

New Zealand: 2006 Article IV Consultation—Staff Report; Public Information Notice; and Statement by the Executive Director for New Zealand on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 14, 2006, with the officials of New Zealand on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 7, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its April 28, 2006 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for New Zealand.

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

Selected Issues Paper

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

NEW ZEALAND

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with New Zealand

Approved by Steven Dunaway and Scott Brown

April 7, 2006

- **The 2006 Article IV Consultation with New Zealand has a streamlined focus on current and medium-term macroeconomic policies.** Longer-term growth and structural policy issues were discussed extensively in the 2005 Article IV Consultation, and New Zealand's first official long-term fiscal report will be released in mid-2006, making next year's Article IV Consultation a suitable opportunity for broader policy discussions.
- **The discussions were held in Wellington between February 7-14, 2006.** The mission met with Minister of Finance Michael Cullen, Reserve Bank of New Zealand Governor Alan Bollard, Treasury Secretary John Whitehead, other senior government officials, and representatives of the private sector and trade unions. The staff team comprised Messrs. Gordon (Head), Beaumont, and Mercereau (all APD). Mr. Dunaway (APD) and Mr. Blazey (OED) also participated in the discussions.
- **Past recommendations and implementation:** In previous consultations, the Fund has praised the clear design and steadfast implementation of inflation targeting, a policy approach which New Zealand has pioneered. The Fund has also commended the medium-term orientation of fiscal policy, which has kept public debt on a low and declining path. With resources tightly stretched in recent years, the authorities have undertaken to manage planned spending increases so as not to exacerbate short-term pressures, an objective endorsed by the Fund. The Fund has also supported the authorities' efforts to provide adequate safeguards for financial stability in New Zealand in the event of a crisis; the recent agreement with Australia on enhanced home-host supervision represents significant progress in this regard. Other policy issues discussed in the 2005 Article IV Consultation are described in the latest Public Information Notice; see <http://www.imf.org/external/np/sec/pn/2005/pn0560.htm>.
- **Exchange system:** The New Zealand dollar floats independently, and New Zealand maintains an exchange system that is free of restrictions on payments and transfers for current international transactions (Annex I).
- **Statistics:** New Zealand publishes an array of high-quality statistics (Annex II). The authorities are addressing issues that have precluded subscription to the Special Data Dissemination Standard.
- **Official development assistance:** New Zealand's ODA is focused on the Pacific, and was 0.27 percent of Gross National Income in 2005, an increase from 0.23 percent in 2004.

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EXECUTIVE SUMMARY

New Zealand's economy expanded at a more sustainable pace in 2005 after a period of strong growth that led to rising inflation, but the external current account deficit widened sharply. Net exports were undermined by the appreciation of the New Zealand dollar, which reached record levels by late 2005, supported by exceptional capital inflows driven by the global "search for yield." At the same time, domestic demand slowed less than expected owing to surprising strength in the housing market.

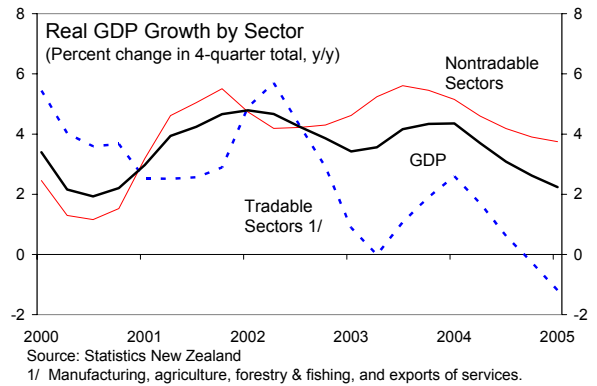
The prospects are for a soft landing, although downside risks remain. Domestic demand has begun to slow, hence growth is expected to be sluggish in 2006, and underlying inflation is likely to begin to decline as pressures on resources ease. The exchange rate has depreciated significantly recently, and may continue to weaken, so rising exports are expected to underpin a pick up in growth. Domestic demand will likely recover more slowly, allowing the external deficit to narrow over time. Initial signs of a cooling of the housing market have appeared, but house price behavior remains a source of uncertainty.

