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New Zealand: 2012 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice

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 2012 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- The staff report for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 2, 2012, 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 May 21, 2012. 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 staff supplement of June 1, 2012 updating information on recent developments.

- A Public Information Notice (PIN).

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International Monetary Fund
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NEW ZEALAND

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

May 21, 2012

KEY ISSUES

Outlook and risks. The economy continues to recover modestly from the post-crisis trough, and inflation pressures are subdued. The key threats to this recovery are the financial and economic fallout from an intensification of the European sovereign debt crisis and a hard landing in China, Australia, or other parts of Asia. However, the authorities have macroeconomic policy space to respond to adverse shocks, and the floating exchange rate would serve as an important buffer.

Medium-term challenges. Reducing New Zealand's external vulnerability will require limiting its external debt and the dependence of its banks on offshore wholesale funding. Central to this will be increasing the national savings rate, where fiscal deficit reduction will play an important role. Reducing the large projected current account deficit would likely imply some depreciation of the exchange rate.

Policy assessment. The authorities' current macroeconomic policy framework is appropriate. Monetary policy should remain accommodative until signs emerge of a robust recovery, and should act as the first line of defense against near-term adverse shocks. The authorities' planned budget deficit reduction path strikes the right balance between the need to limit both public and external debt increases while supporting economic growth during the recovery. The banking sector remains sound, but the authorities should ensure that banks' liquidity and capital buffers are adequate given their balance sheet risks.

Approved By
Hoe Ee Khor and Tamim Bayoumi

Discussions took place in Christchurch, Auckland, and Wellington during March 22-April 2, 2012. The staff team comprised Messrs. Aitken (head), Ding, Jang, and Jauregui, and Ms. Sun (all APD). Mr. Khor (APD) and Ms. Hunter (OED) participated in the Wellington discussions.

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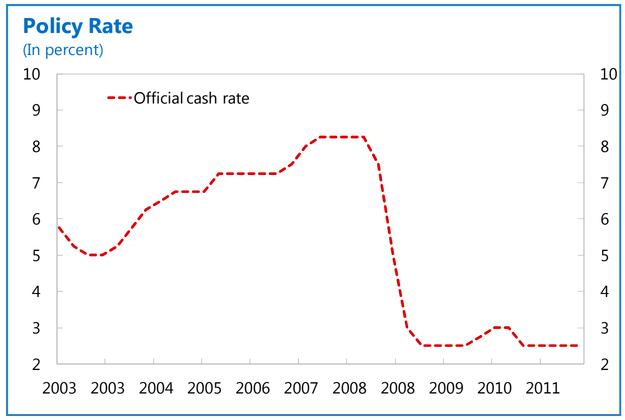
APPENDICES

THE RECOVERY REMAINS MODEST

1. **Growth.** The New Zealand economy continues to grow at a modest pace. Output grew by 1½ percent in 2011, as elevated export commodity prices and favorable agricultural conditions helped offset the adverse impact of large earthquakes in Canterbury in late 2010 and early 2011 (Figure 1). Continued aftershocks have delayed earthquake-related reconstruction. Domestic demand has remained soft as households and businesses continue to deleverage amid a weak housing market and an uncertain outlook.

2. **Inflation.** Elevated rates of unemployment, currently above 6 percent, and spare capacity have helped contain inflation. Annual inflation has been falling and is currently in the middle of the Reserve Bank of New Zealand's (RBNZ) 1–3 percent target band (Figure 2). The strong New Zealand dollar has helped dampen imported inflation.

3. **Monetary policy.** The RBNZ lowered the policy rate in March 2011 by 50 basis points to cushion the impact of the February earthquake. Since then, it has kept the policy rate on hold given the deterioration in the global economic position, subdued domestic activity, and the expected impact on future domestic activity of the strong exchange rate.

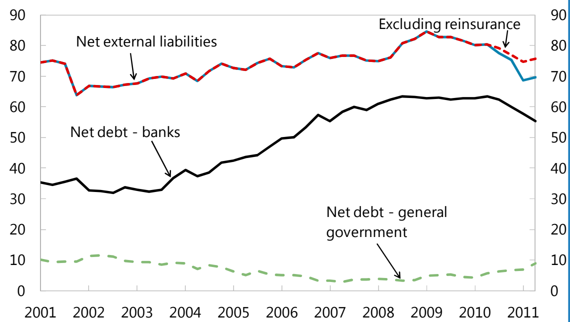


4. **The exchange rate.** The nominal effective exchange rate has appreciated by around 30 percent since its trough in early 2009. The appreciation reflects the effects of higher export prices, positive interest rate differentials, and, although currently volatile, some increase in global risk appetite since end-2011.

5. **Fiscal developments.** Reflecting the slow recovery, past revenue and spending decisions, and accrued earthquake-related spending (which will largely be funded by the government-run Earthquake Commission and sizable reinsurance offshore), the fiscal deficit (total Crown) in 2010/11 reached a record high of 9¼ percent of GDP on an accrual basis. Net government debt increased to 20 percent of GDP by mid-2011 from a low of 5½ percent in 2008.

6. **External sector.** The current account deficit in 2011 remained low at 4 percent of GDP, well below the 8 percent level in 2005-08, reflecting terms of trade gains, weak domestic demand, and low world interest rates. Net external liabilities have declined, in part due to accrued reinsurance payments related to the earthquakes, but remain high at 72 percent of GDP at end-2011.

Net External Liabilities
(In percent of annual GDP)



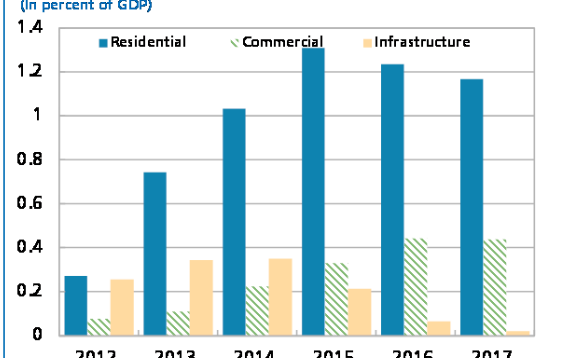
Source: Statistics New Zealand.

7. **The banking sector** is dominated by four large subsidiaries of Australian banks that have proved resilient to the recent turbulence in the global financial markets. Bank profits are strong and nonperforming loans have fallen to less than 2 percent of total loans (Figure 3). Capital adequacy has improved since 2007, with the Tier 1 capital ratio reaching 10 percent in September 2011. All banks are well positioned to meet the Basel III capital requirements, which the RBNZ plans to implement from January 2013. The RBNZ has continued to strengthen regulation and supervision of nonbanks.

OUTLOOK AND RISKS

8. **Near-term outlook.** The pace of New Zealand's economic recovery is likely to remain modest. Output growth should pick up somewhat to 2⅓ percent in 2012 as earthquake reconstruction spending gains pace, although the size and timing of this spending is still uncertain. Other sources of demand will remain soft, however, as global growth prospects are uncertain and households are still highly leveraged and will need to save to strengthen their balance sheets. The spare capacity and elevated unemployment will contain wage and inflation pressures in the near term.

Assumed Timing of Rebuilding (2012-17)
(In percent of GDP)



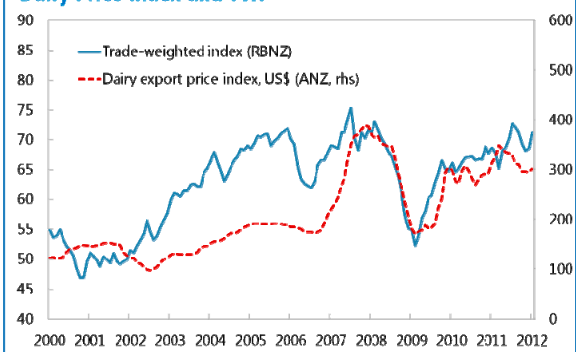
9. **Medium-term outlook.** Assuming that the bulk of reconstruction takes place during 2013–17, staff projects growth to rise to 3¼ percent in 2013 and converge to the potential rate of 2⅓ percent in outer years. High household debt and an expected increase in interest rates are likely to continue to weigh on the growth of private consumption and investment. Moreover, the government's fiscal deficit reduction plan will limit increases in government consumption and investment. Under the baseline assumption of a constant real effective exchange rate, the contribution of net exports to growth would be muted, and the current account deficit is projected to widen as the income deficit worsens with the expected rise in global interest rates.

10. **External risks.** The key risks to the outlook are largely on the external front and on the downside, related to emerging weaknesses in the global economy and a possible upheaval in the global financial system (Box 1). The main channels are:

- *Lower export demand.* One-third of New Zealand exports go to China and Australia, leaving growth prospects vulnerable to their economic outlook.

- *Worsened terms of trade.* Likewise, about three-quarters of New Zealand exports are commodities and agricultural products whose prices are highly dependent on demand from global markets. Falling demand could significantly weaken the terms of trade from recent historically high levels. However, declines in commodity prices in the past have been accompanied to some extent by a weakening of the exchange rate, helping to buffer the impact on the domestic economy.

Dairy Price Index and TWI



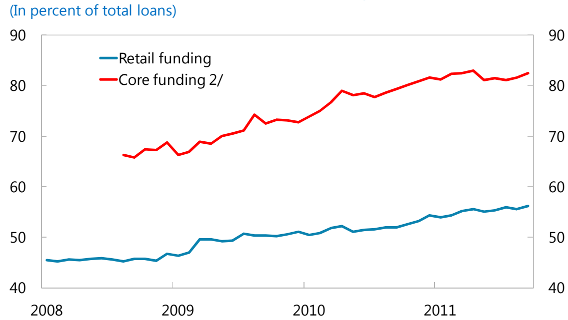
- *Increased cost of external funding.* While New Zealand banks have little direct asset exposure to European borrowers, they do rely heavily on offshore wholesale funding. A worsening of global financial conditions could raise the cost of this funding, putting upward pressure on interest rates for domestic firms and households.

Box 1. New Zealand: Risk Assessment Matrix

Nature/Source of Threats	Likelihood (High, medium, or low)	Expected Impact on Economy (High, medium, or low)
Declining Export Demand	***Medium*** An intensification of the eurozone sovereign debt crisis and/or a slowdown in China and Australia output growth, which are the top two destinations for New Zealand exports.	***Medium to High*** Declining export demand would reduce GDP growth in New Zealand. A sustained decline in GDP growth, together with a rise in unemployment, could also lead to financial stresses in the banking sector.
Worsening Terms of Trade	***Medium*** A slowdown in global growth would reduce demand for New Zealand commodity exports, which would weaken the terms of trade.	***Medium*** The free-floating New Zealand dollar would help buffer the impact on the economy. Declines in commodity prices in the past have been offset to some extent by a weakening of the New Zealand dollar.
Increased Cost of Offshore Funding	***High*** If international funding markets remain difficult, the cost of offshore funding for New Zealand banks will eventually increase. New Zealand banks' reliance on offshore funding remains high.	***Medium*** The increased cost of offshore funding would put upward pressure on interest rates for domestic firms and households, which would reduce consumption and investment. There is less monetary policy space than in 2008/09 to counteract the effects of rising funding costs.
Rollover Risks	***Low*** The eurozone sovereign debt crisis could intensify, leading to a temporary shutdown of global funding markets. New Zealand banks could experience difficulty rolling over their still high short-term debt.	***Low to Medium*** The recent decline in short-term external debt and a lengthening in the maturity of bank borrowing have improved the resilience of the economy to global financial market turbulence. The authorities can provide banks with liquidity support and wholesale funding guarantees.
Significant Decline in House Prices	***Low*** Although affordability ratios have improved recently, house prices remain elevated (10-20 percent above an estimated norm based on observed fundamentals). A sudden price correction could be triggered by a number of factors, including higher borrowing costs or a shock to household incomes.	***Medium to High*** A fall in house prices would dampen private consumption and reduce residential investment. A significant decline in house prices, together with a rise in unemployment or interest rates, may also lead to an increase in default rates in residential mortgages that would hurt banks' balance sheets. The potential risks are, however, mitigated by a number of factors: (i) banks' conservative lending practices, including their limited exposure to low-income earners and high-risk mortgages; (ii) higher capital requirements for mortgages than in many other countries; and (iii) the full recourse nature of mortgage lending.

- *Rollover risks.* Banks' persistent reliance on offshore wholesale funding leaves them vulnerable to the tail risk of a temporary shutdown of global funding markets. While the probability of this event is difficult to determine, banks are less vulnerable than during the market disruption in late 2008, as the share of retail deposits and the average maturity of bank liabilities have been steadily increasing over the last three years and the source of funding is diversified across different regions and products. Nevertheless a sizeable share of offshore funding—almost 30 percent—still needs to be rolled over within 3 months.

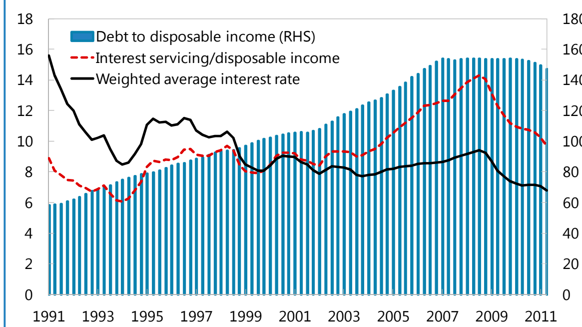
Sources of New Zealand Bank Funding 1/
(In percent of total loans)



Source: RBNZ
1/ Weighted average of seven locally incorporated banks.
2/ Includes retail and longer-dated wholesale funding as well as Tier 1 capital.

