreign liabilities (NFL) stabilize at the norm estimated by the model of about 73 percent of GDP over the medium-term. However, the predicted NFL is mainly explained by the fixed effect, which casts doubt on the model. A larger overvaluation would result if we assume an even faster fall in NFL. A smaller overvaluation of less than 1 percent would result if we assume NFL stabilizes at the end-2008 level of 94 percent of GDP.

The estimates are subject to considerable uncertainty, as shown by the wide range of the confidence intervals. Further discussion of the models and the uncertainty surrounding the analysis is presented in the IMF WP/09/07 "Australia and New Zealand Exchange Rates: A Quantitative Assessment" by H. Edison and F. Vitek.

Exchange Rate Assessment: Baseline Results <sup>1</sup>			
	CA/GDP		REER
	Norm	Projection <sup>2</sup>	Overvaluation
MB Approach: <sup>3</sup>			
Desk	-4.9	-4.4	-2.4
ERER Approach: <sup>4</sup>			
Desk	...	...	-6.8
ES Approach: <sup>5</sup>			
Desk	-3.3	-4.4	5.1

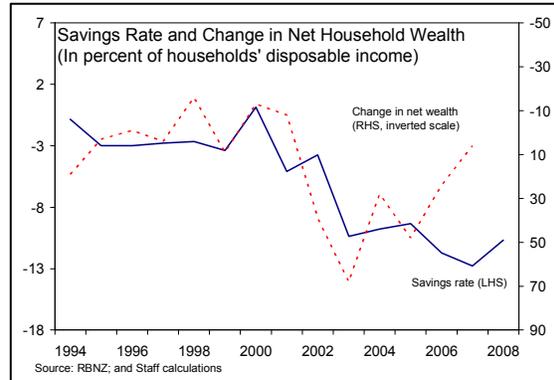
Source: Fund staff estimates.  
 1/ All results are expressed in percent.  
 2/ Staff projection of the underlying CA/GDP in 2013.  
 3/ Based on a semi-elasticity of the CA/GDP with respect to the REER of -0.21  
 4/ Overvaluation is assessed relative to the average for March 2009.  
 5/ Based on nominal GDP growth rate of 5 percent.



#### Box 4. New Zealand: Households' Saving Rate and Wealth

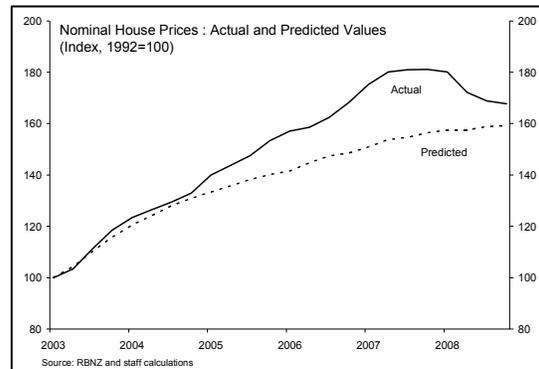
**The decline of household saving was reversed in 2008.** During the recent economic boom, the saving rate (the ratio of household savings to disposable income) fell deeply into negative territory, and reached -13 percent in 2007. In 2008, as the economy slid into recession, the saving rate increased, to an estimated -10½ percent by year-end.

**Saving is negatively correlated with households' net wealth.** In 2008, New Zealand households lost more than 10 percent of their net wealth, as equity and house prices fell. Previous staff analysis has shown that, in addition to wealth effects, the long-term behavior of the households' saving rate in New Zealand is explained by the ease of access of households to credit, the government's fiscal balance, and the level of pension and income support from the government.<sup>1</sup> In 2008, tighter credit conditions and the deterioration in the government's fiscal balance would be expected to increase the household saving rate.



**The household saving rate can be expected to increase further in the near term.**

Households' wealth in New Zealand is held predominantly in housing. Staff estimates show that, although average house prices have fallen by 7½ percent during 2008, they remain about 5 percent above their equilibrium value.<sup>2</sup> Other factors influencing the saving rate are also not likely to reverse. Lending standards will remain tight in the near future, and the government balance will fall further into deficit. A simple extrapolation of past trends suggests that the saving rate may increase further, and become positive within 2–3 years.



<sup>1</sup> *IMF Country Report No. 03/122* (Chapter 2).

<sup>2</sup> This updates staff's analysis in *IMF Country Report No. 08/163* (Box 3).

### III. STAFF APPRAISAL

30. **The economy is in recession, and the near term outlook is challenging.** New Zealand is in a better position than most advanced countries to face the global storm, given its sound macroeconomic policies, flexible exchange rate, low level of public debt, flexible labor markets, and healthy banking sector. Nevertheless, high household debt, falling house and equity prices, and uncertain employment prospects, will weigh down on private consumption. Also, banks' access to offshore funding will continue to be constrained by the global financial turmoil. Negative growth is expected in 2009, and a gradual recovery is not projected to begin until 2010.

31. **A sizable policy stimulus is in train, which should help support domestic demand, but the medium-term fiscal outlook has deteriorated significantly.** Despite the relatively low level of public debt, the scope for further stimulus is constrained by New Zealand's high short-term external debt. Staff is concerned that a market backlash from a further increase in the budget deficit in the near-term could raise borrowing costs and undermine the impact of the stimulus measures taken.