Current macroeconomic policies are broadly suitable. With underlying inflation likely on a downward path, monetary policy tightening has paused for the time being, and there is substantial room for maneuver if the economy slows too abruptly. Fiscal policy will be somewhat expansionary in coming years, reflecting government plans to raise support for families and strengthen social services, and provides a further cushion against downside risks.

I. BACKGROUND

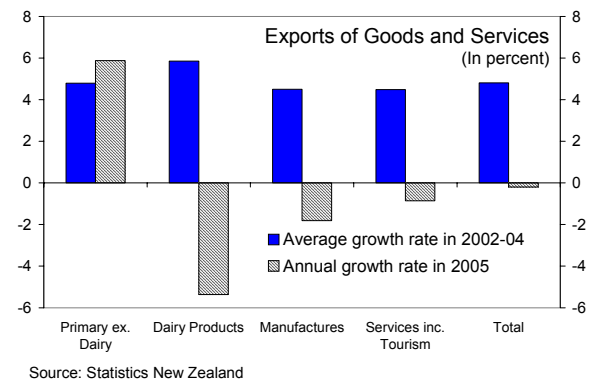
1. Growth slowed in 2005 after the vigorous expansion of recent years, but macroeconomic imbalances increased.

Large migration inflows, wealth effects from rising house prices, and income effects from high commodity prices, were the underlying factors behind real GDP growth averaging 4¼ percent in 2002-04, while unemployment fell to 3½ percent, one of the lowest rates in the OECD (Table 1). However, inflation rose as resources became increasingly stretched. A cyclical slowing commenced in 2005, with growth declining to 2¼ percent, but the slowdown was narrowly based in the tradable sector, and the external current account deficit rose to 9 percent of GDP, double its 20-year average (Table 2).



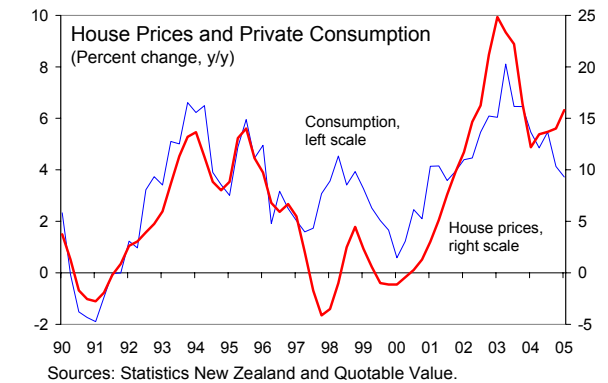
2. With the New Zealand dollar historically high, exports waned while imports surged.

The currency rose to a post–float high on a trade–weighted basis by December 2005, boosted by large capital flows associated with exceptional demand for New Zealand dollar denominated bonds from foreign retail investors in Japan and Europe—net offshore issues reached 15 percent of GDP in 2005 (Box 1). Total export volumes declined despite strong global activity, as the high exchange rate reduced manufactured exports and tourism, and dairy production fell owing to poor weather. Meanwhile, import growth remained rapid, led by capital goods.¹



3. In contrast, domestic demand remained strong for much of 2005, owing to unexpected strength in the housing market.

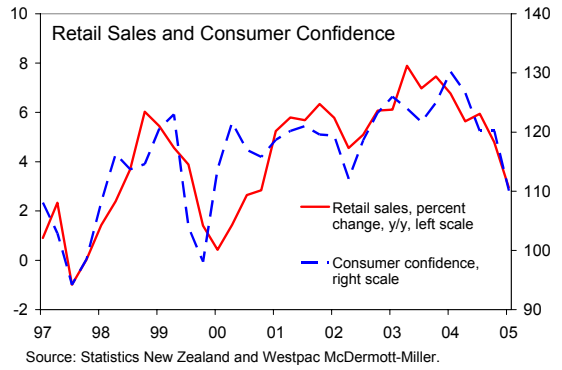
With migration inflows falling, the decline in house price inflation that began in 2004 was expected to continue, but house price inflation picked up to 15 percent y/y in 2005, supporting consumer spending. One factor facilitating the housing market revival was the continuation until late in 2005 of low “fixed-rate” mortgage interest rates despite rising official interest rates.²



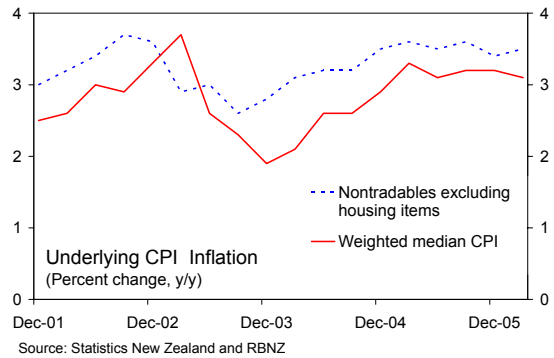
¹ Chapter I of the forthcoming Selected Issues paper finds that the high exchange rate has reinforced the effect of strong domestic demand on imports.