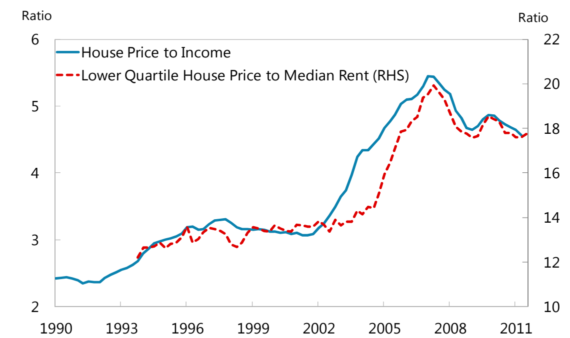
11. **Housing sector risks.** Although affordability ratios and debt servicing ratios have recently improved, house prices still remain elevated at about 10-20 percent above an estimated norm based on observed fundamentals. A sudden price correction, possibly triggered by higher borrowing costs or a shock to household incomes, could shake consumer confidence, worsen banks' balance sheets, and impair the economic recovery. The likelihood of this risk materializing in the near term, however, is low. [1]

Household Debt and Servicing Costs
(In percent)



Source: RBNZ: *Financial Stability Report, 2011.*

House Prices Relative to Fundamental Indicators



Source: Quotable Value Ltd, RBNZ, Statistics New Zealand, Ministry of Housing

[1] Despite a large exposure to residential mortgages, stress tests show some resilience of the banking sector to a stand-alone decline in residential mortgage quality. A shock to house prices and asset quality calibrated on the Irish crisis experience would reduce the four major banks' Tier 1 capital ratios significantly, but to levels well above the regulatory minimum ratio of 4 percent. Full results will be presented in a forthcoming working paper.

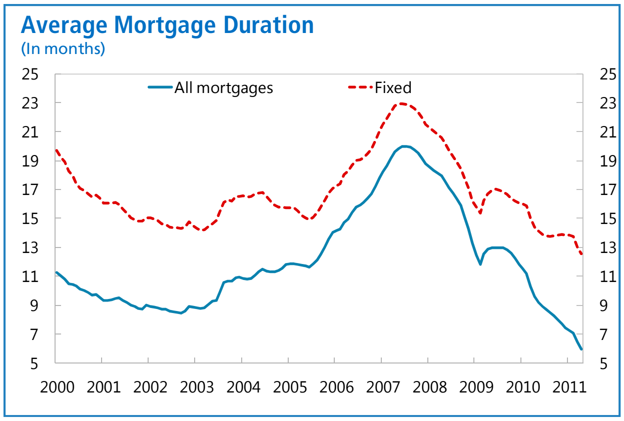
12. **Tail risks and downside scenarios.** Many of the above risks are closely linked—for example, a hard landing in China, which would negatively affect Australia, would consequently reduce demand for New Zealand exports, worsen terms of trade, reduce household income, and could trigger a sudden decline in house prices. This could in turn weaken consumer demand and growth, and negatively affect banks' balance sheets.

13. **New Zealand's exposure.** While difficult to model, the downside macroeconomic impact of such a scenario could be substantial. The Treasury explored an illustrative downside scenario based on financial turmoil in Europe leading to a spike in global risk aversion. The resulting protracted global recession (with a contraction in U.S. output of 1½ percent in 2012) impacts New Zealand through a variety of channels, including deteriorating terms of trade, a loss of business confidence, and a disruption of wholesale funding markets. Based on this, the scenario speculates that growth in New Zealand would be reduced by ½ percent in 2012 and nearly 1 percent in 2013 relative to the baseline scenario, with recovery beginning in 2014. These results are broadly in line with those estimated by a basic Global Projection Model, which shows a comparable correlation of the New Zealand economy to growth abroad.

14. **Authorities' views.** The authorities shared staff's assessment of the economic outlook and risks. They noted that earthquake reconstruction would be a major driver of demand for many years but the precise timing and size of spending is still uncertain.

POLICIES TO SUPPORT NEAR-TERM RECOVERY

15. **Monetary policy stance.** Staff supported the current accommodative monetary policy stance. The output gap will likely remain negative through 2013. Inflation has declined to below 2 percent and inflation expectations are in the middle of the RBNZ's target band of 1-3 percent. Moreover, credit and asset price growth remain subdued. With the shift toward floating rate mortgages in recent years, household consumption should be more sensitive to interest rate changes, allowing the RBNZ to remove the monetary stimulus fairly quickly when required.



16. **Managing risks.** If international financial markets are disrupted or growth falters, staff noted that the authorities have policy space to respond to near-term shocks, with monetary policy serving as the first line of defense. The RBNZ has the scope to lower interest rates and loosen monetary conditions to help buffer against a downside scenario. As evident during the crisis, the free-floating New Zealand dollar provides an additional cushion against external shocks, including disruptions to offshore funding and a negative terms of trade shock. The authorities would also be able to provide emergency liquidity support to banks, a measure which proved effective when wholesale markets shut down in the wake of the 2008 crisis. Moreover, New Zealand's relatively modest public debt gives the authorities scope to delay their planned deficit reduction path (discussed below) in the event of a sharp deterioration in the economic outlook.

17. **Authorities' views.** The RBNZ regards a gradual unwinding of the currently accommodative monetary stance as consistent with keeping inflation in its targeted range of 1 to 3 percent. They noted that their most recent revision downwards in the projected future interest rate track related both to a weaker starting point for the economy and to the strength of the exchange rate—the easing in global monetary policy and recovery in global risk appetite had caused the New Zealand dollar to appreciate by 7 percent in trade-weighted terms since December, which (all else equal) will dampen the outlook for domestic economic activity. They expected that some tightening pressure could come from international funding markets if expected increases in average bank funding costs lead to upward pressure on retail interest rates relative to a given policy rate. They agreed that monetary policy should be the first line of defense against shocks.

REDUCING EXTERNAL VULNERABILITY

18. **Current account.** Reflecting low national saving relative to investment, New Zealand has run persistent current account deficits, resulting in large net external liabilities. With the recovery and as earthquake reconstruction activity gathers pace, and

absent a depreciation of the real exchange rate, staff projects that the current account deficit will widen to around 7 percent of GDP over the medium term. The widening deficits would raise net external liabilities to around 90 percent of GDP by 2017.

19. **Increasing national saving** would be an important part of reducing the projected rise in current account deficits and net external liabilities, and reducing banks' reliance on offshore wholesale funding. Staff noted that much will depend on whether the recent increase in the household saving rate—the measured rate recently became positive for the first time since 2000—represents a structural break from the past or is related to the business cycle and will eventually unwind. To boost household saving, staff supported the recommendations of the government's Savings Working Group on further shifts from income to consumption taxation over the medium term and indexation of interest income and expenses to inflation for tax purposes.[2]

20. **Fiscal deficit reduction** (discussed below) would also contribute to raising national saving and reducing future net external liabilities. Staff analysis indicates that orderly reductions in net external liabilities in other advanced and emerging market countries have been mostly associated with improvements in public saving, to which fiscal deficit reduction has contributed (Box 2).

21. **Exchange rate regime.** New Zealand's free floating exchange rate regime is expected to continue to play a key role in containing external vulnerabilities, as evident during the recent global crisis when depreciation provided a useful buffer against shocks. Widespread hedging mitigates the impact of exchange rate movements on banks' balance sheets.

22. **Exchange rate assessment.** Staff analysis suggests that the New Zealand dollar is currently stronger than would be needed to bring the current account deficit to a level that is sustainable over the longer term (Box 3). Part of the current strength of the New Zealand dollar reflects the positive interest rate differentials with major currencies, which may dissipate with eventual tightening by the central banks.

23. **Authorities' views.** The authorities agreed that fiscal deficit reduction would help increase national saving. They stressed that the high New Zealand dollar is working against a rebalancing of growth and shared staff's assessment that without depreciation, the

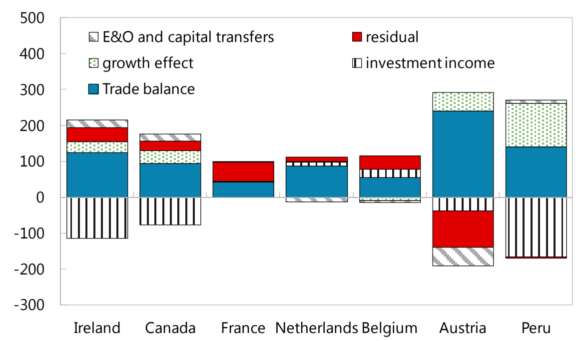
[2] Tax reforms announced in the 2010/11 budget included increasing the goods and services tax rate to 15 percent from 12.5 percent, cutting personal and corporate income tax rates, and reducing tax incentives to invest in properties.

Box 2. Cross-Country Experiences in Reducing Net Foreign Liabilities[1/]

New Zealand's net foreign liabilities, at over 70 percent of GDP, are high by advanced country standards. Unlike many other similar countries, most of this debt is owed by the private sector, particularly by banks borrowing offshore to fund their domestic operations. This private debt could potentially become a fiscal liability in the event of large negative shocks to systemically important banks' balance sheets.

This raises the question, are there experiences where countries have reduced large net foreign liabilities in an orderly way, and if so, how? As a first step in providing answers, we have identified some 22 episodes over the period of 1970-2010 where advanced and emerging market economies have reduced net foreign liabilities. These episodes exclude short-lived reductions that may reflect cyclical rather than structural and policy factors (an episode of "sustained" reduction is defined as a period of 8 years or more during which a country's net liability-to-GDP ratio displays a clear downward trend). In most of these cases, however, major economic and financial crises are a prominent feature in early years, suggesting that crises may have played a role in prompting adjustments. Excluding these crisis-related cases, just seven episodes of orderly reduction remain.[2/] In all seven cases, an improved trade balance has been a major factor in reducing foreign liabilities on a sustained basis.

Contribution to Decreases in NFLs
(In percent of total)



Source: author's calculation.

We consider the link between fiscal deficit reduction, private sector deleveraging, and reduction in net foreign liabilities in the seven episodes. The main finding is that orderly reductions in liabilities have mostly occurred when there have been improvements in gross public savings instead of private savings, and that in most cases the decline has occurred alongside successful fiscal deficit reduction. This would suggest that deficit reduction should help in reducing New Zealand's foreign liabilities. Earlier staff analysis suggests that a 1 percent of GDP increase in public saving would raise national saving by about ½–⅔ percent of GDP.[3/] New Zealand is unique however in that most of its liabilities are private rather than public, raising the question whether this would limit the ability of budget deficit reduction in the case of New Zealand to bring about a reduction in foreign liabilities more broadly.

[1/] Preliminary findings based on a forthcoming paper by Y. Sun and W. Schule.

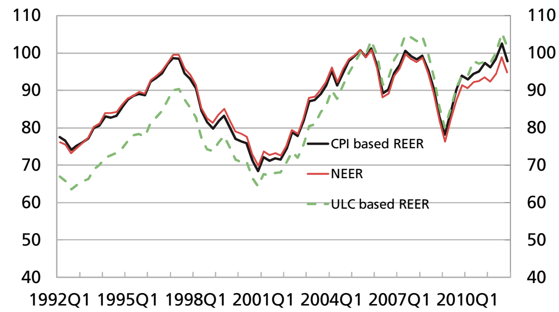
[2/] Austria (2001–09), Belgium (1985–2000), Canada (1993–2006), France (1993–2000), Ireland (1985–1999), Netherlands (2002–10), and Peru (1999–2006).

[3/] New Zealand: Selected Issues Paper, Chapter I (2011), IMF Country Report No. 11/103.

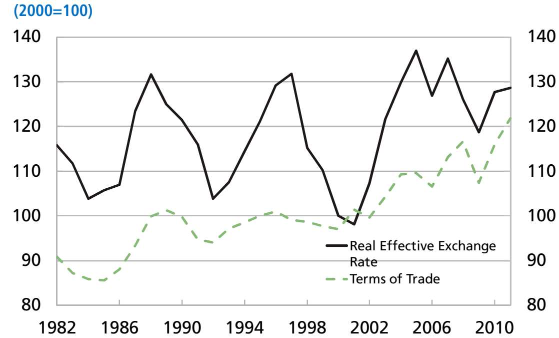
Box 3. New Zealand's Real Effective Exchange Rate

Real effective exchange rates based on both consumer prices and unit labor costs remain elevated, reflecting strengthening of the nominal effective exchange rate. The REER has appreciated by almost 35 percent from its trough in early 2009 and is currently 13 percent above the 1982-2011 average. The appreciation reflects the effects of higher commodity prices (which pushed the terms of trade to 20 percent above the average of the past two decades), positive interest rate differentials, and, although currently volatile, some increase in global risk appetite since end-2011. The strong exchange rate may inhibit the growth of the non-commodity tradable sector.

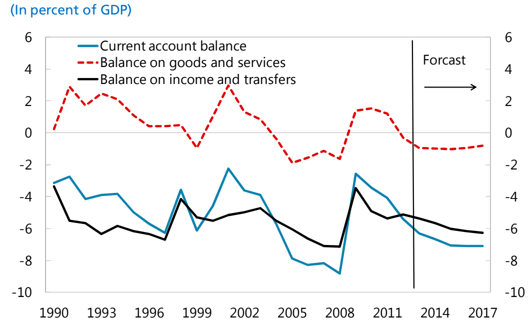
Effective Exchange Rates
(2005=100)



Real Effective Exchange Rate and Terms of Trade
(2000=100)



Current Account
(In percent of GDP)



Despite recent improvements, the current account deficit is projected to increase over the medium term. Under the baseline assumption of a constant real effective exchange rate, the current account deficit is projected to widen to about 7 percent of GDP over the medium term as earthquake reconstruction activity gains pace and global interest rates normalize. The widening deficits would increase net external liabilities from 72 percent of GDP in 2011 to around 90 percent of GDP by 2017.