32. **Staff welcomes the authorities' commitment to limit the increase in public debt.** Preserving investor confidence will require a credible strategy to reduce the deficit over the medium term. While the focus of fiscal consolidation should be on the expenditure side, revenue measures are likely to be needed to close the gap. Staff advises that concrete measures be laid out in the May 2009 budget to stabilize gross public debt in the medium term and bring it back to around the current level in the longer term. Even with consolidation, the fiscal stance would likely remain expansionary through 2010–11, because of already-budgeted personal tax cuts and spending increases.

33. **The substantial easing of monetary policy was appropriate and should help support domestic demand.** Further easing of monetary policy is needed, given the weak outlook for inflation, slowing in credit growth and increase in banks' borrowing spreads. In contrast with many advanced countries, monetary policy remains effective in New Zealand, as banks are sound and have passed on most of the reduction in the official cash rate to borrowers. Nevertheless, it would be useful to consider alternative instruments, such as quantitative easing, and their potential efficacy, in the unlikely event that such measures are needed. The inflation targeting framework remains appropriate as it has helped anchor medium-term inflation expectations.

34. **The banking sector has weathered the global crisis well so far, and measures taken by the authorities have supported confidence.** The introduction of the retail and wholesale funding guarantees and the extension of the Reserve Bank's liquidity facilities were timely measures that have helped to improve confidence in the financial system and eased funding pressures for banks. Nevertheless, banks' reliance on short-term external debt remains high, and they are vulnerable to an increase in loan defaults. Banks should be

required to undertake extreme stress tests and increase their capital if needed. The authorities should also press ahead with the proposed prudential liquidity rules that will reduce banks' dependence on short-term offshore funding.

35. **The sharp fall of the exchange rate brought the currency broadly in line with fundamentals.** The narrowing of interest rate differentials and the fall in commodity prices have been the key factors behind the depreciation.

36. **The depreciation of the exchange rate, combined with the global financial turmoil and domestic recession will drive an adjustment in the current account deficit.** This adjustment will be conditional on, and driven by, an increase in private savings.

37. Staff recommends that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. New Zealand: Selected Economic and Financial Indicators, 2005–10

Nominal GDP (2008): US\$128.9 billion  
 Population (2008): 4.3 million  
 GDP per capita (2008): US\$30,045  
 Quota: SDR 894.6 million

	2005	2006	2007	2008	2009 Proj.	2010 Proj.
<b>Real growth (percent change)</b>						
GDP (production basis)	2.8	1.9	3.2	0.3	-2.0	0.5
Final domestic demand	4.4	2.3	4.2	-0.2	-3.2	-1.3
Private consumption	4.8	2.5	4.1	0.2	-2.2	-2.5
Government consumption	3.9	4.9	3.6	4.0	3.1	2.4
Fixed investment	3.7	-0.1	5.0	-3.6	-10.2	-1.2
Inventories 1/	-0.1	-0.8	0.4	0.4	-0.6	0.0
Exports of goods and services	-0.3	1.8	3.8	-1.7	-5.0	2.9
Imports of goods and services	5.5	-2.6	8.4	2.6	-10.3	-2.6
<b>Headline CPI inflation (percent change)</b>						
End of period (percent change)	3.0	3.4	2.4	4.0	1.3	1.1
Unemployment rate (in percent)	3.2	2.7	3.2	3.4	0.8	1.3
<b>Investment and saving (in percent of GDP)</b>						
Investment	3.7	3.8	3.6	4.1	6.5	7.5
National saving 2/	24.9	23.6	24.0	23.2	19.8	20.2
<b>Public finance (in percent of GDP) 3/</b>						
Revenue	16.5	14.9	15.8	14.3	12.0	13.1
Expenditure	33.5	35.8	34.4	34.5	33.3	32.4
Operating balance 4/	29.4	31.0	31.8	31.9	35.4	37.5
Operating balance before gains and losses	4.3	6.2	3.5	1.8	-1.7	-3.9
Net Crown debt including NZS Fund	4.7	4.6	3.7	3.0	-1.4	-4.2
	3.0	-1.1	-4.4	-7.3	-4.5	-0.2
<b>Money and credit (end of period)</b>						
Resident M3 (percent change) 5/	9.4	11.3	11.1	10.1	8.9	...
Private domestic credit (percent change) 5/	10.2	12.4	12.8	7.3	6.0	...
<b>Interest rates (period average)</b>						
Interest rate (90-day, in percent) 6/	7.1	7.5	8.3	8.0	3.7	...
Government bond yield (10-year, in percent) 6/	5.9	5.8	6.3	6.1	4.6	...
<b>Balance of payments (in percent of GDP)</b>						
Current account	-8.5	-8.7	-8.2	-8.9	-7.8	-7.0
(In billions of New Zealand dollars)	-13.2	-14.2	-14.4	-16.0	-13.4	-12.1
Trade balance (goods)	-2.4	-1.9	-1.3	-1.3	-1.2	-0.7
Terms of trade (percent change)	1.1	0.0	6.0	7.4	-7.3	-4.3
<b>Foreign assets and liabilities (NZ\$ billion)</b>						
Net international investment position	-131.1	-142.2	-152.6	-169.3	-182.7	-194.9
(In percent of GDP)	-84.3	-87.1	-87.1	-93.8	-106.1	-113.0
Official reserves 5/	13.1	19.9	22.3	19.3	24.5	...
<b>Exchange rate (period average)</b>						
U.S. dollar per New Zealand dollar 6/	0.70	0.65	0.74	0.71	0.53	...
Trade-weighted index (June 1979 = 100) 6/	70.4	65.4	70.9	65.7	53.8	...
Nominal effective exchange rate 7/	134.3	123.8	133.0	124.1	97.5	...
Real effective exchange rate 7/	137.6	128.1	137.7	129.3	104.4	...
GDP (in billions of New Zealand dollars)	155.6	163.2	175.1	180.4	172.2	172.5

Sources: Data provided by the New Zealand authorities; and Fund staff estimates and projections.