² Fixed-rate mortgages account for about four-fifths of total mortgages in New Zealand. They are similar to adjustable rate mortgages in the United States, with rates usually reset at 1 to 3 year intervals.

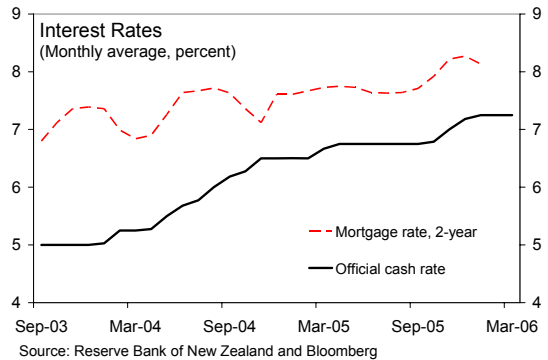
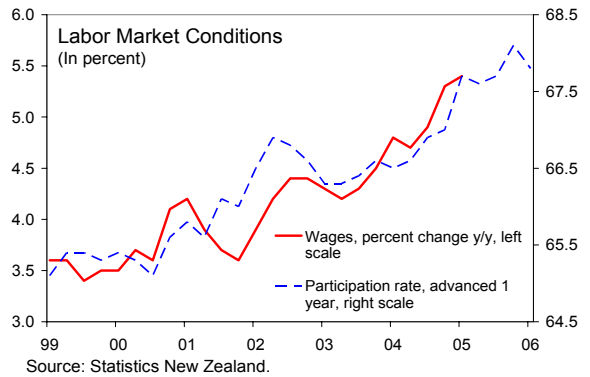
4. **Domestic demand has slowed more recently.** Consumer confidence fell to 5-year lows in late 2005, reflecting rising mortgage rates and high fuel prices. At the same time, the high exchange rate and increasing labor and energy costs reduced business confidence to 20-year lows. More recent indicators, including retail sales, employment growth, and imports, have increasingly confirmed that a significant slowing in domestic demand growth is underway.



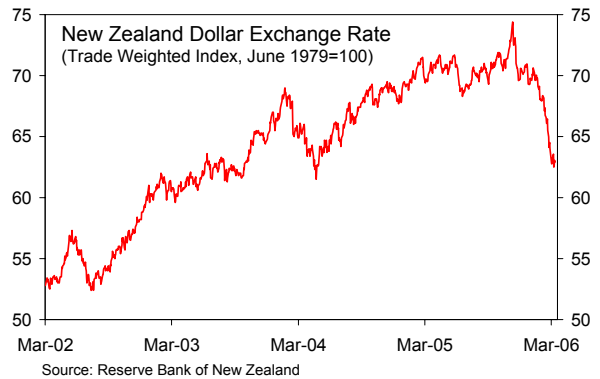
5. **While underlying inflation is no longer increasing, the labor market remains tight.** Headline CPI inflation rose to 3.3 percent y/y in March 2006, from 2.8 percent a year earlier, slightly exceeding the medium-term target range of 1 to 3 percent. However, almost half of this increase reflected the direct impact of higher oil prices, and most measures of underlying inflation leveled out during the past year. Moreover, resource pressures, as measured by capacity utilization and the difficulty of finding labor, have begun to ease as growth has slowed. Nonetheless, wages increased by 5½ percent y/y in 2005 compared to 4¾ percent in 2004 (measured by the unadjusted Labor Cost Index), suggesting that the labor market remains relatively tight. Inflation expectations have risen according to survey data, although expectations for two or more years remain within the target and short-run expectations have eased more recently.