Staff analysis suggests that the New Zealand dollar is currently stronger than is consistent with a level of the current account deficit that is more sustainable over the longer term. To stabilize net external liabilities at the 2009 level of 80 percent of GDP, the current account deficit needs to be reduced to -3¾ percent of GDP, implying that, given the staff's estimated trade elasticities, the New Zealand dollar would need to be about 15 percent weaker than its current level. Although subject to much uncertainty, model-based cross-country econometric approaches estimated with respect to a medium-term current account norm—in line with the IMF's CGER exercise—show the exchange rate to be in the range of 10-20 percent above its equilibrium.

projected current account deficit would lead to a further buildup of external liabilities. The authorities agreed that part of the currency's current strength may dissipate with eventual tightening by major central banks, but underscored their concern that weak global growth and persistent European financial turmoil could delay this tightening for some time, inhibiting growth in New Zealand's tradable sector.

INCREASING PUBLIC SAVING

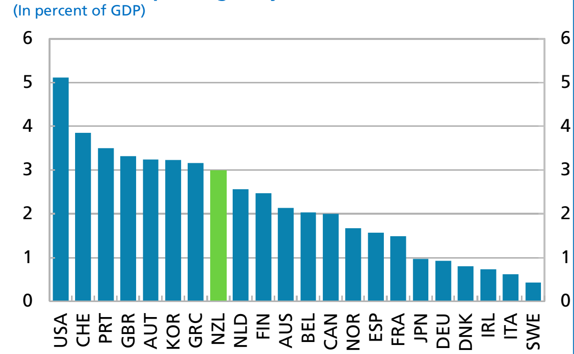
24. **Fiscal deficit reduction plan.** The government's medium-term deficit reduction plan is aimed at limiting the increase in public debt to preserve the fiscal space to guard against future economic risks and at contributing to lower external debt. To this end, the 2011/12 budget plans to reduce the fiscal deficit (total Crown) to about 6 percent of GDP, and return to budget surplus by 2014/15, mainly through spending control (Figure 4). According to this plan, net government debt would peak at about 30 percent of GDP in 2015, and decline to 20 percent of GDP by 2021.

25. **Benefits of this plan.** The pace of deficit reduction entails an improvement of about 5 percent of GDP in the structural balance over the next five years. In staff view, this strikes the right balance between the need to limit public debt increases while containing any adverse impact on economic growth during the recovery. Specifically:

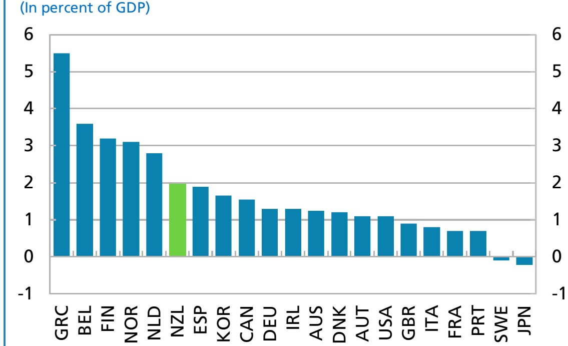
- It contains the aggregate demand impact by withdrawing fiscal stimulus in line with expected increases in private sector and earthquake-related reconstruction spending. This spending will be a strong driver of growth over the next several years, allowing deficit reduction to proceed without jeopardizing output growth.

- It creates fiscal space to help the country cope with a possible sharp reduction in domestic economic activity or the assumption of potential liabilities associated with future adverse shocks. Over the longer term, it will create space to deal with aging and rising health care costs.

Public Health Spending: Projected Increases Over 2010-30
(In percent of GDP)



Source: IMF Fiscal Monitor database.



Source: IMF Fiscal Monitor database.

- It will facilitate a shift towards a more optimal macroeconomic policy mix, with a tighter fiscal policy easing pressure on monetary policy and therefore the exchange rate. This would help reduce the current account deficit, limit the increase in foreign liabilities, and reduce reliance on offshore wholesale funding.

26. **Spending measures.** The fiscal deficit reduction plan focuses on controlling spending, and the 2011/12 budget introduced measures to contain transfers to middle-income households. The government also plans to shift spending to higher-priority areas such as education and health by requiring government departments to find savings elsewhere. Capital spending will be funded by the proceeds of selling a stake in state-owned enterprises amounting to about 3 percent of 2011 GDP over the next four years, and thereby reduce borrowing. The government plans to reform the welfare system to reduce long-term welfare dependency, addressing major deficiencies identified by the Welfare Working Group.

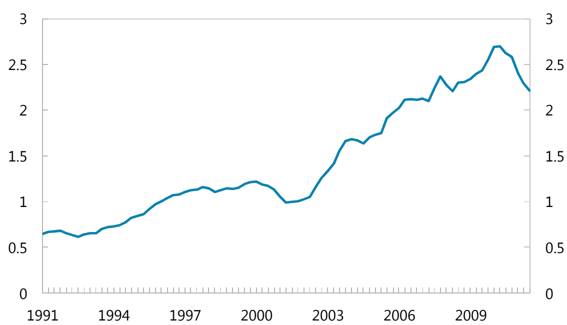
27. **Authorities' views.** The authorities emphasized that returning to budget surplus by 2014/15 is a core commitment of the government. They argued that although public debt is still low by international standards, its rate of increase has been rapid and needs to be arrested. The authorities agreed that deficit reduction would help to rebuild fiscal space to help the country cope with future economic and fiscal shocks, and would reduce pressure on monetary policy and therefore the exchange rate, as earthquake reconstruction gathers pace.

MAINTAINING FINANCIAL STABILITY

28. **Balance sheet risks.** New Zealand banks face a number of unique risks. On the asset side, banks' large exposure to highly indebted households and to the agriculture sector is a key vulnerability. Household debt remains high at about 150 percent of disposable income, and a rise in mortgage rates together with an increase in unemployment could lead to an increase in nonperforming loans. A large fall in dairy and

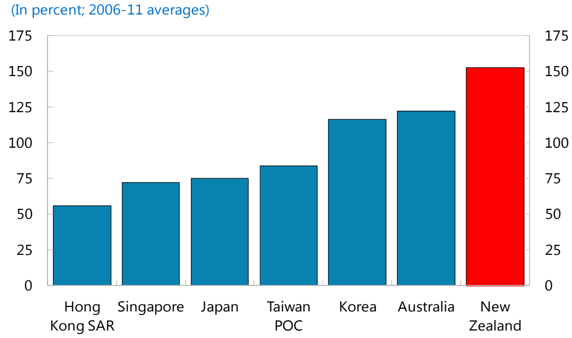
meat prices would reduce the quality of agricultural loans, but the capital requirements for these loans have been strengthened since mid-2011. On the liability side, banks have made steady progress in lengthening the maturity profile of their wholesale funding since 2008 and increasing the share of retail deposits, but the total stock of banks' gross external liabilities remains above 70 percent of GDP and loan-to-deposit ratios remain high.

Agricultural Debt to Agricultural Export Earnings
(In ratio)



Sources: RBNZ SSR, Statistics New Zealand.

Loan-to-Deposit Ratios in Asian Countries
(In percent; 2006-11 averages)



Source: IMF staff calculations.

29. **Bank supervision and regulation.** To address these risks the RBNZ has in place a conservative approach to bank supervision and regulation, requiring that capital ratios be determined using more conservative risk weights and loss-given-default standards than in many other countries.[3] Banks have also limited their exposure to low-income earners and high-risk mortgages, and the full recourse nature of mortgage lending also helps limit strategic loan defaults by households. The authorities are in close collaboration with the Australian authorities on crisis management, including undertaking a Trans-Tasman crisis management exercise in 2011.

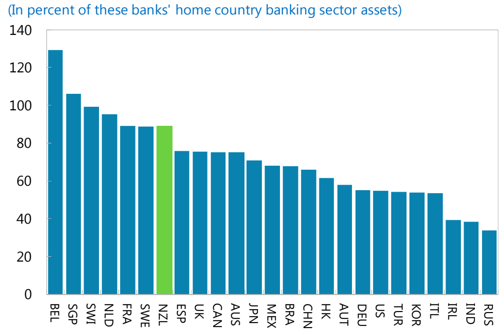
30. **Prudential measures.** While recognizing this conservative approach, staff encouraged the authorities to assess on an ongoing basis the balance between banking sector vulnerability versus efficiency to ensure that the systemically important banks' large wholesale funding needs and their exposure to highly leveraged households and farmers do not pose a sizable potential fiscal liability.[4] Options to strengthen prudential norms could include setting the four large banks' capital requirements above the Basel III minimum or raising the core funding ratio more than the planned 75 percent. Staff also noted that

[3] For example, staff estimates suggest that if the New Zealand banks applied a loss-given-default assumption for residential mortgages of 10 percent (the Basel II minimum) rather than the 20 percent minimum required by the RBNZ, their Tier 1 capital ratio would rise by about 1½ percentage points.

[4] New Zealand's four large banks account for about 90 percent of the banking system and their assets amount to about 170 percent of GDP. Given their size, markets and ratings agencies perceive them as too big to fail.

future stress tests of bank balance sheets could be more stringent than in the past to include a disruption to bank funding, a large increase in longer-term interest rates, and a longer time horizon to take into account the impact of sustained high unemployment.

Assets of Four Major Banks for Selected Countries, 2010
(In percent of these banks' home country banking sector assets)



Sources: Bankscope; Banks' Annual Reports; and IMF staff calculations.

31. **Macroprudential measures.** The RBNZ is examining the potential for various macroprudential measures to limit a build-up of systemic risk during periods of rapid credit growth. The core funding ratio for banks, for example, introduced in April 2010 with the aim of reducing banks' dependence on short-term wholesale funding, may also help constrain excessive credit growth during upswings. The RBNZ's recent study has been centered on the effectiveness of four instruments: the counter-cyclical capital buffer, adjustments to the core funding ratio, overlays to sectoral risk weights, and loan-to-value restrictions. Staff noted that the measures under consideration may be useful to manage risks from excessive bank credit growth during upswings.

32. **Authorities' views.** The authorities emphasized their conservative approach to bank regulation and supervision. Given this together with New Zealand banks' high capital quality, the banking system is well positioned to meet the Basel III capital requirements at an early date. The authorities envisaged that macroprudential tools are best reserved for periods of exceptional credit growth rather than being deployed frequently, and also noted possible regulatory arbitrage issues. They agreed that many of the issues related to prudential norms and stress testing could be informed by the results of the upcoming review of the Australian financial sector (FSAP), which will also cover New Zealand banking subsidiaries.

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33. **Outlook and risks.** The pace of New Zealand's economic recovery is likely to remain modest. Output growth should pick up somewhat in 2012 as earthquake reconstruction spending is expected to gain pace, but the size and timing of this spending is still uncertain. High household debt is likely to weigh on the growth of private consumption as households will need to save to strengthen their balance sheets. The spare

capacity and elevated unemployment will contain wage and inflation pressures in the near term. The risks to this outlook are on the downside and largely external, stemming mainly from emerging weaknesses in the global economy and a possible upheaval in the global financial system. The flexible exchange rate would provide an important buffer against shocks.

34. **Monetary policy.** The current accommodative monetary stance is appropriate. If the recovery remains on track and downside risks dissipate, monetary policy will need to tighten gradually to contain inflationary pressures. However, if the global recovery stalls or international capital markets are disrupted, the RBNZ has scope to cut the policy rate and provide liquidity support for banks.

35. **Fiscal policy.** The planned deficit reduction path strikes a balance between the need to contain both public and external debt increases while limiting any adverse impact on economic growth during the recovery. The authorities' plan to return to budget surplus by 2014/15 should put New Zealand in a better position to deal with future shocks and the long-term costs of aging. Moreover, it will relieve pressure on monetary policy and thereby the exchange rate, helping contain the current account deficit over the medium term. New Zealand's relatively modest public debt gives the authorities some scope to delay their planned deficit reduction path in the event of a sharp deterioration in the economic outlook.

36. **External vulnerabilities and the exchange rate.** New Zealand's large net liabilities present a risk. Despite recent improvements, the current account deficit is projected to increase over the medium term as earthquake reconstruction activity gains pace and global interest rates normalize. To contain this increase and limit a further buildup of foreign liabilities over the longer term, the New Zealand dollar would need to be weaker than its current level. However, part of its current strength may dissipate over time with the eventual tightening of policy rates by major central banks. Increasing national saving, including through the planned fiscal deficit reduction, would reduce external vulnerability.

37. **Financial sector issues.** Banks remain sound, but they are exposed to highly leveraged households and farmers and rollover risks associated with large short-term offshore funding needs. While New Zealand's bank regulatory norms are more conservative than in many other countries, the authorities should assess on an ongoing basis the balance between banking sector vulnerability versus efficiency to minimize the risk that systemically

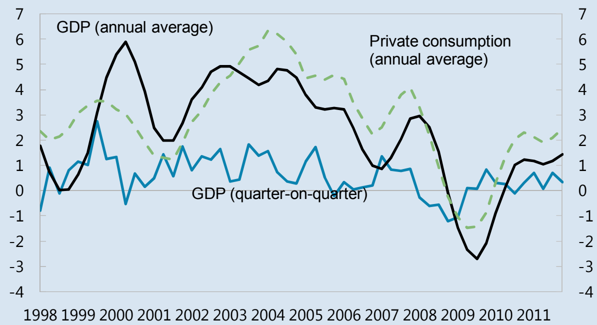
important banks pose to the economy. Options to strengthen prudential norms if needed could include setting banks' capital requirements above the Basel III minimum or raising the core funding ratio more than the planned 75 percent to reduce short term external debt further. The RBNZ's continued work on the costs and benefits of macroprudential measures is welcome, as is the authorities' intention to implement key features of Basel III in early 2013.