1/ Contribution in percent of GDP.

2/ Based on national accounts data.

3/ Fiscal years ending June 30.

4/ Equals revenue less expenditure plus net surplus of state-owned enterprises and Crown entities.

5/ Data for 2009 are for January.

6/ Data for 2009 are for January-March.

7/ IMF Information Notice System index (2000 = 100). Data for 2009 are for January.

Table 2. New Zealand: Summary of Central Government Budget, 2004/05–2008/09 1/

	2004/05	2005/06	New GAAP		2008/09 Proj.
			2006/07	2007/08	
(In billions of New Zealand dollars)					
Revenue	51.0	57.0	58.5	61.7	58.7
Tax revenue	45.7	50.0	53.3	55.0	52.0
Expenditure	44.9	49.3	54.0	57.0	62.3
Social security and welfare	14.3	15.4	16.8	17.9	19.1
Health	8.6	9.4	10.4	11.3	12.4
Education	7.7	9.8	9.3	9.6	10.7
Defense	1.2	1.4	1.5	1.6	1.8
Finance costs	2.2	2.3	2.3	2.5	2.7
Other	10.9	11.0	13.8	14.3	15.7
Net surplus from SOEs and Crown entities	0.4	2.2	1.4	-1.5	0.6
Operating balance 2/	6.6	9.8	5.9	3.2	-3.0
Operating balance before gains and losses	7.1	7.3	6.3	5.4	-2.5
Residual cash balance 3/	3.1	3.0	2.9	2.1	-8.3
Gross sovereign-issued debt	35.5	33.9	30.6	31.4	36.5
Net core Crown debt with NZS Fund	4.5	-1.8	-7.5	-13.0	-7.9
Net worth 4/	35.5	50.0	96.8	105.5	107.8
(In percent of GDP)					
Revenue	33.5	35.8	34.4	34.5	33.3
Tax revenue	30.0	31.4	31.4	30.8	29.5
Expenditure	29.4	31.0	31.8	31.9	35.4
Social security and welfare	9.3	9.7	9.9	10.0	10.9
Health	5.6	5.9	6.1	6.3	7.0
Education	5.0	6.2	5.5	5.4	6.1
Defense	0.8	0.9	0.9	0.9	1.0
Finance costs	1.4	1.5	1.4	1.4	1.5
Other	7.2	6.9	8.1	8.0	8.9
Net surplus from SOEs and Crown entities	0.3	1.4	0.8	-0.8	0.3
Operating balance 2/	4.3	6.2	3.5	1.8	-1.7
Operating balance before gains and losses	4.7	4.6	3.7	3.0	-1.4
Residual cash balance 3/	2.0	1.9	1.7	1.2	-4.7
Gross sovereign-issued debt	23.3	21.3	18.1	17.6	20.7
Net core Crown debt with NZS Fund	3.0	-1.1	-4.4	-7.3	-4.5
Net worth 4/	23.2	31.4	57.0	59.1	61.2
<i>Memorandum items</i> (in billions of NZ dollars)					
Contributions to NZS Fund	2.1	2.3	2.0	2.1	2.2
NZS Fund balance	4.0	6.6	13.0	14.2	14.3

Sources: New Zealand Treasury; Economic and Fiscal Forecasts, December 2008; and Fund staff estimates and projections.

1/ Fiscal years ending June 30. From 2006/07, accounts follow the new version of New Zealand Generally Accepted Accounting Practices.

2/ Equals revenue less expenditure plus net surplus of state-owned enterprises and Crown entities.

3/ Net core Crown cashflow from operations after contributions to NZS Fund, purchases of physical assets, and advances and capital injections.

4/ Includes financial assets of the NZS Fund.