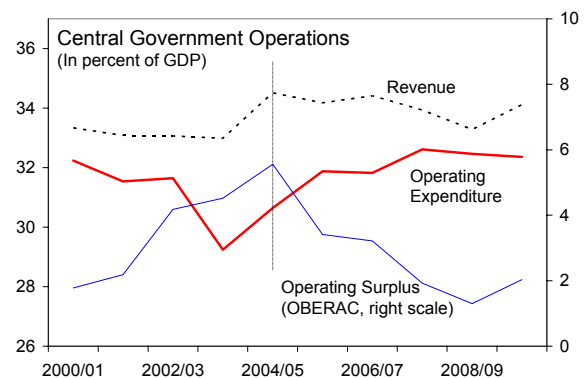
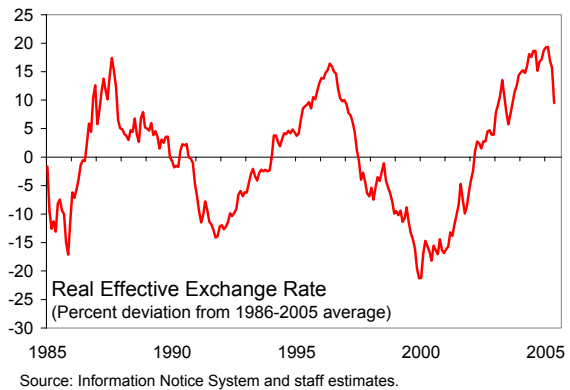
6. **Monetary policy is on hold after a further tightening in 2005.** The RBNZ raised the official cash rate (OCR) by 75 basis points in 2005 to 7¼ percent, with two hikes late in the year prompted by the persistent strength in household spending. Growth in household credit remained around 15 percent y/y, and household debt rose to 150 percent of disposable income, despite RBNZ statements aimed at raising awareness about the potential risks of residential property investments and high indebtedness.



7. **Exchange rate adjustment is finally underway.** When the trade-weighted exchange rate index (TWI) peaked in early December 2005, the RBNZ stated that the exchange rate was “exceptionally and unjustifiably high” signaling that one of the criteria for considering foreign exchange intervention had been met, although, to date, no intervention has occurred.³ By early-April, the TWI had retraced 16 percent from its peak, with most of this decline occurring since mid-February.⁴ Nonetheless, the REER still remains about 9 percent above its 20-year average.



8. **Fiscal surpluses remain large.** Strong revenues lifted the operating surplus (OBERAC excluding earnings of the New Zealand Superannuation Fund) to 5½ percent of GDP in 2004/05 (Table 3). The government’s December 2005 *Half Year Economic and Fiscal Update* (HYEFU) projects the 2005/06 operating surplus to fall to 4 percent of GDP (excluding write-downs of student loans), partly reflecting the expansion in support for low income families announced in 2004.⁵ In September 2005, the Labour party won its third term in government, with the support of minor parties. Though high surpluses made fiscal policy a key election issue, the spending allowance for 2006/07 was raised by just ¼ percent of GDP relative to earlier plans, with no increase for later years.⁶ The government



³ Under the policy adopted in March 2004, the other criteria required for the RBNZ to contemplate intervention are that it would be consistent with the objectives of monetary policy, and that an opportunity would exist for it to be effective.

⁴ The exchange rate began to decline once weak economic data was released that markets interpreted as indicating an end to the monetary tightening cycle. At the same time, concerns about the end of the global carry trade weakened sentiment toward a number of currencies, including the New Zealand dollar. In this environment, the issuance of New Zealand dollar-denominated Uridashi issues dried up in March, although this may also be associated with reduced demand by New Zealand banks for funds in line with the cooling economy.

⁵ The overall fiscal surplus on an SNA basis (net lending in Table 4) is projected at 3 percent of GDP in 2005/06, which is exceeded only by Norway and Singapore among the advanced economies.

⁶ The key measures adopted, effective April 2006, were an expansion in the number of working families qualifying for income support; making student loans interest free under certain conditions; and, for the

(continued)

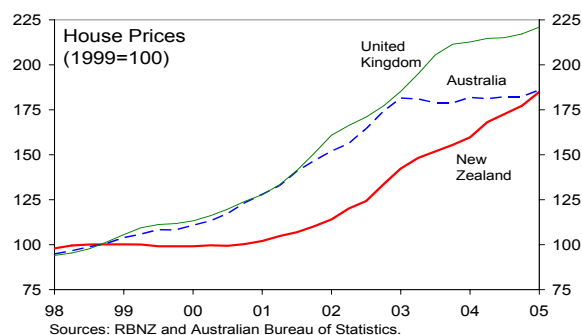
has also initiated a review of business taxation, which is due to report by mid-2006.