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

Figure 1. A Modest Recovery from Recession

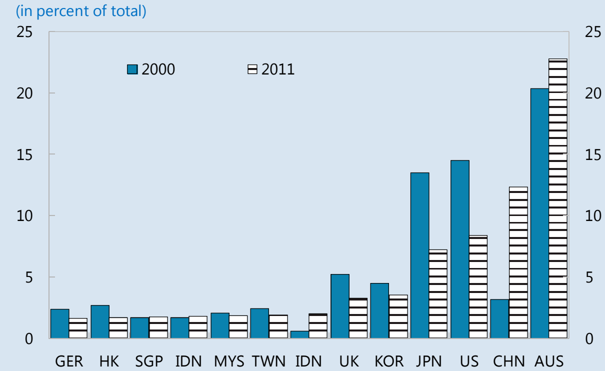
A modest recovery continued in 2011…

Real Growth
(Seasonally adjusted, in percent)



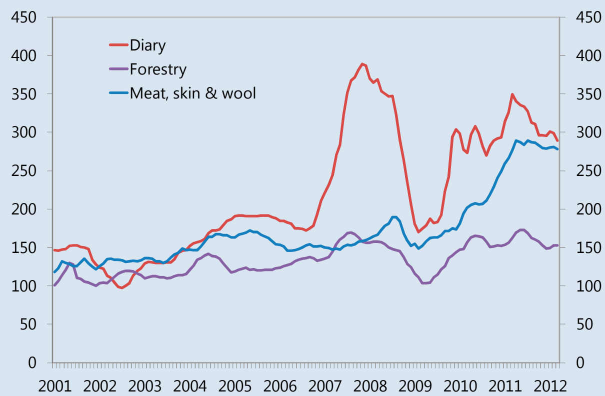
…helped by increasing ties with Australia and faster growing countries such as China…

Export by Destination
(in percent of total)



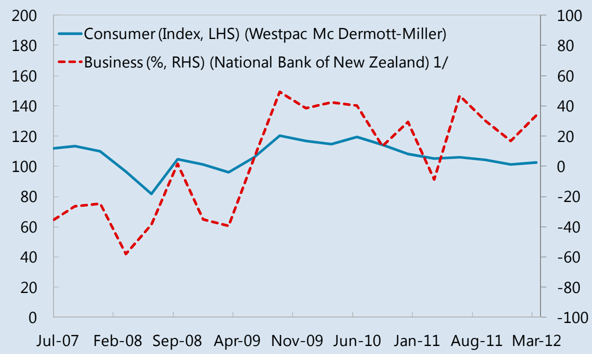
…and elevated commodity prices.

Export commodity price index



Confidence has declined recently…

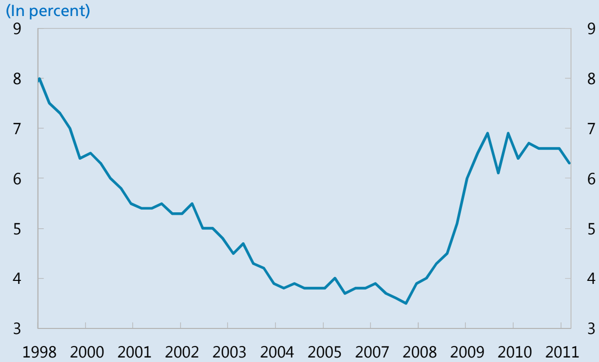
Consumer and Business Confidence



1/ Percentage expecting improvement in general business conditions minus percentage expecting deterioration.

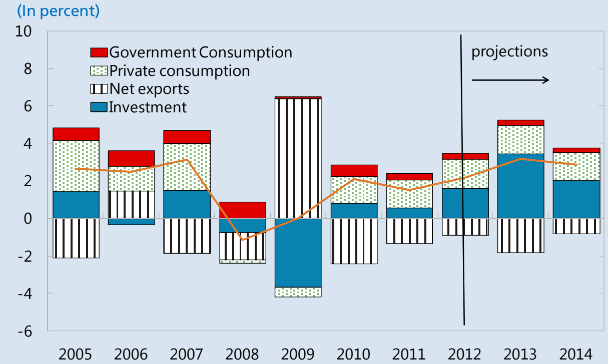
…and unemployment remains elevated.

Unemployment Rate
(In percent)



Growth is expected to be supported by earthquake reconstruction spending.

Contribution to Annual GDP Growth
(In percent)

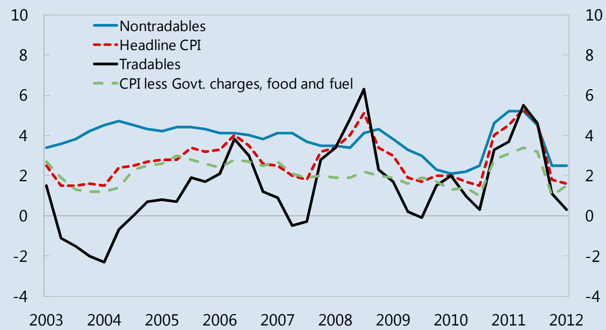


Sources: Statistics New Zealand; Reserve Bank of New Zealand; UNIDO database; Haver Analytics database; World Economic Outlook; and Fund staff estimates.

Figure 2. An Accommodative Monetary Stance

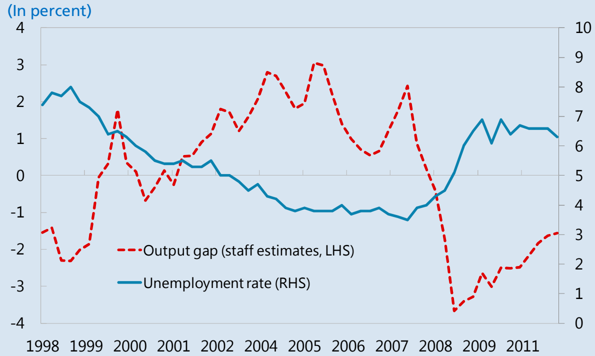
Inflation has declined owing to weak domestic demand and falling food prices…

CPI Inflation
(Percent change, y/y)



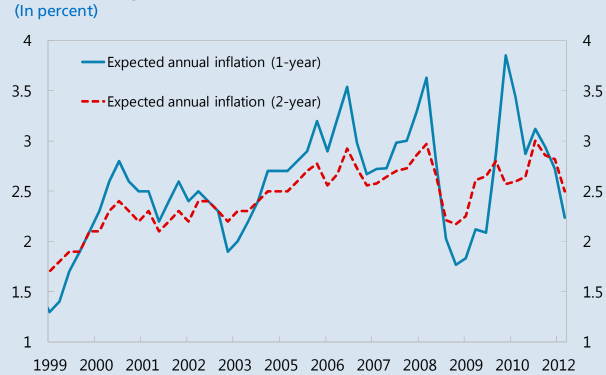
…and economic slack remains significant

Indicators of Resource Pressure
(In percent)



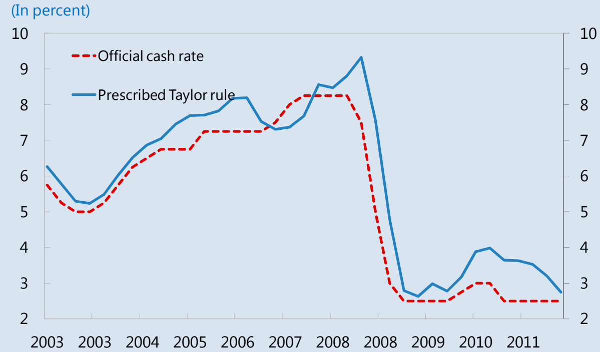
Inflation expectations are within the 1–3 percent inflation target band.

Inflation Expectations
(In percent)



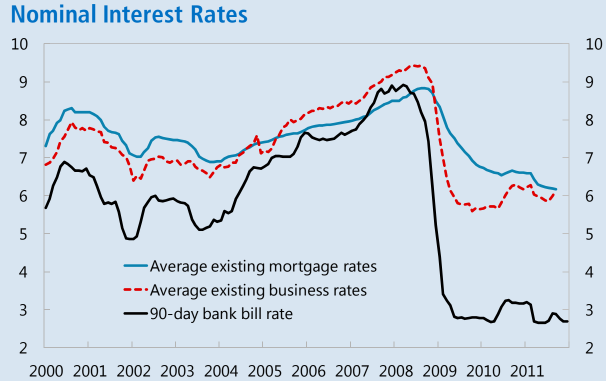
Thus the policy rate remains low.

Policy Rate
(In percent)



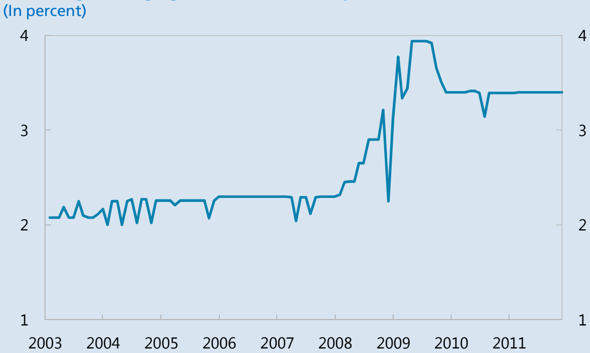
Effective lending rates fell, but not as much as the policy rate and the bank bill rate.

Nominal Interest Rates



The spread between the OCR and banks' floating mortgage rates remains high because of competition for deposits.

Floating Mortgage Rate to OCR Spread
(In percent)

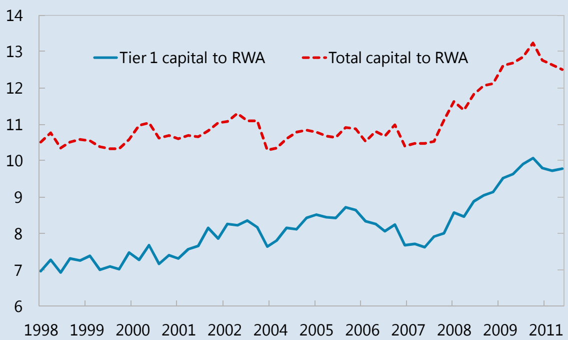


Sources: Reserve Bank of New Zealand; Statistics New Zealand; New Zealand Institute of Economic Research; Bloomberg; International Financial Statistics database.

Figure 3. Banking Sector Developments

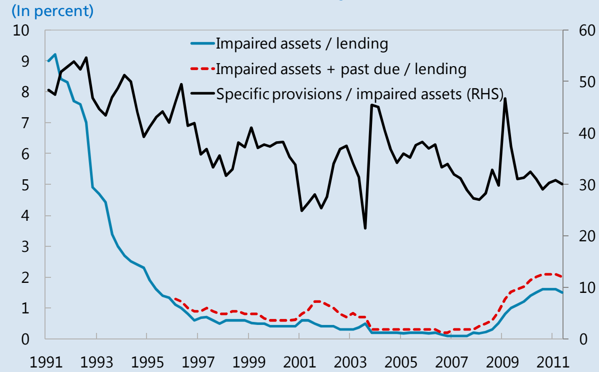
Bank capital has increased since 2007…

Capital Adequacy Ratios
(In percent)



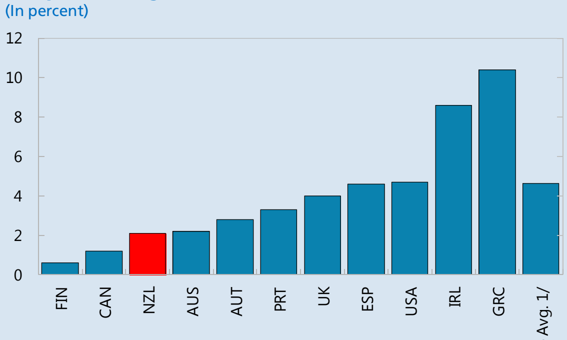
…and asset quality has started improving.

New Zealand Banks Asset Quality
(In percent)



Nonperforming loans are low by advanced economy standards.

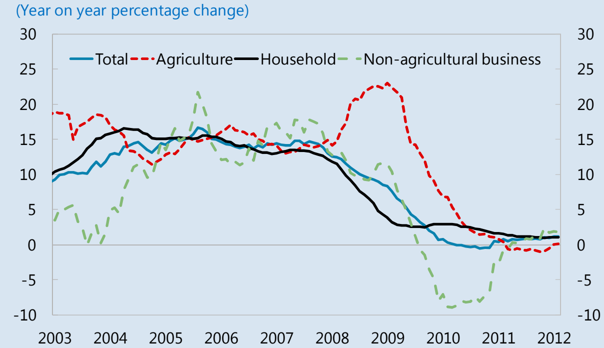
Nonperforming Loans to Total Loans, 2010
(In percent)



1/ Simple (unweighted) average of comparator countries, excluding New Zealand.

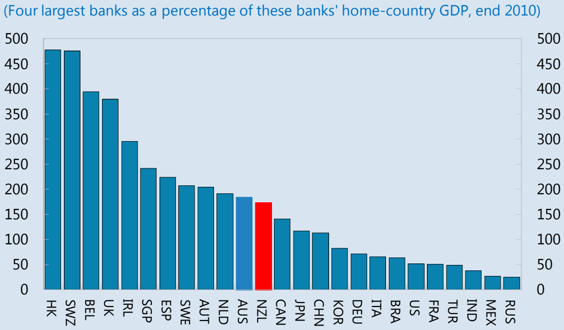
Credit growth remains weak.

Credit Growth
(Year on year percentage change)



The assets of four major banks are large.

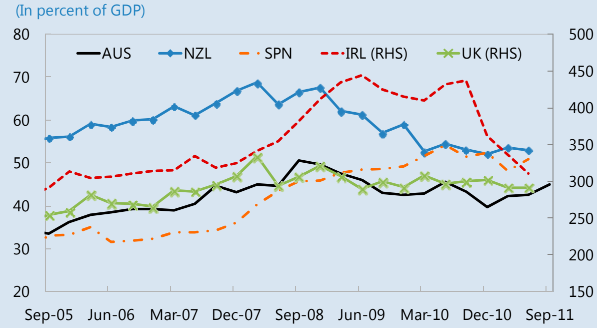
Banking Sector Assets for Selected Countries
(Four largest banks as a percentage of these banks' home-country GDP, end 2010)



Sources: Bankscope; Banks' Annual Reports; and IMF staff calculations.

Despite recent declines, short-term debt mostly held by banks remains high.