Table 3. New Zealand: Balance of Payments and External Debt, 2004–09

	2004	2005	2006	2007	2008	2009 Proj.
	(In percent of GDP)					
Current account balance	-6.4	-8.5	-8.7	-8.2	-8.9	-7.8
Goods balance	-1.4	-2.4	-1.9	-1.3	-1.3	-1.2
Exports, f.o.b.	20.8	20.1	21.3	21.1	24.3	25.5
Imports, f.o.b.	-22.2	-22.4	-23.2	-22.5	-25.5	-26.7
Services balance	0.9	0.3	0.2	0.2	-0.6	-2.3
Receipts	8.2	7.9	7.6	7.2	6.9	6.7
Payments	-7.3	-7.5	-7.5	-7.1	-7.5	-8.9
Income balance	-6.0	-6.7	-7.3	-7.5	-7.5	-4.9
Receipts	1.6	1.4	1.5	2.1	1.6	2.3
Payments	-7.7	-8.1	-8.8	-9.6	-9.1	-7.1
Transfers balance	0.1	0.2	0.4	0.3	0.5	0.5
Inflows	0.9	1.1	1.2	1.1	1.3	1.4
Outflows	0.6	0.6	0.6	0.6	0.6	0.6
Capital and financial account balance	7.7	7.7	7.8	8.4	4.2	...
Capital account (net)	0.2	-0.2	-0.2	-0.4	-0.4	...
Financial account (net)	7.6	7.9	8.0	8.8	4.6	...
Direct investment (net)	3.1	2.7	6.9	-0.6	1.5	...
Portfolio investment (net)	6.2	0.0	-1.3	8.4	-5.3	...
Equity securities (net)	-1.5	-1.1	-1.0	-0.4	0.3	...
Debt securities (net)	7.7	1.1	-0.4	8.9	-5.7	...
Other investment (net)	-1.7	5.2	2.5	0.9	8.5	...
Assets	-0.2	1.6	-5.1	-4.0	6.2	...
Liabilities	-1.5	3.6	7.6	5.0	2.3	...
Net errors and omissions	-1.4	0.8	0.9	-0.2	4.7	...
Overall balance	0.0	0.0	0.0	0.0	0.1	...
	(Assets and liabilities as of end-December)					
Total external debt	107.6	106.7	115.5	123.1	137.4	148.3
Short-term	53.3	55.4	59.5	67.2	64.3	...
Long-term	54.3	51.3	56.0	55.9	73.1	...
Net international investment position	-81.8	-84.3	-87.1	-87.1	-93.8	-106.1
Net equity	-14.2	-12.1	-11.2	-8.8	-7.2	...
Net debt	-67.6	-72.2	-75.9	-78.3	-86.6	...
	(In billions of New Zealand dollars)					
Gross official reserves 1/	9.7	13.1	19.9	22.3	19.3	24.5
RBNZ net short position in forex swaps 1/	1.5	2.7	10.5	10.3	5.8	11.8
RBNZ net open foreign currency position 1/	0.0	0.0	-0.1	2.5	5.0	4.8
Gross reserves in months of future imports of g&s	3.9	5.1	8.1	8.1	6.5	8.1
Gross reserves as percent of short-term debt	12.2	15.2	20.5	18.9	16.6	20.5

Sources: Data provided by the New Zealand authorities; and Fund staff estimates and projections.

1/ For 2009, actual number for end-February.

Table 4. New Zealand: Medium-Term Scenario, 2008–14

	Average	Projections						
	1998-2007	2008	2009	2010	2011	2012	2013	2014
<b>Real growth (percent change)</b>								
GDP (production basis)	3.2	0.3	-2.0	0.5	2.4	3.1	3.2	3.2
Final domestic demand	4.0	-0.2	-3.2	-1.3	0.6	2.3	2.6	2.9
Consumption	3.6	1.0	-1.0	-1.3	0.4	2.0	2.4	2.7
Private consumption	3.8	0.2	-2.2	-2.5	-0.2	2.0	2.5	2.9
Government consumption	3.1	4.0	3.1	2.4	2.3	2.1	2.0	2.0
Fixed investment	5.2	-3.6	-10.2	-1.2	1.4	3.0	3.2	3.5
Private business	5.5	1.0	-14.1	-4.8	0.0	2.9	3.5	4.0
Private residential	3.1	-17.3	-17.8	2.4	3.5	3.2	2.5	2.8
Public investment	8.1	-5.6	2.9	5.6	3.2	3.1	3.0	3.0
Changes in inventories 1/	0.0	0.4	-0.6	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	4.0	-1.7	-5.0	2.9	5.4	5.6	5.5	5.2
Imports of goods and services	6.0	2.6	-10.3	-2.6	-0.3	2.9	3.7	4.1
Net exports (contribution to growth)	-0.7	-1.5	2.4	1.8	1.8	0.8	0.6	0.4
<b>Saving and investment (percent of GDP)</b>								
Gross capital formation	22.9	23.2	19.8	20.2	20.2	20.3	20.5	20.6
Fixed investment	22.0	22.3	19.2	19.6	19.7	19.8	19.9	20.1
Changes in inventories	0.9	0.9	0.5	0.5	0.5	0.5	0.5	0.5
National saving 2/	17.1	14.3	12.0	13.1	14.8	15.7	16.1	16.3
Private	14.2	15.7	15.6	17.9	20.0	21.1	21.7	22.0
Public	2.8	-1.4	-3.6	-4.8	-5.2	-5.4	-5.6	-5.7
<b>Inflation and unemployment (percent)</b>								
Headline CPI inflation (period average)	2.2	4.0	1.3	1.1	1.7	2.1	2.0	2.1
Headline CPI inflation (end of period)	2.3	3.4	0.8	1.3	2.0	2.1	2.0	2.2
Unemployment rate	5.0	4.1	6.5	7.5	6.4	5.3	4.8	4.6
Output gap (staff estimate)	...	0.2	-2.0	-3.2	-2.6	-1.9	-1.1	-0.4
<b>Government budget (percent of GDP) 3/</b>								
Revenue	33.0	34.5	33.3	32.4	31.5	31.4	31.8	31.6
Expenditure	30.9	31.9	35.4	37.5	37.5	37.5	37.9	38.0
SOE and Crown entity surplus (net)	0.8	-0.8	0.3	1.2	1.0	0.9	0.8	0.8
Operating balance 4/	2.9	1.8	-1.7	-3.9	-4.9	-5.2	-5.4	-5.6
Operating balance before gains and losses	2.6	3.0	-1.4	-4.2	-5.1	-5.4	-5.6	-5.9
Residual cash balance	0.9	1.2	-4.7	-6.8	-8.4	-8.5	-8.8	-9.1
Gross Crown debt	28.3	17.6	20.7	25.7	33.6	40.0	46.6	53.3
Net Crown debt including NZS Fund	...	-7.3	-4.5	-0.2	8.6	16.2	24.1	31.9
<b>Terms of trade (2002=100, goods &amp; services)</b>								
Terms of trade (2002=100, goods)	104.4	120.9	108.4	102.9	101.9	101.7	101.8	102.0
Terms of trade (percent change, goods)	103.7	123.4	114.4	109.5	109.0	109.2	109.8	110.4
Export prices	1.8	7.4	-7.3	-4.3	-0.4	0.2	0.5	0.5
Import prices	2.4	19.6	1.6	-0.6	4.3	4.3	4.4	3.9
Import prices	0.6	11.3	9.6	3.9	4.7	4.1	3.9	3.3
<b>Balance of payments (percent of GDP)</b>								
Current account balance	-5.8	-8.9	-7.8	-7.0	-5.4	-4.7	-4.4	-4.3
Balance on goods and services	0.0	-1.8	-3.4	-3.4	-1.8	-1.0	-0.4	0.1
Balance on income and transfers	-5.8	-7.0	-4.4	-3.7	-3.6	-3.6	-4.0	-4.4
<b>Net foreign liabilities (percent of GDP) 5/</b>								
Gross external debt 5/	81.6	93.8	106.1	113.0	114.0	112.9	111.5	110.0
	108.0	137.4	148.3	153.9	154.7	153.8	152.6	151.4