II. REPORT ON THE DISCUSSIONS

A. Economic Outlook and Risks

9. Sluggish growth is expected in 2006.

The recent slowing in domestic demand is expected to continue, reducing real GDP growth to about 1 percent in 2006 (Table 5). Rising mortgage interest rates will contribute to the downturn—an estimated 40 percent of fixed-rate mortgages are to be repriced in 2006, with an average expected interest rate increase of about 1 percentage point. Given the elevated level of house prices relative to household incomes and rents, the authorities expect house prices to flatten out in 2006, thereby slowing demand, as experienced in Australia and the United Kingdom in recent years. Lower housing market turnover in December to February suggests that a turning point in house prices may be near, although such predictions have in the past not always proved accurate.



10. **Growth is expected to strengthen once the economy rebalances.** Although inflation would remain near the top of the target range in 2006, the authorities expect it will decline as resource pressures further unwind, allowing an eventual easing in monetary policy. The authorities also expect the exchange rate to continue declining to more typical levels over the next few years, which is consistent with IMF staff estimates that by December 2005, the New Zealand dollar was 10–25 percent above medium-term equilibrium (based on a combination of the macroeconomic balance approach and a modified PPP framework). Net exports would accelerate as the tradable sector responds to the lower exchange rate, but domestic demand growth may remain modest, partly because real house prices could decline moderately for a number of years as in previous housing cycles. Staff project real GDP growth to rise to about 2 percent in 2007, and return to trend levels from 2008, while the external deficit would narrow substantially over the medium term.

11. **While the central outlook is for a soft landing, the authorities have given thought to less favorable scenarios.**⁷ For example, the HYEPU considered a situation of generalized weakness in demand and exports, that would reduce the growth projection by 1 percentage point in the year ended March 2007. Similarly, the RBNZ's December 2005 *Monetary Policy Statement* allowed for a sharper correction of imbalances, with domestic demand growth and the exchange rate falling more rapidly than in the baseline. Another possibility, although this seems

duration of the current parliament, an increase in pension benefits by 1 percentage point to 66 percent of average wages.

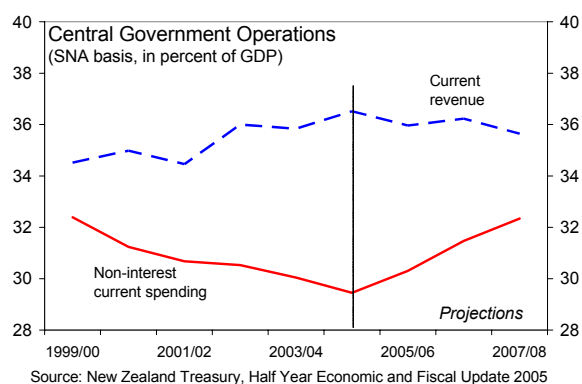
⁷ Chapter II of the forthcoming Selected Issues paper discusses the macroeconomic risks posed by external imbalances in advanced economies.

less likely now than at the time of the mission, is that the slowing in demand is deferred, in which case a hard landing could occur later. In such a scenario, continued momentum in the housing market would sustain strong demand in 2006, lifting inflation and resulting in additional monetary tightening, followed by an eventual sharper correction in house prices and domestic demand. The authorities also agreed that external shocks, such as further oil price increases or a fall in U.S. economic growth, could trigger a harder landing.⁸

12. **Risks of a harder landing remain, but are mitigated by the strength of balance sheets.** Domestic demand could still weaken more sharply in the near term, but strong labor income growth and fiscal stimulus cushion such downside risks. Moreover, the recent slowing in demand and depreciation of the exchange rate appear to have diminished the risks of a later hard landing. Although the housing market remains a source of some uncertainty, the authorities consider that the banking sector is robust to a scenario with more significant house price declines. In particular, the authorities have monitored developments in bank lending practices, noting some expansion in loans with high loan-to-value ratios, or lower documentation of debtor's income, but consider that banks continue to allocate and price these risks appropriately so that risks to bank capital have not increased substantively. Hence, the banking sector stress tests conducted by the 2004 FSAP, which found a high degree of financial soundness, continue to be germane. In addition, corporate and private sector balance sheets generally remain strong, although households have likely become more sensitive to interest rate pressures.⁹