Total Short-Term External Debt 1/
(In percent of GDP)



1/ Short-term debt is on a residual maturity basis for Australia and New Zealand and on an original maturity basis for other countries.
Source: WB-IMF-RES-OECD; Joint External Debt Hub; and IMF staff calculations

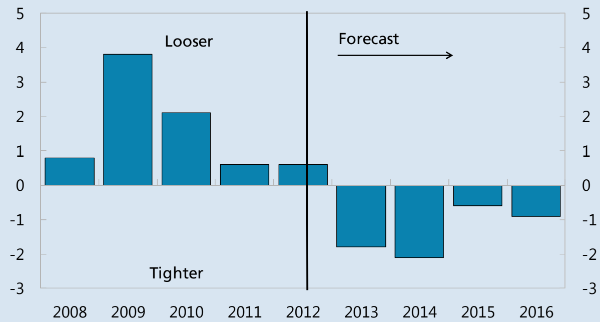
Sources: Reserve Bank of New Zealand; Bankscope; APRA; Haver Analytics database; and IMF staff estimates.

Figure 4. The Government's Deficit Reduction Plan 1/

The government's deficit reduction plan aims …

Fiscal Impulse[1/]

(In percent of GDP, fiscal year)

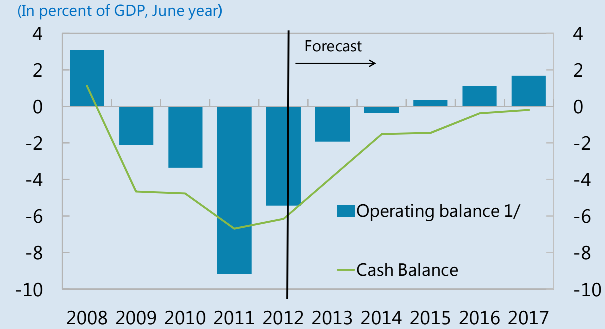


1/ Based on cyclically adjusted cash balances, including earthquake-related spending.

… to return to budget surplus in 2014/15…

Fiscal Balance

(In percent of GDP, June year)

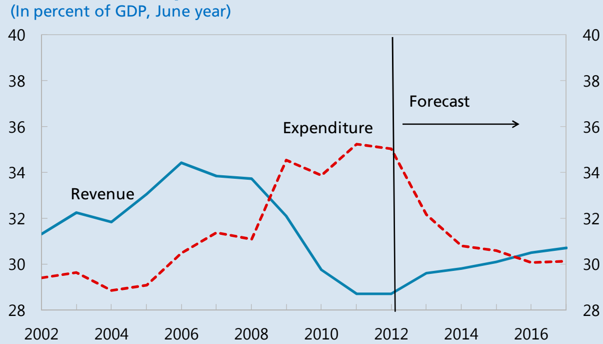


1/ Before gains and losses (total Crown).

...mainly through control of spending and fiscal drag.

Revenue and Expenditure

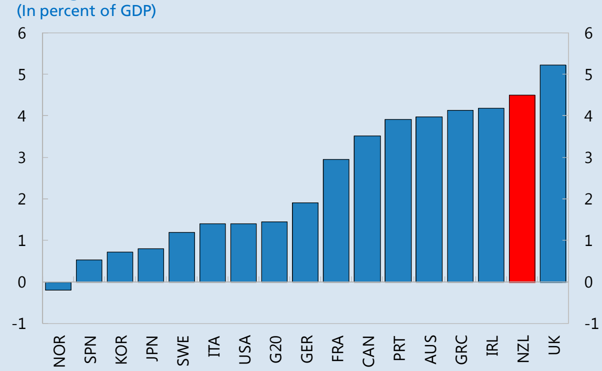
(In percent of GDP, June year)



The planned deficit reduction is faster than in most other advanced countries.

Change in Structural Balance, 2011-16

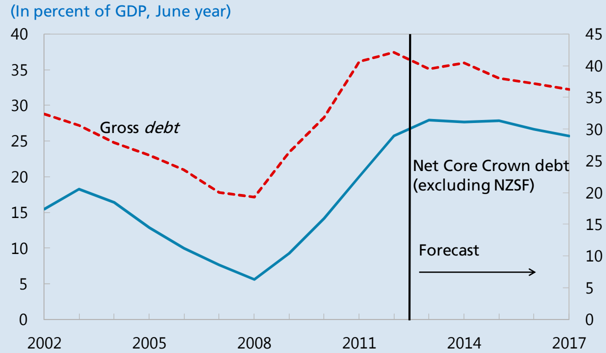
(In percent of GDP)



Net debt is projected to rise to almost 30 percent of GDP…

Gross and Net Debt

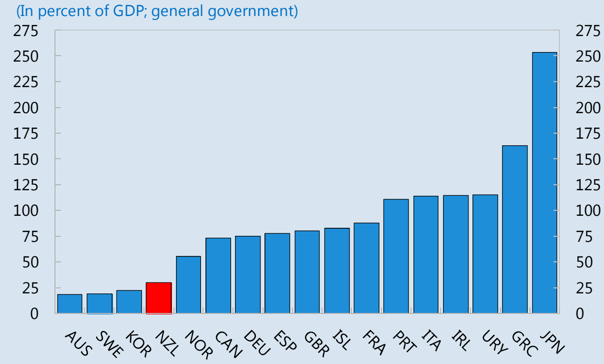
(In percent of GDP, June year)



… but gross debt is projected to remain among the lowest in advanced economies.

General Government Gross Debt, 2016

(In percent of GDP; general government)



1/ Core Crown only.

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

Table 1. New Zealand: Selected Economic and Financial Indicators, 2008–13

Nominal GDP (2011): US$161.9 billion | GDP per capita (2011): US$38,227

Population (2011): 4.4 million | Quota: SDR 894.6 million

	2008	2009	2010	2011	2012 Proj.	2013 Proj.
Real growth (percent change)						
GDP (production basis)	-0.1	-2.1	1.2	1.4	2.3	3.2
Final domestic demand	0.0	-3.9	2.8	2.3	3.4	5.0
Private consumption	-0.2	-0.9	2.3	2.5	2.5	2.4
Government consumption	5.0	0.5	3.4	1.8	1.7	1.5
Fixed investment	-2.8	-14.1	3.7	2.4	6.9	14.4
Inventories 1/	0.4	-2.3	1.7	0.5	-0.4	-0.3
Exports of goods and services	-1.3	2.2	2.7	2.5	1.8	2.7
Imports of goods and services	3.0	-14.9	10.0	6.1	3.9	7.2
Output gap	-0.3	-3.2	-2.6	-1.8	-1.5	-0.3
Headline CPI inflation (percent change)	4.0	2.1	2.3	4.0	2.1	2.4
End of period (percent change)	3.4	2.0	4.0	1.8	2.6	2.5
Unemployment rate (period average, in percent)	4.2	6.1	6.5	6.5	6.0	5.4
Investment and saving (in percent of GDP)						
Investment	23.0	18.9	19.7	19.5	21.4	22.3
National saving 2/	15.2	16.3	16.2	15.3	15.9	15.9
Public finance (in percent of GDP) 3/						
Revenue	37.5	36.9	34.7	36.0	32.7	32.9
Expenditure	34.3	37.1	37.6	43.4	37.6	35.5
Net operating balance	3.8	0.2	-1.8	-6.9	-3.8	-1.7
Net lending (+)/borrowing (–)	3.2	-0.2	-2.8	-7.4	-4.9	-2.6
Operating balance before gains and losses (total Crown)	3.1	-2.1	-3.3	-9.2	-5.4	-1.9
Net core Crown debt excluding NZS Fund and advances	5.6	9.2	14.1	20.0	25.7	27.9
Money and credit (end of period)						
Resident M3 (percent change) 4/	9.1	1.9	3.9	6.7	6.5	...
Private domestic credit (percent change) 4/	8.3	1.7	0.5	1.6	1.9	...
Interest rates (period average)						
Interest rate (90-day, in percent) 4/	8.0	3.0	3.0	2.7	2.8	...
Government bond yield (10-year, in percent) 4/	6.1	5.5	5.6	4.6	4.2	...
Balance of payments (in percent of GDP)						
Current account	-8.8	-2.6	-3.4	-4.1	-5.4	-6.3
(In billions of New Zealand dollars)	-16.3	-4.7	-6.7	-8.3	-11.8	-14.5
Trade balance (goods)	-1.3	1.3	1.8	1.7	0.2	-0.5
Terms of trade (percent change)	7.4	-10.1	10.3	4.6	-4.0	1.6
Foreign assets and liabilities ($NZ billion)						
Net international investment position	-152.6	-151.8	-146.5	-147.0	-158.5	-172.6
(In percent of GDP)	-82.7	-81.8	-75.1	-71.9	-72.5	-74.9
Official reserves 4/	19.1	21.6	21.7	22.1	23.1	...
Exchange rate (period average)						
U.S. dollar per New Zealand dollar 4/	0.71	0.64	0.72	0.79	0.82	...
Trade-weighted index (June 1979 = 100) 4/	65.7	63.5	66.7	69.3	72.5	...
Nominal effective exchange rate 4/ 5/	91.1	84.3	92.2	95.1	99.3	...
Real effective exchange rate 4/ 5/	92.0	86.7	94.9	98.8	102.0	...
GDP (in billions of New Zealand dollars)	184.5	185.5	195.1	204.5	218.5	230.4

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

1/ Contribution in percent of GDP.

2/ Based on national accounts data.

3/ Fiscal years ending June 30.

4/ Data for 2012 are for March.

5/ IMF Information Notice System index (2000 = 100).

Table 2a. New Zealand: Statement of Operations of Budgetary Central Government, 2007/08-2012/13 1/
(In billions of New Zealand dollars)

	2007/08	2008/09	2009/10	2010/11	2011/12 Proj.	2012/13 Proj.
Revenue	68.8	68.3	65.6	72.1	69.2	73.3
Taxes	59.7	57.8	54.3	55.8	57.9	61.6
Other revenue	9.1	10.4	11.3	16.4	11.3	11.7
Property income	1.7	2.2	3.1	3.0	2.4	2.7
Sales of goods and services and other revenues	7.4	8.2	8.3	13.4	8.9	9.0
Expenditure	62.8	68.7	71.0	87.0	79.5	79.0
Expense	61.8	67.8	69.1	86.1	77.2	77.0
Compensation of employees	16.4	17.9	18.4	18.8	19.2	19.3
Consumption of fixed capital	2.7	3.2	3.0	3.4	3.2	3.3
Interest	1.3	1.4	2.0	2.7	3.0	3.1
Grants and subsidies	3.6	4.0	3.9	4.7	5.0	4.7
Social benefits	18.0	19.5	20.8	21.7	22.0	22.7
Other expense 2/	19.8	21.8	21.0	34.7	24.8	24.0
Net acquisition of nonfinancial assets	1.0	0.9	1.9	0.9	2.3	1.9
Gross Operating Balance	9.7	3.7	-0.4	-10.5	-4.7	-0.5
Net Operating Balance	7.0	0.4	-3.5	-13.9	-7.9	-3.8
Net lending (+)/borrowing (–)	5.9	-0.4	-5.4	-14.8	-10.3	-5.7
Net financial transactions	5.9	-0.4	-5.4	-14.8	-10.3	-5.7
Net acquisition of financial assets	9.7	7.9	4.8	19.4	-3.0	-7.6
Domestic	9.7	7.9	4.8	19.4	-3.0	-7.6
Debt securities 3/	6.1	0.8	1.3	8.1	-3.1	-8.4
Loans	0.5	1.7	3.4	1.6	1.5	1.7
Other accounts receivable	3.1	5.4	0.2	9.8	-1.3	-0.9
Net incurrence of liabilities	3.8	8.3	10.2	34.3	7.3	-1.9
Domestic	3.8	8.3	10.2	34.3	7.3	-1.9
Debt securities	0.8	6.8	8.9	20.8	10.9	2.0
Other accounts payable	3.0	1.5	1.3	13.4	-3.6	-4.0
Memorandum items:						
Cash receipts from operating activities	67.6	64.7	64.9	66.0	71.5	76.0
Cash payments from operating activities	57.3	63.5	65.8	71.7	78.6	78.4
Net cash inflow (outflow) from operating activities	10.3	1.2	-0.9	-5.7	-7.1	-2.4
Cash surplus (deficit)	6.7	-2.8	-5.4	-10.1	-14.6	-9.5
Operating balance before gains and losses (total Crown)	5.6	-3.9	-6.3	-18.4	-11.5	-4.3
Earthquake expenses (total Crown)				9.1	3.0	0.6
Residual cash balance (core Crown)	2.1	-8.6	-9.0	-13.4	-13.0	-8.6
Structural residual cash balance (core Crown)	1.0	-6.8	-6.6	-9.9	-8.8	-7.0
Gross sovereign-issued debt 4/	31.4	43.4	53.6	72.4	79.1	78.1
Net core Crown debt 5/	10.3	17.1	26.7	40.1	54.4	62.2
Net worth (Core Crown) 6/	57.0	53.1	44.7	34.9	21.5	18.5
Nominal GDP	183.3	185.2	189.0	200.3	211.6	222.5

Source: New Zealand Treasury

1/ Fiscal year ending June 30. Includes core Crown (excluding RBNZ) and Crown entities.

2/ Includes use of goods and services.

3/ Includes currency, deposits and equities.

4/ Excluding Reserve Bank Settlement cash.

5/ Excluding NZ Superannuation Fund and advances.

6/ Includes financial assets of NZ Superannuation Fund.