Sources: Data provided by the New Zealand authorities; and Fund staff estimates and projections.

1/ Contribution in percent of GDP.

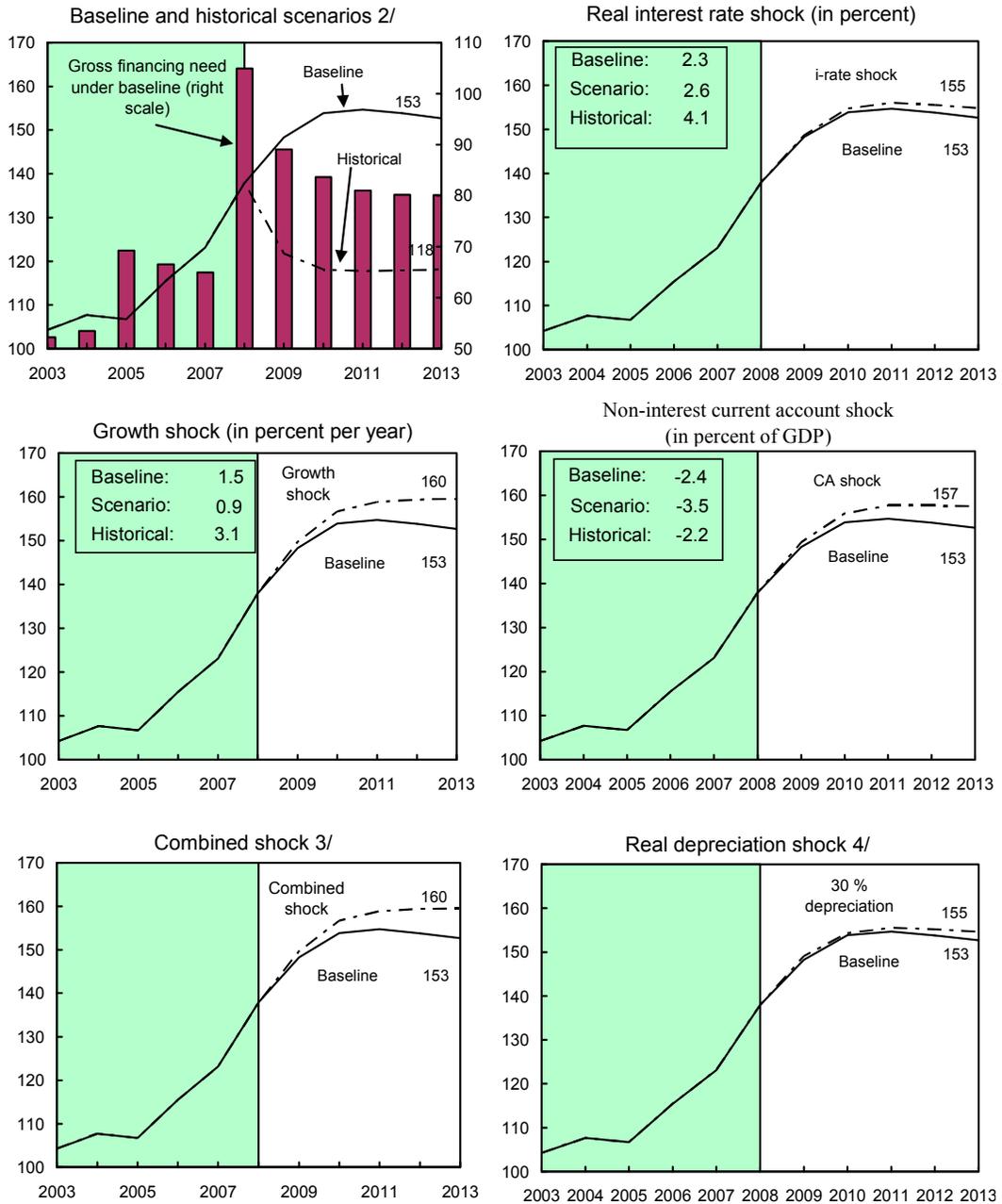
2/ Fund staff estimates; calculated as residual from gross national investment and external current account balance.