B. Macroeconomic and Financial Sector Policies

13. **The government plans to raise spending significantly over the medium term as gross debt declines.** Non-interest current spending is projected to rise to 32½ percent of GDP in 2007/08, from 30 percent on average in the three years to 2004/05 (Table 4). This expansion is fully consistent with meeting the government's medium-term fiscal objectives; the HYEFU projects the operating balance to remain in surplus by 2 percent of GDP



⁸ The high degree of hedging of foreign exchange risks is a key factor reducing New Zealand's economic vulnerability, as seen in the robustness of the external debt position to shocks (see Figure 1). The New Zealand authorities have also made contingency plans in the case of an avian flu pandemic, including by actively working with financial institutions to promote adequate business continuity planning: see <http://www.moh.govt.nz/pandemicinfluenza> and <http://www.rbnz.govt.nz/crisismgmt/2176891.pdf>.

⁹ Chapter III of the forthcoming Selected Issues paper analyzes New Zealand's vulnerabilities from a sectoral balance sheet perspective and includes the standard Financial Soundness Indicators.

by 2007/08, gross debt to fall below 20 percent of GDP by 2009/10, and net worth to rise by 6 percentage points of GDP over the same period.¹⁰

14. The medium-term orientation of fiscal policy continues to serve New Zealand well.

The floating exchange rate regime provides New Zealand's small open economy with a crucial shock absorber against external events such as major swings in commodity prices, and has permitted monetary policy to act as the primary lever to lean against cyclical developments. By contrast, fiscal policy has provided support through the operation of automatic stabilizers, an approach that has enhanced the predictability and prudence of fiscal policy, contributing to macroeconomic stability. According to Treasury estimates, current fiscal plans imply an estimated fiscal stimulus of about ½ percent of GDP in 2006/07 and 1¼ percent of GDP in 2007/08. Assuming the slowdown proceeds as projected, staff judged these plans to be consistent with the authorities' goal of managing the fiscal position to avoid exacerbating pressures in the economy. Moreover, if the economy was to slow more rapidly, there is ample room for monetary policy maneuver.

15. Nonetheless, in certain circumstances, a degree of flexibility in fiscal policy might be useful.

Although the scenario now looks less likely, staff questioned whether there was scope for running a somewhat tighter fiscal policy should domestic demand continue to be strong and imbalances threaten to persist. In a situation with a continued high exchange rate, along with high house prices and household indebtedness, relying solely on monetary policy to respond to stronger demand could increase the risks of an eventual harder landing.¹¹ Staff therefore questioned whether there was any flexibility to defer part of the planned increase in spending should this be necessary. Although the 2006/07 budget was largely finalized, the authorities noted that they still had some scope to manage the NZ\$1.9 billion in new spending planned for 2007/08. However, the Finance Minister saw little prospect that such flexibility would be needed given the slowing economy.

16. Ensuring “value for money” and sustained growth benefits from the additional fiscal resources will be crucial.

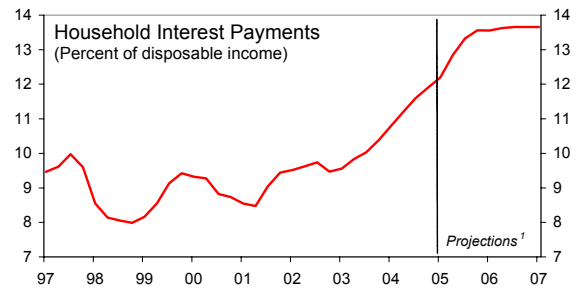
Staff welcomed the government's plans to review expenditure across departments and agencies at a time when relatively rapid growth in spending could undermine expenditure efficiency in the public sector. Moreover, the government's efforts to maintain wage discipline in the public sector were particularly important given the relatively tight labor market. Staff encouraged the government to focus the extra fiscal resources on strengthening the drivers of sustained economic growth, in order to boost medium-term economic prospects and enhance New Zealand's capacity to manage long-run fiscal challenges. In this respect, staff looked forward to the conclusions of the review of business taxation, which has the overarching aim to encourage investment and promote productivity. Tax competitiveness with Australia, along with incentives for tax planning created by the gap between the 33 percent

¹⁰ The key objective is to slowly reduce gross debt to below 20 percent of GDP before 2015, while making contributions to the NZ Superannuation Fund, which are currently 1½ percent of GDP per annum.