Table 2b. New Zealand: Statement of Operations of Budgetary Central Government, 2007/08-2012/13 1/
(In percentage of GDP)

	2007/08	2008/09	2009/10	2010/11	2011/12 Proj.	2012/13 Proj.
Revenue	37.5	36.9	34.7	36.0	32.7	32.9
Taxes	32.6	31.2	28.7	27.8	27.4	27.7
Other revenue	4.9	5.6	6.0	8.2	5.3	5.2
Property income	0.9	1.2	1.6	1.5	1.2	1.2
Sales of goods and services and other revenues	4.0	4.4	4.4	6.7	4.2	4.0
Expenditure	34.3	37.1	37.6	43.4	37.6	35.5
Expense	33.7	36.6	36.6	43.0	36.5	34.6
Compensation of employees	8.9	9.7	9.7	9.4	9.1	8.7
Consumption of fixed capital	1.5	1.7	1.6	1.7	1.5	1.5
Interest	0.7	0.8	1.1	1.4	1.4	1.4
Grants and subsidies	1.9	2.1	2.1	2.3	2.3	2.1
Social benefits	9.8	10.5	11.0	10.8	10.4	10.2
Other expense 2/	10.8	11.8	11.1	17.3	11.7	10.8
Net acquisition of nonfinancial assets	0.6	0.5	1.0	0.5	1.1	0.9
Gross Operating Balance	5.3	2.0	-0.2	-5.3	-2.2	-0.2
Net Operating Balance	3.8	0.2	-1.8	-6.9	-3.8	-1.7
Net lending (+)/borrowing (–)	3.2	-0.2	-2.8	-7.4	-4.9	-2.6
Net financial transactions	3.2	-0.2	-2.8	-7.4	-4.9	-2.6
Net acquisition of financial assets	5.3	4.3	2.6	9.7	-1.4	-3.4
Domestic	5.3	4.3	2.6	9.7	-1.4	-3.4
Debt securities 3/	3.3	0.5	0.7	4.1	-1.5	-3.8
Loans	0.3	0.9	1.8	0.8	0.7	0.8
Other accounts receivable	1.7	2.9	0.1	4.9	-0.6	-0.4
Net incurrence of liabilities	2.0	4.5	5.4	17.1	3.5	-0.9
Domestic	2.0	4.5	5.4	17.1	3.5	-0.9
Debt securities	0.4	3.7	4.7	10.4	5.1	0.9
Other accounts payable	1.6	0.8	0.7	6.7	-1.7	-1.8
Memorandum items:						
Cash receipts from operating activities	36.9	34.9	34.3	32.9	33.8	34.2
Cash payments from operating activities	31.3	34.3	34.8	35.8	37.2	35.2
Net cash inflow (outflow) from operating activities	5.6	0.6	-0.5	-2.8	-3.4	-1.1
Cash surplus (deficit)	3.7	-1.5	-2.9	-5.0	-6.9	-4.3
Operating balance before gains and losses (total Crown)	3.1	-2.1	-3.3	-9.2	-5.4	-1.9
Earthquake expenses (total Crown)				4.5	1.4	0.3
Residual cash balance (core Crown)	1.1	-4.7	-4.8	-6.7	-6.1	-3.8
Structural residual cash balance (core Crown)	0.5	-3.6	-3.4	-4.8	-4.1	-3.1
Gross sovereign-issued debt 4/	17.1	23.4	28.4	36.2	37.4	35.1
Net core Crown debt 5/	5.6	9.2	14.1	20.0	25.7	27.9
Net worth (Core Crown) 6/	31.1	28.6	23.6	17.4	10.2	8.3
Nominal GDP (in billions of NZ dollars)	183.3	185.2	189.0	200.3	211.6	222.5

Source: New Zealand Treasury

1/ Fiscal year ending June 30. Includes core Crown (excluding RBNZ) and Crown entities.

2/ Includes use of goods and services.

3/ Includes currency, deposits and equities.

4/ Excluding Reserve Bank Settlement cash.

5/ Excluding NZ Superannuation Fund and advances.

6/ Includes financial assets of NZ Superannuation Fund.

Table 2c. New Zealand: Central Government Balance Sheet, 2007/08-2012/13
(In billions of New Zealand dollars)

	2007/08	2008/09	2009/10	2010/11	2011/12 Proj.	2012/13 Proj.
Net worth	93.9	102.3	95.8	91.8	77.8	65.2
Nonfinancial assets	72.6	77.3	82.7	84.5	84.8	87.5
Net Financial Worth	21.3	25.0	13.1	7.3	-7.0	-22.3
Financial Assets	81.6	93.4	98.6	102.7	122.1	117.3
Currency and deposits	6.8	10.2	13.2	12.7	20.5	17.9
Debt securities	14.3	18.3	17.9	20.2	21.3	16.8
Equity and inv. fund shares	41.0	43.6	45.1	45.7	48.2	53.1
Loans	7.9	7.9	8.1	10.5	11.4	12.0
Other financial assets	11.6	13.3	14.3	13.7	20.8	17.6
Liabilities	60.3	68.4	85.5	95.4	129.0	139.7
Currency and deposits	3.2	3.8	5.0	5.4	7.4	9.0
Debt securities and loans	24.1	26.1	36.4	44.0	62.6	71.6
Insurance and pension liabilities	7.2	8.3	9.0	9.9	10.2	10.6
Other liabilities	25.8	30.3	35.1	36.0	48.9	48.5
Memorandum items:						
Net financial worth (in % of GDP)	11.6	13.5	6.9	3.7	-3.3	-10.0
Financial assets (in % of GDP)	44.5	50.4	52.2	51.3	57.7	52.7
Liabilities (in % of GDP)	32.9	36.9	45.2	47.6	61.0	62.8
Nominal GDP	183.3	185.2	189.0	200.3	211.6	222.5

Source: New Zealand Treasury.

Table 3. New Zealand: Balance of Payments and External Debt, 2006–11
(In percent of GDP)

	2006	2007	2008	2009	2010	2011
Current account balance	-8.3	-8.2	-8.8	-2.6	-3.4	-4.1
Goods balance	-1.8	-1.3	-1.3	1.3	1.8	1.7
Exports, f.o.b.	21.0	20.8	23.8	21.7	22.7	23.7
Imports, f.o.b.	-22.8	-22.1	-25.1	-20.5	-20.9	-22.0
Services balance	0.2	0.2	-0.3	0.1	-0.2	-0.5
Receipts	7.5	7.2	7.2	7.0	6.4	6.2
Payments	-7.3	-7.0	-7.5	-6.9	-6.6	-6.8
Income balance	-7.0	-7.4	-7.6	-3.7	-4.9	-5.2
Receipts	3.2	3.6	3.0	3.2	3.4	3.3
Payments	-10.2	-11.0	-10.7	-6.9	-8.3	-8.5
Transfers balance	0.4	0.3	0.5	0.2	0.0	-0.2
Receipts	1.2	1.1	1.3	1.0	0.7	0.6
Payments	-0.8	-0.8	-0.8	-0.8	-0.7	-0.8
Capital and financial account balance	7.6	5.9	4.4	0.6	2.9	4.3
Capital account (net)	-0.2	-0.4	-0.3	0.3	1.9	5.3
Financial account (net)	7.8	6.3	4.7	0.3	1.0	-1.0
Direct investment (net)	5.0	-0.4	3.1	0.2	0.0	0.3
Portfolio investment (net)	-0.5	6.9	-4.0	1.1	1.7	1.5
Assets	-0.7	-2.3	1.8	-3.3	-1.7	-1.5
Equity securities	-0.5	-2.0	2.1	-1.9	-1.4	-0.6
Debt securities	-0.2	-0.3	-0.3	-1.4	-0.2	-0.9
Liabilities	0.2	9.2	-5.7	4.4	3.3	2.9
Equity securities	-0.4	0.2	0.2	0.8	-0.2	1.0
Debt securities	0.6	9.0	-5.9	3.6	3.6	2.0
Other investment (net)	3.4	-0.2	5.6	-1.1	-0.7	-2.8
Assets	-5.3	-3.7	5.1	-3.5	-1.7	-2.2
Liabilities	8.7	3.5	0.5	2.4	1.0	-0.6
Net errors and omissions 1/	0.7	2.3	4.6	1.9	0.6	-0.3
Overall balance	0.0	0.1	0.1	-0.1	0.0	0.0
(Assets and liabilities as of end-December)						
Gross external debt	116.1	122.2	137.2	130.4	128.7	125.8
Short-term (less than one year on residual maturity basis)	61.7	68.5	66.6	59.1	52.0	50.9
Long-term	54.4	53.6	70.6	71.2	76.7	74.9
Gross external debt	116.1	122.2	137.2	130.4	128.7	125.8
Of which: Denominated in New Zealand dollars	63.2	62.8	68.3	63.7	65.4	69.5
Gross external debt	116.1	122.2	137.2	130.4	128.7	125.8
Public sector	8.9	9.7	10.2	12.5	16.8	17.7
Private sector	107.2	112.4	127.0	117.9	111.9	108.1
Net international investment position 2/	-77.6	-75.1	-82.7	-81.8	-75.1	-71.9
Net equity	-4.3	-0.8	0.2	-0.2	2.4	-0.6
Net debt	-73.4	-74.3	-82.9	-81.6	-77.5	-71.2
Gross official reserves	12.0	12.5	10.4	11.6	11.1	11.7
Gross reserves in months of future imports of g&s	8.2	8.2	8.4	9.4	9.1	10.3
Gross reserves as percent of short-term debt	19.5	18.2	15.5	19.7	21.4	23.0

Sources: Data provided by the New Zealand authorities; and IMF staff estimates and projections.
1/ The large net errors and omissions in 2008 and 2009 mainly reflect financial account data issues, as extreme volatility in exchange rates and market prices during that period made it difficult to separate out valuation effects from financial account transaction.
2/ IIP balance sheet positions arise from transactions and valuation changes. The large net errors and omissions in 2008-09 do not lead to large under-estimation of net foreign liabilities.

Table 4. New Zealand: Balance of Payments and External Debt, 2006–11
(In billions of U.S. dollars)

	2006	2007	2008	2009	2010	2011
Current account balance	-8.9	-10.7	-11.6	-3.0	-4.8	-6.6
Goods balance	-1.9	-1.8	-1.7	1.5	2.5	2.8
Exports, f.o.b.	22.6	27.3	31.4	25.6	31.9	38.4
Imports, f.o.b.	-24.6	-29.0	-33.1	-24.1	-29.4	-35.6
Services balance	0.2	0.3	-0.4	0.2	-0.3	-0.8
Receipts	8.1	9.5	9.5	8.2	9.0	10.1
Payments	-7.9	-9.2	-9.9	-8.1	-9.3	-10.9
Income balance	-7.6	-9.7	-10.0	-4.3	-6.9	-8.4
Receipts	3.5	4.8	4.0	3.8	4.8	5.3
Payments	-11.0	-14.5	-14.1	-8.1	-11.6	-13.7
Transfers balance	0.4	0.4	0.6	0.2	0.0	-0.3
Receipts	1.3	1.4	1.7	1.2	1.0	1.0
Payments	-0.9	-1.0	-1.1	-1.0	-1.0	-1.3
Capital and financial account balance	8.2	7.8	5.7	0.7	4.1	7.0
Capital account (net)	-0.2	-0.6	-0.4	0.4	2.7	8.6
Financial account (net)	8.4	8.3	6.2	0.3	1.4	-1.6
Direct investment (net)	5.3	-0.6	4.1	0.3	0.0	0.5
Portfolio investment (net)	-0.6	9.1	-5.2	1.3	2.4	2.4
Assets	-0.8	-3.0	2.3	-3.9	-2.3	-2.4
Equity securities	-0.6	-2.6	2.8	-2.2	-2.0	-1.0
Debt securities	-0.2	-0.4	-0.4	-1.6	-0.3	-1.4
Liabilities	0.2	12.1	-7.5	5.1	4.7	4.8
Equity securities	-0.4	0.3	0.2	0.9	-0.3	1.6
Debt securities	0.7	11.8	-7.8	4.2	5.0	3.2
Other investment (net)	3.7	-0.2	7.4	-1.3	-1.0	-4.5
Assets	-5.7	-4.8	6.7	-4.1	-2.4	-3.5
Liabilities	9.4	4.6	0.7	2.9	1.4	-0.9
Net errors and omissions 1/	0.8	3.0	6.0	2.3	0.8	-0.5
Overall balance	0.0	0.1	0.1	-0.1	0.1	0.0
(Assets and liabilities as of end-December)						
Gross external debt	136.0	168.8	146.4	175.6	195.9	196.6
Short-term (less than one year on residual maturity basis)	72.3	94.7	71.1	79.7	79.2	79.6
Long-term	63.8	74.1	75.3	96.0	116.7	117.0
Gross external debt	136.0	168.8	146.4	175.6	195.9	196.6
Of which: denominated in New Zealand dollars	74.0	86.8	72.9	85.8	99.5	108.6
Gross external debt	136.0	168.8	146.4	175.6	195.9	196.6
Public sector	10.4	13.5	10.9	16.8	25.5	27.6
Private sector	125.6	155.3	135.5	158.8	170.4	169.0
Net international investment position 2/	-91.0	-103.8	-88.3	-110.2	-114.3	-112.3
Net equity	-5.0	-1.1	0.3	-0.2	3.7	-1.0
Net debt	-86.0	-102.7	-88.5	-110.0	-118.0	-111.3
Gross official reserves	14.1	17.2	11.1	15.7	16.9	18.3
RBNZ net short position in forex swaps	7.4	8.0	3.4	7.4	9.4	10.3
RBNZ net open foreign currency position	0.0	1.9	2.9	2.5	2.2	1.7
U.S./New Zealand exchange rate (e.o.p.)	0.7	0.8	0.6	0.7	0.8	0.8
U.S./New Zealand exchange rate (period average)	0.6	0.7	0.7	0.6	0.7	0.8

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

1/ The large net errors and omissions in 2008 and 2009 mainly reflect financial account data issues, as extreme volatility in exchange rates and market prices during that period made it difficult to separate out valuation effects from financial account transaction.

2/ IIP balance sheet positions arise from transactions and valuation changes. The large net errors and omissions in 2008-09 do not lead to large under-estimation of net foreign liabilities.