3/ Fiscal years ending June 30.

4/ Equals revenue less expenditure plus net surplus of state-owned enterprises and Crown entities.

5/ Data for end-December.

Figure 7. New Zealand: External Debt Sustainability: Bound Tests 1/  
(Gross external debt in percent of GDP)



Sources: Fund staff estimates and projections.

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/ The historical scenario assumes that real GDP growth, inflation, current account deficit, and nominal interest rate are equal to ten-year historical averages from 2009 onward.

3/ Permanent 1/4 standard deviation shocks applied to interest rate, growth rate, and current account balance.

4/ This scenario assumes foreign exchange hedging covers 91 percent of foreign currency debt, consistent with the findings of hedging surveys conducted by Statistics New Zealand.

Appendix I. New Zealand: Main Recommendations of the 2008 Article IV Consultation  
(Consultation discussions ended on March 3, 2008)

Fund Recommendations	Policy Actions
<p><b>Monetary policy:</b> Staff recommended that policy remain on hold pending clearer indications of the future path of the economy. Staff advised the authorities to be ready to respond if the slowdown in trading partners or the fallout from global financial turmoil turned out worse than expected.</p>	<p>The Official Cash Rate (OCR) was kept unchanged a 8.25 percent through July 2008. As the outlook for growth deteriorated and inflationary pressures eased, the RBNZ responded by cutting the OCR by a total of 525 basis points to 3.0 percent.</p>
<p>Staff advised against any major changes to the inflation targeting framework.</p>	<p>A parliamentary inquiry into the monetary policy framework enclosed the inflation-targeting regime and recommended no significant changes.</p>
<p><b>Fiscal policy:</b> Staff supported a transition to lower budget surpluses conditional on the state of the economy, and recommended flexibility in the implementation of the fiscal stimulus so that its effects be felt once inflationary pressures were expected to have abated. Staff pointed to uncertainty regarding the durability of higher corporate tax revenues and noted it would be prudent to delay spending the revenue surprises until it was clear that they were structural.</p>	<p>The May 2008 budget introduced cuts in personal income taxes (staggered over three years) and an increase in spending. The sharper-than-expected economic downturn has resulted in a further deterioration of the fiscal position. The operating balance before gains and losses (OBEGAL) is projected to reach a deficit of 1½ percent of GDP in 2008/09.</p>
<p><b>Financial sector policy:</b> Staff recommended that the RBNZ prepare a contingency plan to provide additional domestic liquidity in case of further disruption o banks' access to liquidity, and welcomed the RBNZ's steps to develop a set of liquidity rules to reduce banks' reliance on short-term external funding.</p>	<p>The RBNZ has twice (in May and December 2008) expanded the range of securities acceptable for domestic liquidity operations. In October it established a US\$15 billion swap line with the U.S. Fed, and in November it introduced two new facilities to support banking system liquidity: a term auction facility (TAF) and Reserve Bank bill tenders. In October 2008 the RBNZ issued a consultation paper on new prudential liquidity rules. When implemented, these rules should improve banks' liquidity management and reduce their reliance on short-term wholesale funding.</p>

## Appendix II. New Zealand: Policy Responses to the Global Financial Crisis

<b>Monetary Policy</b>	The Official Cash Rate (OCR) has been reduced by 525 basis points since July 2008, to 3.0 percent.
<b>Liquidity Support</b>	<p>The Reserve Bank expanded in May and December 2008 the range of securities eligible as collateral for domestic Reserve Bank's liquidity operations, to include mortgage-backed, asset-backed, and corporate securities.</p> <p>In October 2008, the Reserve Bank established a US\$15 billion swap line with the U.S. Fed, initially through April 2009 and later extended to October 2009.</p> <p>The Reserve Bank introduced in November 2008 two new facilities to support bank liquidity: a term auction facility and Reserve Bank bill tenders.</p>
<b>Funding Guarantees</b>	<p>In October 2008 the Treasury introduced a blanket guarantee on all deposits in approved deposit-taking institutions for two years. The guarantee is free on the first NZ\$5 billion of deposits, then charged at 10 bps. A fee of 300 bps will apply to finance companies rated below BB.</p> <p>In November 2008 the guarantee was offered on banks' wholesale funding, on an opt-in basis (by institution and by instrument) for a fee differentiated by the risk of the issuer and the maturity of the security.</p>
<b>Financial Regulation/Supervision</b>	<p>In October 2008 non-bank deposit takers were subjected to tighter requirements, including restrictions on dividends and increased reporting requirements.</p> <p>The reserve Bank is currently consulting with banks on a new prudential liquidity regime. When implemented, the new policy should strengthen banks' arrangements for liquidity risk management and enhance their liquidity position, including by reducing their reliance on short-term wholesale funding.</p>
<b>Fiscal Policy</b>	<p>Although not directly in response to the crisis, the May 2008 budget introduced personal income tax cuts (staggered over three years, starting in October 2008) as well as a rise in spending, for a total estimated fiscal impulse of 3.5 percent of GDP in FY 2008/09.</p> <p>A relief package for small businesses, totaling NZ\$480 million (0.3 percent of GDP) was announced in February 2009. It aims at lowering taxes on cash flows, improving access to credit, and reducing compliance costs.</p>