¹¹ Discretionary management of fiscal policy faces substantial practical difficulties, but may have a role in the context of a high exchange rate or asset prices, see Ramakrishnan and Zhang, “Macroeconomic Policy Coordination and Short-term Economic Stabilization,” IMF Country Report No. 04/127.

company tax rate and the top personal income tax rate of 39 percent, appeared to be possible issues for reform in an otherwise very sound tax system.¹²

17. **A period of stability in the stance of monetary policy is appropriate with the risks to underlying inflation now more balanced around a declining path.** In the March 2006 *Monetary Policy Statement*, the RBNZ noted that prospects for an economic slowdown and easing resource pressures had been further confirmed. Hence, it did not expect to raise the OCR again in this cycle, so long as inflation risks, in particular from the labor and housing markets, remain under control. Staff agree that decisions to further tighten policy would need to be carefully weighed, particularly given the monetary contraction already in the pipeline. The RBNZ also did not expect to be in a position to ease policy in 2006, because labor market and resource pressures would take some time to dissipate. Though an earlier easing was possible, this would require a more rapid reduction in domestic inflation pressures than currently projected.



Source: Reserve Bank of New Zealand and staff calculations.
¹ Based on mortgage rate projections from RBNZ *Monetary Policy Statement*, Mar. 2006, and assuming that household credit growth slows to 11 percent in 2006 and 7 percent in 2007, such that household debt rises to 160 percent of disposable income.

18. **The authorities have welcomed the recent depreciation of the exchange rate.** Staff endorsed the RBNZ's statements in late 2005 regarding the overly high level of the New Zealand dollar, but agreed that the extent to which these statements had contributed to the subsequent depreciation was unclear. Further currency declines may occur, and staff supported the RBNZ's position that it would look through the first-round inflation effects of a depreciation and not tighten monetary policy as long as inflation expectations remain anchored. Experience during the 20 percent depreciation in mid-1998 to end-1999 suggests that expectations would be well behaved in the context of a slowing economy.

19. **Banking sector policies have progressed and a new supervisory framework for non-bank financial institutions is being developed.** An important step forward was the agreement with Australia on the legislative foundations for enhanced home-host banking supervision arrangements.¹³ Plans to conduct joint Australia-New Zealand crisis preparedness exercises are one example of closer ongoing cooperation with the Australian Prudential Regulatory Authority. The authorities have also continued to address issues highlighted by the 2004 FSAP.¹⁴ In this context, the capacity to conduct stress tests, particularly in relation to households' capacity to service debt, is being strengthened. The RBNZ's November 2005

¹² For further details see the Inland Revenue Department's *Briefing for the Incoming Minister*: <http://www.taxpolicy.ird.govt.nz/publications/files/bim2005.pdf>.

¹³ The key elements of the legislative changes proposed by the Trans-Tasman Council on Banking Supervision are described at: <http://www.rbnz.govt.nz/finstab/banking/supervision/2420258.html>.

¹⁴ The RBNZ has finalized its policy on outsourcing and issues of local bank incorporation have been resolved. Lender of last resort and failure management policies have been further operationalized, and disclosure requirements have been expanded to cover the quality of large exposures.

Financial Stability Report points to the general soundness of the financial sector, but raises concerns about the robustness of some finance companies, especially those exposed to property development. Although the macro-economic risks are limited by the small scale of these companies, staff supported the authorities' decision to establish a new supervisory framework for non-bank financial institutions.