Table 5. New Zealand: Medium-Term Scenario, 2009–17

	Average				Projections					
	1998-2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real growth (percent change)										
GDP (production basis)	2.9	-2.1	1.2	1.4	2.3	3.2	2.9	2.6	2.4	2.3
GDP (expenditure basis)	2.9	0.0	2.1	1.5	2.2	3.2	2.9	2.6	2.4	2.3
Final domestic demand	3.6	-3.9	2.8	2.3	3.4	5.0	3.5	2.7	2.5	2.4
Consumption	3.3	-0.5	2.6	2.3	2.3	2.2	2.1	2.1	2.2	2.2
Private consumption	3.3	-0.9	2.3	2.5	2.5	2.4	2.4	2.4	2.4	2.4
Government consumption	3.4	0.5	3.4	1.8	1.7	1.5	1.4	1.3	1.3	1.3
Fixed investment	4.7	-14.1	3.7	2.4	6.9	14.4	7.7	4.4	3.3	3.2
Changes in inventories 1/	0.1	-2.3	1.7	0.5	-0.4	-0.3	-0.1	0.0	0.0	0.0
Exports of goods and services	3.5	2.2	2.7	2.5	1.8	2.7	2.7	2.9	2.1	2.1
Imports of goods and services	5.8	-14.9	10.0	6.1	3.9	7.2	4.3	3.1	2.4	2.4
Net exports (contribution to growth)	-0.7	6.4	-2.4	-1.3	-0.9	-1.8	-0.8	-0.3	-0.3	-0.3
Saving and investment (percent of GDP)										
Gross capital formation	22.6	18.9	19.7	19.5	21.4	22.3	22.9	23.2	23.3	23.5
Fixed investment	21.8	19.9	19.3	18.9	19.4	21.7	22.7	23.2	23.3	23.5
Fixed investment excluding earthquakes	...	...	19.3	18.8	18.8	20.5	21.1	21.3	21.6	21.8
Changes in inventories	0.9	-0.9	0.4	0.6	2.0	0.6	0.1	0.0	0.0	0.0
National saving 2/	17.2	16.3	16.2	15.3	15.9	15.9	16.1	16.0	16.1	16.3
Private	11.5	14.5	15.5	16.2	15.2	15.0	14.2	13.4	13.0	13.0
Public	5.7	1.8	0.6	-0.9	0.7	0.9	2.0	2.7	3.1	3.3
Inflation and unemployment (percent)										
Headline CPI inflation (period average)	2.3	2.1	2.3	4.0	2.1	2.4	2.4	2.3	2.1	2.0
Headline CPI inflation (end of period)	2.4	2.0	4.0	1.8	2.6	2.5	2.4	2.2	2.0	2.0
Unemployment rate	5.1	6.1	6.5	6.5	6.0	5.4	4.8	4.6	4.5	4.5
Output gap (staff estimate)	0.7	-3.2	-2.6	-1.8	-1.5	-0.3	0.0	0.0	0.0	0.0
Government budget (percent of GDP) 3/										
Revenue	32.5	36.9	34.7	36.0	32.7	32.9	33.0	33.5	33.7	33.7
Expenditure	30.5	37.1	37.6	43.4	37.6	35.5	33.8	33.5	33.2	33.2
Net operating balance	2.8	0.2	-1.8	-6.9	-3.8	-1.7	-0.2	0.6	1.2	1.2
Net lending (+)/borrowing (–)	...	-0.2	-2.8	-7.4	-4.9	-2.6	-0.8	0.0	0.5	0.5
Operating balance before gains and losses (total Crown)	2.6	-2.1	-3.3	-9.2	-5.4	-1.9	-0.3	0.3	1.1	1.7
Residual cash balance (core Crown)	0.9	-4.7	-4.8	-6.7	-6.1	-3.8	-1.5	-1.4	-0.4	-0.2
Gross soveign-issued debt 4/	26.9	23.4	28.4	36.2	37.4	35.1	36.0	33.8	33.1	32.2
Net core Crown debt excluding NZS Fund and advances	17.1	9.2	14.1	20.0	25.7	27.9	27.6	27.9	26.7	25.7
Terms of trade (2002=100, goods and services)	105.9	110.4	120.4	125.2	122.2	124.6	126.3	126.6	127.2	128.3
Terms of trade (2002=100, goods)	105.5	111.0	122.4	128.0	122.9	124.9	126.1	126.1	126.2	126.9
Terms of trade (percent change, goods)	2.3	-10.1	10.3	4.6	-4.0	1.6	0.9	0.0	0.0	0.5
Export prices	3.9	-12.6	6.6	7.5	-4.8	2.1	1.4	2.0	0.7	1.0
Import prices	1.5	-2.8	-3.4	2.8	-0.9	0.6	0.4	1.9	0.6	0.5
Balance of payments (percent of GDP)										
Current account balance	-5.7	-2.6	-3.4	-4.1	-5.4	-6.3	-6.7	-7.0	-7.1	-7.1
Balance on goods and services	-0.1	1.4	1.5	1.2	-0.3	-0.9	-1.0	-1.0	-0.9	-0.8
Balance on goods	-0.3	1.3	1.8	1.7	0.2	-0.5	-0.8	-0.9	-1.0	-1.0
Balance on services	0.2	0.1	-0.2	-0.5	-0.5	-0.4	-0.2	-0.1	0.1	0.2
Balance on income and transfers	-5.7	-3.5	-4.9	-5.4	-5.1	-5.4	-5.7	-6.0	-6.1	-6.3
Balance on income	-6.0	-3.7	-4.9	-5.2	-4.9	-5.2	-5.5	-5.9	-6.0	-6.1
Balance on transfers	0.3	0.2	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Net foreign liabilities (percent of GDP) 5/	75.4	81.8	75.1	71.9	72.5	74.9	78.1	81.3	84.8	88.0
Gross external debt (percent of GDP) 5/	110.7	130.4	128.7	125.8	126.3	128.2	130.8	133.3	136.1	138.6
Nominal GDP (in billions of New Zealand dollars)	141.9	185.5	195.1	204.5	218.5	230.4	240.8	252.6	263.5	275.4
Partners' GDP growth	4.0	-0.1	4.8	3.2	3.2	3.7	3.9	4.1	4.0	4.0
Partners' import volume growth (goods and services)	7.6	-9.1	14.1	7.3	5.6	5.9	6.2	6.4	6.5	6.5

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

1/ Contribution in percent of GDP.

2/ Converted from March year basis for historical data. Public saving covers general government.

3/ Fiscal years ending June 30.

4/ Excluding Reserve Bank Settlement cash.

5/ Data for end-December.

Table 6. New Zealand: Indicators of External and Financial Vulnerability, 2006–11
(In percent of GDP, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011
External indicators						
Real exports of goods and services (percent change)	1.7	4.0	-1.3	2.2	2.7	2.5
Real imports of goods and services (percent change)	-2.5	8.9	3.0	-14.9	10.0	6.1
Terms of trade (goods; percent change)	0.0	6.0	7.4	-10.1	10.3	4.6
Current account balance	-8.3	-8.2	-8.8	-2.6	-3.4	-4.1
Capital and financial account balance	7.6	5.9	4.4	0.6	2.9	4.3
Of which:						
Net portfolio investment	-0.5	6.9	-4.0	1.1	1.7	1.5
Net direct investment	5.0	-0.4	3.1	0.2	0.0	0.3
Total reserves (in billions of New Zealand dollars)	19.9	22.3	19.1	21.6	21.7	22.1
In months of imports of goods and services	8.2	8.2	8.4	9.4	9.1	9.5
Net foreign liabilities	77.6	75.1	82.7	81.8	75.1	71.9
Net foreign equity liabilities	4.3	0.8	-0.2	0.2	-2.4	0.6
Net foreign debt liabilities	73.4	74.3	82.9	81.6	77.5	71.2
Of which:						
Net external public sector debt	-5.5	-5.7	-4.6	-4.1	-2.0	1.7
Net external private sector debt	78.9	79.9	87.7	85.7	79.5	69.5
Investment income balance to exports (in percent)	-24.6	-26.4	-24.6	-12.7	-16.8	-17.3
Nominal effective exchange rate (percent change)	-8.2	6.6	-6.8	-7.5	9.3	3.1
Financial market indicators						
General government gross debt	8.7	9.4	9.7	12.1	16.2	20.5
Interest rates (percent end-year)						
3-month T-bill	7.5	8.3	8.0	3.0	3.0	2.8
3-month T-bill, real	4.0	5.8	3.9	0.9	0.7	-1.2
3-month interest rate spread vis-à-vis U.S.	2.7	3.8	6.6	3.0	3.0	2.8
Stock market index (percent change, end-year)	20.3	-0.3	-32.8	6.6	9.7	6.2
Capital adequacy (in percent)						
Regulatory capital to risk-weighted assets 1/	10.9	10.7	10.5	11.4	12.6	13.2
Tier I capital to risk-weighted assets 2/	8.1	7.6	8.5	9.5	9.8	9.8
Asset quality (in percent)						
Nonperforming loans to total loans	0.2	0.3	0.9	1.7	2.1	1.8
Provisions to nonperforming loans 2/	155.7	187.9	111.5	56.2	58.8	56.7
Asset composition (share of total)						
Agricultural	12.7	13.0	14.6	15.6	15.7	15.5
Business	26.1	26.2	27.0	24.7	24.0	24.1
Households	61.2	60.8	58.4	59.7	60.4	60.4
Of which: Housing	56.3	56.3	54.2	55.7	56.3	56.6

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

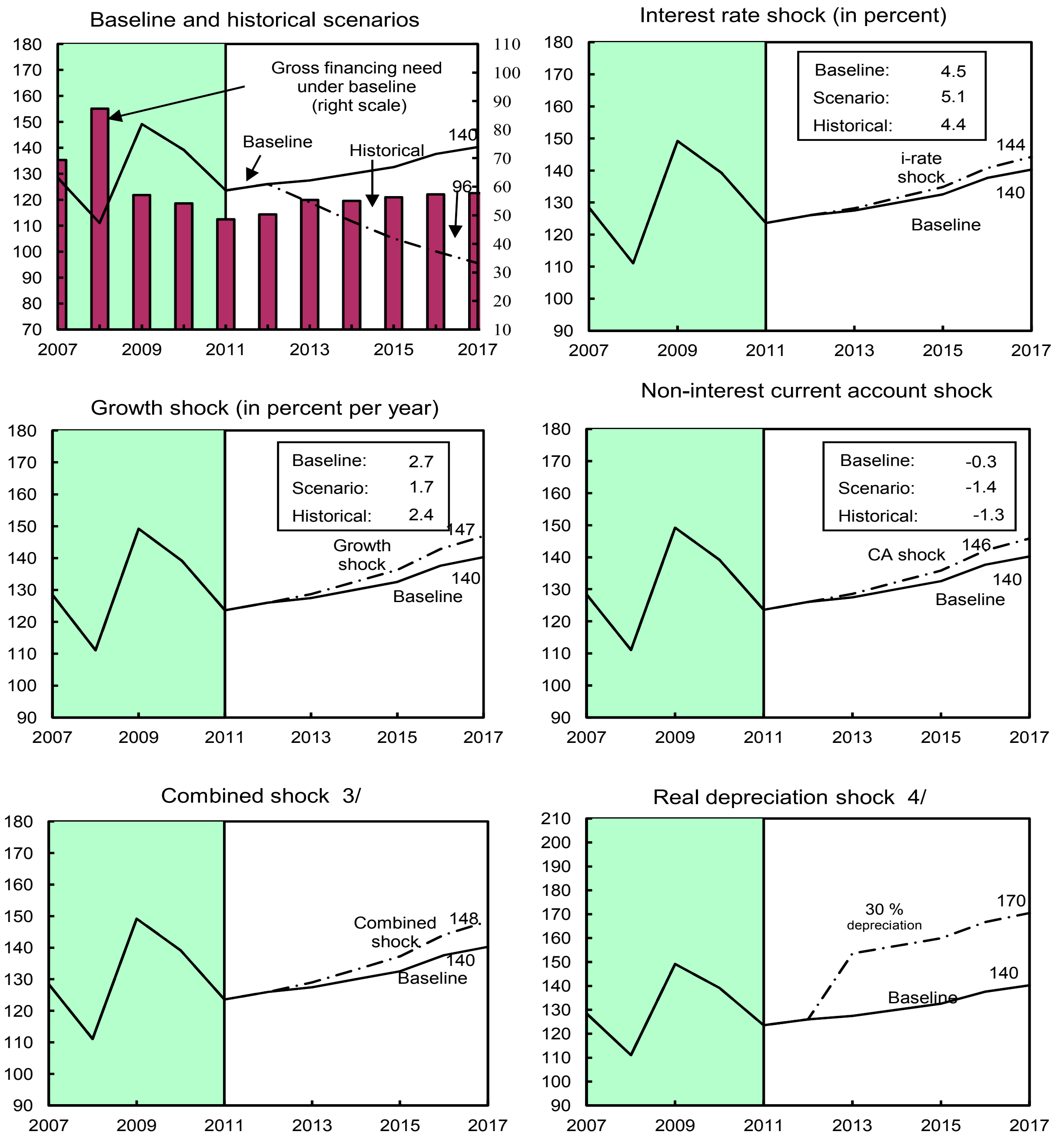
1/ Data for 2011 are for end-September.

2/ Data for 2011 are for end-June.