INTERNATIONAL MONETARY FUND

NEW ZEALAND

**Staff Report for the 2009 Article IV Consultation—Informational Annex**

Prepared by the Asia and Pacific Department

April 22, 2009

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**ANNEX I. NEW ZEALAND: FUND RELATIONS**  
(As of March 31, 2009)

**I. Membership Status:** Joined: August 31, 1961; Article VIII

<b>II. General Resources Account:</b>	SDR Million	Percent Quota
Quota	894.60	100.00
Fund Holdings of Currency	780.87	87.29
Reserve position in Fund	113.74	12.71

<b>III. SDR Department:</b>	SDR Million	Percent Allocation
Net cumulative allocation	141.32	100.00
Holdings	14.36	10.16

**IV. Outstanding Purchases and Loans:** None

**V. Financial Arrangements:** None

**VI. Projected Obligations to Fund:** None

**VII. 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).

**VIII. Article IV Consultation:**

New Zealand is on the 12-month consultation cycle. The 2008 Article IV consultation discussions were held during February 22–March 3, 2008; the Executive Board discussed the staff report (IMF Country Report No. 08/163) and concluded the consultation on May 9, 2008.

**IX. FSAP Participation and ROSCs:**

FSAP mission took place during October 30–November 18, 2003. The FSSA 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.

**X. Technical Assistance:** None

**XI. Resident Representative/Advisor:** None

## ANNEX II. NEW ZEALAND: STATISTICAL ISSUES

New Zealand publishes a wide array of high quality economic and financial data, which are fully adequate for surveillance purposes. The authorities are continuing to enhance data quality and expand the range of data products available, including a project led by the New Zealand Treasury to publish fiscal data consistent with the *Government Finance Statistics Manual 2001 (GFSM 2001)*. The Reserve Bank of New Zealand has indicated that it is not at present in a position to submit the standardized report forms for monetary statistics introduced in October 2004. New Zealand has made progress toward becoming a subscriber to the Special Data Dissemination Standard (SDDS). The main remaining issues are the requirement for publication of an industrial production index, and the timeliness of local government data.

Table of Common Indicators Required for Surveillance  
(As of April 17, 2009)

	Date of latest observation	Date received	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of Publication <sup>6</sup>
Exchange Rates	4/17/09	4/17/09	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	2/09	3/30/09	M	M	M
Reserve/Base Money	2/09	3/30/09	M	M	M
Broad Money	2/09	3/30/09	M	M	M
Central Bank Balance Sheet	2/09	3/30/09	M	M	M
Consolidated Balance Sheet of the Banking System	2/09	3/30/09	M	M	M
Interest Rates <sup>2</sup>	4/17/09	4/17/09	D	D	D
Consumer Price Index	Q1 2009	4/17/09	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —General Government <sup>4</sup>	2007/08	10/6/08	A	A	NA
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> — Central Government	2/09	4/3/09	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	2/09	4/3/09	M	M	M
External Current Account Balance	Q4 2008	3/26/09	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2008	3/26/09	Q	Q	Q
GDP/GNP	Q4 2008	3/27/09	Q	Q	Q
Gross External Debt	Q4 2008	3/27/09	Q	Q	Q

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

<sup>2</sup> Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic non-bank financing.

<sup>4</sup> The general government consists of the central government (including budgetary, extra budgetary, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 09/57  
FOR IMMEDIATE RELEASE  
May 14, 2009

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2009 Article IV Consultation with New Zealand**

On May 6, 2009 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with New Zealand.<sup>1</sup>

### **Background**

After several years of strong growth, the New Zealand economy entered a recession in early 2008. The long-anticipated cooling of domestic demand was initially triggered by the end of the housing boom and a severe drought, and later exacerbated by the global slowdown. Real GDP contracted in all quarters of 2008. CPI inflation has eased since peaking in September 2008, driven by weak economic activity and a sharp decline in oil prices. The labor market remained relatively resilient, but also started to weaken in late 2008, with unemployment rising to 4.6 percent.

As the economy contracted and inflation pressures eased, monetary policy was loosened and the exchange rate depreciated significantly. The official cash rate (OCR) was cut by a total of 575 basis points since July 2008, to 2½ percent. The fiscal position remained strong, but the outlook has weakened considerably. The budget balance is projected to reach a deficit of

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<sup>1</sup> 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. 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.

1½ percent of GDP in 2008/09 (July-June), compared to a surplus of 3 percent of GDP in 2007/08.

The trade balance deteriorated, widening the current account deficit further to about 9 percent of GDP in 2008. Private capital inflows continued to finance the deficit, and net foreign liabilities increased to 94 percent of GDP.

The banking sector remains sound. However, banks' significant exposure to short-term external wholesale funding and housing loans makes them vulnerable to rollover risk and a sharp increase in mortgage default rates.

The near-term outlook is weak, and the uncertainty regarding the economy's prospects is higher than usual, due to the unprecedented uncertainties surrounding the depth and duration of the global recession. On balance, staff expects the economy to contract by about 2 percent in 2009.

### **Executive Board Assessment**

Executive Directors noted that, following a decade of strong growth, during which significant imbalances and vulnerabilities accumulated, the New Zealand economy slipped into recession in early 2008. As the housing boom ended in response to tight monetary policy, the downturn was exacerbated by the global economic crisis and the near-term outlook is challenging. Directors commended the New Zealand authorities for their policy response, which will help support domestic demand in the short run and enhance financial stability. Moreover, the authorities' strong track record of sound and transparent macroeconomic policies and structural reforms has allowed New Zealand to enter the downturn from a position of strength.

Directors noted that the significant fiscal stimulus underway will help cushion the near-term impact of the downturn. The combined effect of the stimulus and the weaker outlook for commodity prices and growth is, however, resulting in a significant deterioration of the medium-term fiscal outlook. Given New Zealand's considerable short-term external debt and large current account deficit, a rapid increase in public debt could lead to a higher country risk premium, which would reduce the benefits from the macroeconomic stimulus. Directors therefore welcomed the authorities' commitment to limit the increase in public debt, and to present in the upcoming 2009 budget a credible strategy to reduce the fiscal deficit over the medium term. In this context, they noted that steps are already being taken to eliminate existing unfunded commitments and to stop the growth of employment in government administration. Directors encouraged the authorities to make contingency plans, given the unprecedented uncertainties in the global economic environment.

Directors considered that the significant easing of monetary policy since July 2008 has been appropriate. Lower policy rates have been largely passed on to lending rates, stimulating demand and gradually providing relief to existing borrowers. Directors observed that, in light of the weak outlook for growth and inflation, further easing may be warranted, but should proceed cautiously. Directors concurred that the inflation targeting regime has served New Zealand well providing a strong anchor for inflation expectations. Directors noted that the monetary easing, together with the fall in international commodity prices, has also led to a significant depreciation of the exchange rate. The exchange rate is now broadly in line with fundamentals, and the depreciation should help narrow the current account deficit.

Directors noted that the financial sector has remained resilient in the global crisis, buttressed by sound prudential policies. They commended the authorities for taking timely measures to strengthen confidence and support bank access to funding, including through the introduction of funding guarantees and the expansion of the Reserve Bank's liquidity facilities and acceptable collateral instruments. Noting that banks remain highly exposed to short-term external debt and to an increase in mortgage defaults, Directors welcomed the authorities' commitment to closely monitor the financial system, and called for extreme stress tests for banks and increased bank capital if needed. The proposed prudential liquidity rules for the banking system should help reduce banks' reliance on short-term external funding. Directors commended the ongoing collaboration with the Australian authorities on banking supervision, regulation, and crisis preparedness.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2009 Article IV Consultation with New Zealand is also available.

## New Zealand: Selected Economic Indicators

	2005	2006	2007	2008	Proj. 2009	Proj. 2010
<b>Real economy</b> (percent change)						
GDP (production basis)	2.8	1.9	3.2	0.3	-2.0	0.5
Final domestic demand	4.4	2.3	4.2	-0.2	-3.2	-1.3
Exports of goods and services	-0.3	1.8	3.8	-1.7	-5.0	2.9
Imports of goods and services	5.5	-2.6	8.4	2.6	-10.3	-2.6
Headline CPI inflation (end of period)	3.2	2.7	3.2	3.4	0.8	1.3
Unemployment rate (in percent)	3.7	3.8	3.6	4.1	6.5	7.5
National saving (in percent of GDP) 1/	16.5	14.9	15.8	14.3	12.0	13.1
Investment (in percent of GDP)	24.9	23.6	24.0	23.2	19.8	20.2
<b>Government budget</b> (in percent of GDP) 2/						
Revenue	33.5	35.8	34.4	34.5	33.3	32.4
Expenditure	29.4	31.0	31.8	31.9	35.4	37.5
Operating balance before gains and losses	4.7	4.6	3.7	3.0	-1.4	-4.2
Net Crown debt including NZS Fund	3.0	-1.1	-4.4	-7.3	-4.5	-0.2
<b>Money and credit</b> (end of period)						
M3, resident (change in percent)	9.4	11.3	11.1	10.1	8.9	...
Private domestic credit (change in percent)	10.2	12.4	12.8	7.3	6.0	...
<b>Interest rates</b> (period average)						
Interest rate (90-day, in percent) 3/	7.1	7.5	8.3	8.0	3.7	...
Government bond yield (10-year, in percent) 3/	5.9	5.8	6.3	6.1	4.6	...
<b>Balance of payments</b> (in percent of GDP)						
Current account balance	-8.5	-8.7	-8.2	-8.9	-7.8	-7.0
Trade balance (goods)	-2.4	-1.9	-1.3	-1.3	-1.2	-0.7
Terms of trade (change in percent)	1.1	0.0	6.0	7.4	-7.3	-4.3
<b>External assets and liabilities</b> (in percent of GDP)						
Official reserves (\$NZ billion) 4/	13.1	19.9	22.3	19.3	24.5	...
Gross external debt	106.7	115.5	123.1	137.4	148.3	153.9
Net international investment position	-84.3	-87.1	-87.1	-93.8	-106.1	-113.0
<b>Exchange rate</b> (period average)						
US\$/NZ\$ 5/	0.7	0.6	0.7	0.7	0.5	...
Trade-weighted index (June 1979 = 100) 5/	70.4	65.4	70.9	65.7	53.8	...
Nominal effective exchange rate 6/	134.3	123.8	133.0	124.1	97.5	...
Real effective exchange rate 6/	137.6	128.1	137.7	129.3	104.4	...

Sources: Data provided by the New Zealand authorities; and IMF staff estimates and projections.

1/ Based on national accounts data.

2/ Fiscal years ending June 30.

3/ Data for 2009 are as of end-March.

4/ Data for 2009 are as of end-January.

5/ Data for 2009 are for January-March.

6/ IMF Information Notice System index (2000 = 100). Data for 2009 are for January.