Appendix 1. New Zealand: Main Recommendations of the 2011 Article IV Consultation

Fund Recommendations	Policy Actions
Fiscal policy: Staff advised returning to fiscal surpluses by 2014/15 or earlier if possible and encouraged the government to take concrete measures to control spending. Fiscal consolidation would create a buffer against future shocks. It would also relieve pressure on monetary policy and thereby the exchange rate, helping rebalance the economy and contain the current account deficit over the medium term.	The 2011/12 budget plans to return to budget surplus by 2014/15, which is a core commitment of the government. The fiscal deficit reduction plan focuses on controlling spending, including transfers to middle-income households. The authorities also plan to sell a stake in state-owned enterprises to fund capital spending.
Monetary policy: Staff supported the early 2011 cut in the policy interest rate in response to earthquakes but suggested that the RBNZ will need to tighten monetary policy once it becomes clear that the recovery is under way.	The RBNZ kept its policy rate unchanged at 2.5 percent since early 2011 given increased uncertainty over the global outlook, soft domestic demand, and benign inflationary expectations.
Financial sector policy: Staff recommended that future stress tests include funding risks and that the core funding ratio be increased more than planned over time to reduce short-term debt further. Staff also suggested considering the merits of raising bank capital gradually to levels well above the Basel III requirements.	The RBNZ plans to implement the Basel III capital requirements from January 2013, ahead of the Basel III timetable. The upcoming review of the Australian financial sector (FSAP), which will also cover New Zealand banking subsidiaries, is expected to include funding risks as part of its stress tests. The RBNZ delayed the planned increase in the core funding ratio for banks by six months due to current global financial market turbulence.
Staff supported the RBNZ's continued work on the costs and benefits of macroprudential measures.	The RBNZ is examining the potential for various macroprudential measures to limit a build-up of systemic risk during periods of rapid credit growth.

Appendix 2. 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 2013.

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 21, 2012

Prepared By

The Asia and Pacific Department
(In Consultation with Other Departments)

CONTENTS

ANNEX I. FUND RELATIONS

(As of March 31, 2012)

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

II. General Resources Account:	SDR Million	Percent Quota
Quota	894.60	100.00
Fund Holdings of Currency	612.65	68.48
Reserve position in Fund	281.97	31.52
Lending to the Fund		
New Arrangements to Borrow	48.10	

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	853.76	100.00
Holdings	822.36	96.32

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 2011 Article IV consultation discussions were held during March 11–22, 2011; the Executive Board discussed the staff report (IMF Country Report No. 11/102) and concluded the consultation on May 9, 2011.

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

ANNEX II. STATISTICAL ISSUES

Data provision is adequate for surveillance. The authorities are continuing to enhance data quality and expand the range of data available, including a project led by the Reserve Bank of New Zealand to publish data consistent with the *Monetary and Financial Statistics Manual 2000 (MFSM 2000).* Given New Zealand's high level of external indebtedness, the publication of up to date institutional sector and flow of funds accounts would be an important addition to the current suite of statistics. It is recommended that the authorities subscribe to the IMF's Special Data Dissemination Standard.

Table of Common Indicators Required for Surveillance

(As of May 9, 2012)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	5/9/12	5/9/12	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	3/12	4/17/12	M	M	M
Reserve/Base Money	3/12	4/30/12	M	M	M
Broad Money	3/12	4/30/12	M	M	M
Central Bank Balance Sheet	3/12	4/30/12	M	M	M
Consolidated Balance Sheet of the Banking System	3/12	4/30/12	M	M	M
Interest Rates[2]	5/9/12	5/9/12	D	D	D
Consumer Price Index	Q1 2012	4/19/12	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2010/11	10/11/11	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	3/12	5/8/12	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	3/12	5/8/12	M	M	M
External Current Account Balance	Q4 2011	3/21/12	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2011	3/21/12	Q	Q	Q
GDP/GNP	Q4 2011	3/22/12	Q	Q	Q
Gross External Debt	Q4 2011	3/21/12	Q	Q	Q
International Investment Position[6]	Q4 2011	3/21/12	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] The general government consists of the central government (including budgetary, extra budgetary, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

NEW ZEALAND

June 1, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Approved By **Hoe Ee Khor and Tamim Bayoumi**

Staff wish to highlight some developments supplementary to the Staff Report issued to the Board last week.

- **Exchange rate.** Since end-April the New Zealand dollar has weakened on a trade weighted basis by about 5 percent. Contributing factors include an increase in global financial uncertainty and a corresponding waning in risk appetite, and the recent decline in New Zealand commodity prices and domestic interest rates.

- **Budget.** The 2012 Budget released on May 24 was broadly in line with the fiscal discussion in the staff report, with a return to budget surplus by 2015. The Prime Minister underscored the government's commitment to these targets, but signaled a willingness to push back the path of deficit reduction if the European financial crisis proves worse than anticipated.

- **Revisions to GDP.** The national statistical office recently released a revision to the GDP data, with historical GDP readings being updated and revised to incorporate new industry standard classifications. After the revision, growth for calendar 2011 came to 1.1 percent, down from a previously published figure of 1.4 percent.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 12/55
FOR IMMEDIATE RELEASE
June 7, 2012

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

IMF Executive Board Concludes 2012 Article IV Consultation with New Zealand

On June 6, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with New Zealand and considered, and endorsed, the staff appraisal without a meeting on a lapse-of-time basis.[2]

Background

The New Zealand economy continues to grow at a modest pace. Output grew by 1 percent in 2011, as elevated export commodity prices and favorable agricultural conditions helped offset the adverse impact of large earthquakes in Canterbury in late 2010 and early 2011. Continued aftershocks have delayed earthquake-related reconstruction. Domestic demand has remained soft as households and businesses continue to deleverage amid a weak housing market and an uncertain outlook. Elevated rates of unemployment, currently above 6 percent, and spare capacity have helped contain inflation.

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[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.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

The Reserve Bank of New Zealand (RBNZ) lowered the policy rate in March 2011 by 50 basis points to cushion the impact of the February earthquake. Since then, it has kept the policy rate on hold given the deterioration in the global economic position, subdued domestic activity, and the expected impact on future domestic activity of the strong exchange rate.

The nominal effective exchange rate has appreciated by around 30 percent since its trough in early 2009. The appreciation reflects the effects of higher export prices, positive interest rate differentials, and, although currently volatile, some increase in global risk appetite since end-2011.

Reflecting the slow recovery, past revenue and spending decisions, and accrued earthquake-related spending, the fiscal deficit in 2010/11 reached a record high of 9¼ percent of GDP on an accrual basis. Net government debt increased to 20 percent of GDP by mid-2011 from a low of 5½ percent in 2008.

The current account deficit in 2011 remained low at 4 percent of GDP, well below the 8 percent level in 2005-08, reflecting terms of trade gains, weak domestic demand, and low world interest rates. Net external liabilities have declined, but remain high at 72 percent of GDP at end-2011.

The banking sector remains sound. Bank profits are strong and nonperforming loans have fallen to less than 2 percent of total loans. Capital adequacy has improved since 2007, with the Tier 1 capital ratio reaching 10 percent in September 2011. Banks have made steady progress in lengthening the maturity profile of their wholesale funding since 2008 and increasing the share of retail deposits, but the total stock of banks' gross external liabilities remains above 70 percent of GDP and loan-to-deposit ratios remain high.

The pace of New Zealand's economic recovery is likely to remain modest. Output growth should pick up somewhat to 2⅓ percent in 2012 as earthquake reconstruction spending gains pace, although the size and timing of this spending is still uncertain. Growth is projected to rise to 3¼ percent in 2013, led by reconstruction. The key risks to the outlook are largely on the external front and on the downside, related to emerging weaknesses in the global economy and a possible upheaval in the global financial system.

Executive Board Assessment

In concluding the 2012 Article IV consultation with New Zealand, Executive Directors endorsed staff's appraisal as follows:

Outlook and risks. The pace of New Zealand's economic recovery is likely to remain modest. Output growth should pick up somewhat in 2012 as earthquake reconstruction spending is expected to gain pace, but the size and timing of this spending is still uncertain. High household debt is likely to weigh on the growth of private consumption as households will need to save to strengthen their balance sheets. The spare capacity and elevated unemployment will contain wage and inflation pressures in the near term. The risks to this outlook are on the downside and largely external, stemming mainly from emerging weaknesses in the global economy and a possible upheaval in the global financial system. The flexible exchange rate would provide an important buffer against shocks.

Monetary policy. The current accommodative monetary stance is appropriate. If the recovery remains on track and downside risks dissipate, monetary policy will need to tighten gradually to contain inflationary pressures. However, if the global recovery stalls or international capital markets are disrupted, the RBNZ has scope to cut the policy rate and provide liquidity support for banks.

Fiscal policy. The planned deficit reduction path strikes a balance between the need to contain both public and external debt increases while limiting any adverse impact on economic growth during the recovery. The authorities' plan to return to budget surplus by 2014/15 should put New Zealand in a better position to deal with future shocks and the long-term costs of aging. Moreover, it will relieve pressure on monetary policy and thereby the exchange rate, helping contain the current account deficit over the medium term. New Zealand's relatively modest public debt gives the authorities some scope to delay their planned deficit reduction path in the event of a sharp deterioration in the economic outlook.

External vulnerabilities and the exchange rate. New Zealand's large net liabilities present a risk. Despite recent improvements, the current account deficit is projected to increase over the medium term as earthquake reconstruction activity gains pace and global interest rates normalize. To contain this increase and limit a further buildup of foreign liabilities over the longer term, the New Zealand dollar would need to be weaker than its current level. However, part of its current strength may dissipate over time with the eventual tightening of policy rates by major central banks. Increasing national saving, including through the planned fiscal deficit reduction, would reduce external vulnerability.

Financial sector issues. Banks remain sound, but they are exposed to highly leveraged households and farmers and rollover risks associated with large short-term offshore funding needs. While New Zealand's bank regulatory norms are more conservative than in many other countries, the authorities should assess on an ongoing basis the balance between banking sector vulnerability versus efficiency to minimize the risk that systemically important banks pose to the economy. Options to strengthen prudential norms if needed could include setting banks' capital requirements above the Basel III minimum or raising the core funding ratio more than the planned 75 percent to reduce short term external debt further. The RBNZ's continued work on the costs and benefits of macroprudential measures is welcome, as is the authorities' intention to implement key features of Basel III in early 2013.

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 2012 Article IV Consultation with New Zealand is also available.

New Zealand: Selected Economic and Financial Indicators, 2008–13

Nominal GDP (2011): US$161.9 billion — GDP per capita (2011): US$38,227

Population (2011): 4.4 million — Quota: SDR 894.6 million

	2008	2009	2010	2011	2012 Proj.	2013 Proj.
Real growth (percent change) 1/						
GDP (production basis)	-0.2	-2.0	1.5	1.1	2.3	3.2
Final domestic demand	-0.1	-4.2	2.0	1.4	3.4	5.0
Private consumption	0.0	-1.5	2.3	1.1	2.5	2.4
Government consumption	5.4	0.9	0.5	0.2	1.7	1.5
Fixed investment	-3.8	-14.5	2.5	3.2	6.9	14.4
Inventories 2/	0.9	-3.1	2.6	0.2	-0.4	-0.3
Exports of goods and services	-1.3	2.1	3.3	1.1	1.8	2.7
Imports of goods and services	2.8	-14.8	10.5	6.4	3.9	7.2
Output gap	-0.3	-3.2	-2.6	-1.8	-1.5	-0.3
Headline CPI inflation (percent change)	4.0	2.1	2.3	4.0	2.1	2.4
End of period (percent change)	3.4	2.0	4.0	1.8	2.6	2.5
Unemployment rate (period average, in percent)	4.2	6.1	6.5	6.5	6.0	5.4
Investment and saving (in percent of GDP)						
Investment	23.0	18.9	19.7	19.5	21.4	22.3
National saving 3/	15.2	16.3	16.2	15.3	15.9	15.9
Public finance (in percent of GDP) 4/						
Revenue	37.5	36.9	34.7	36.0	32.7	32.9
Expenditure	34.3	37.1	37.6	43.4	37.6	35.5
Net operating balance	3.8	0.2	-1.8	-6.9	-3.8	-1.7
Net lending (+)/borrowing (–)	3.2	-0.2	-2.8	-7.4	-4.9	-2.6
Operating balance before gains and losses (total Crown)	3.1	-2.1	-3.3	-9.2	-5.4	-1.9
Net core Crown debt excluding NZS Fund and advances	5.6	9.2	14.1	20.0	25.7	27.9
Money and credit (end of period)						
Resident M3 (percent change) 5/	9.1	1.9	3.9	6.7	6.5	...
Private domestic credit (percent change) 5/	8.3	1.7	0.5	1.6	1.9	...
Interest rates (period average)						
Interest rate (90-day, in percent) 5/	8.0	3.0	3.0	2.7	2.8	...
Government bond yield (10-year, in percent) 5/	6.1	5.5	5.6	4.6	4.2	...
Balance of payments (in percent of GDP)						
Current account	-8.8	-2.6	-3.4	-4.1	-5.4	-6.3
(In billions of New Zealand dollars)	-16.3	-4.7	-6.7	-8.3	-11.8	-14.5
Trade balance (goods)	-1.3	1.3	1.8	1.7	0.2	-0.5
Terms of trade (percent change)	7.4	-10.1	10.3	4.6	-4.0	1.6
Foreign assets and liabilities ($NZ billion)						
Net international investment position	-152.6	-151.8	-146.5	-147.0	-158.5	-172.6
(In percent of GDP)	-82.7	-81.8	-75.1	-71.9	-72.5	-74.9
Official reserves 5/	19.1	21.6	21.7	22.1	23.1	...
Exchange rate (period average)						
U.S. dollar per New Zealand dollar 5/	0.71	0.64	0.72	0.79	0.82	...
Trade-weighted index (June 1979 = 100) 5/	65.7	63.5	66.7	69.3	72.5	...
Nominal effective exchange rate 5/ 6/	91.1	84.3	92.2	95.1	99.3	...
Real effective exchange rate 5/ 6/	92.0	86.7	94.9	98.8	102.0	...

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

1/ Data for GDP growth reflect the revisions to the historical GDP figures by Statistics New Zealand in May 2012 to incorporate the new industry classification.

2/ Contribution in percent of GDP.

3/ Based on national accounts data.

4/ Fiscal years ending June 30.

5/ Data for 2012 are for March.

6/ IMF Information Notice System index (2000 = 100).