III. STAFF APPRAISAL

20. **New Zealand's economy has slowed after a period of strong growth, and while the current account deficit widened in 2005, the economy has started to rebalance.** Net exports were undermined by the historically high exchange rate in 2005, which was supported by large capital inflows associated with exceptional foreign demand for New Zealand dollar denominated bonds in a world of low international interest rates. Hence growth slowed to 2¼ percent even as domestic demand remained strong with a revival in the housing market, and the external current account deficit rose to 9 percent of GDP. At the same time, with resources tightly stretched and global oil prices increasing, inflation edged up to the top end of the 1–3 percent medium-term target range. More recently, domestic demand appears to have slowed and the exchange rate has depreciated significantly. While growth is expected to be sluggish in 2006, an export-led recovery is expected in 2007, with the current account deficit narrowing over the medium term.

21. **Budgetary plans cushion downside risks to the outlook.** The *Half Year Economic and Fiscal Update* projects the operating surplus to decline to 2 percent of GDP by 2007/08, from 4 percent of GDP in 2005/06. This decline is fully consistent with meeting the government's prudent medium-term fiscal objectives, and the associated fiscal stimulus should not exacerbate pressures in the economy given the expected pace of slowing in activity. In the case of a sharper-than-expected downturn, monetary policy provides the first line of defense within New Zealand's well-established macroeconomic framework, while fiscal policy should contribute through the full play of the automatic stabilizers.

22. **Monetary policy should continue to steer a steady course in the near term.** Underlying inflation is expected to decline as resource pressures ease, and given the lagged effects of previous tightening still to come, the current pause in monetary policy tightening is appropriate. However, with the labor market remaining tight, there is little room to cut rates in the near term. By contrast, there is ample room for maneuver if the economy slows more abruptly. The recent depreciation of the exchange rate is welcome, and with the slowing economy anchoring inflation expectations, monetary policy is well placed to "look through" a temporary rise in headline CPI inflation arising from a decline in the currency.

23. **Recent and prospective advances in the financial sector regulatory framework will further enhance financial and hence macroeconomic stability.** The financial sector is sound, but close monitoring of households' debt service capacity will need to continue given the rise in household indebtedness. The agreement with Australia regarding arrangements for enhanced home-host supervision is particularly welcome as close cooperation with bank supervisors across the Tasman will be essential, especially in the case of banks experiencing distress. A new regulatory framework for non-bank financial institutions will take time to establish, but will facilitate the further development of New Zealand's financial system and promote growth.

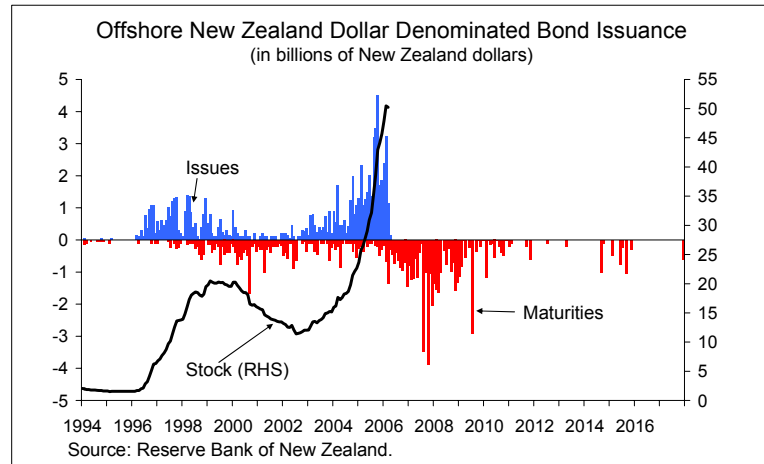
24. **It is proposed that the next Article IV consultation with New Zealand take place on the standard 12-month cycle.**

Box 1. Eurokiwi and Uridashi Bond Issues and New Zealand's External Financing¹

There has been a rapid expansion in offshore issues of New Zealand dollar (NZD) denominated Eurokiwi and Uridashi bonds over the last few years.

Widely recognized foreign entities with a high credit standing are the main issuers of these bonds, as they are able to profit by issuing NZD denominated bonds and then swapping the proceeds for foreign currency borrowed abroad by New Zealand banks. At a time when international interest rates have been low, retail investors in Europe or Japan looking for high yields have been the main buyers of these offshore NZD bonds, which are called “Eurokiwis” or “Uridashis” when issued in Japan.

These retail investors are buyers of NZD dollars when they purchase the bonds and sellers of NZD when the bonds mature. Thus the Eurokiwi and Uridashi markets provide support to the NZD during periods of positive net issuance.

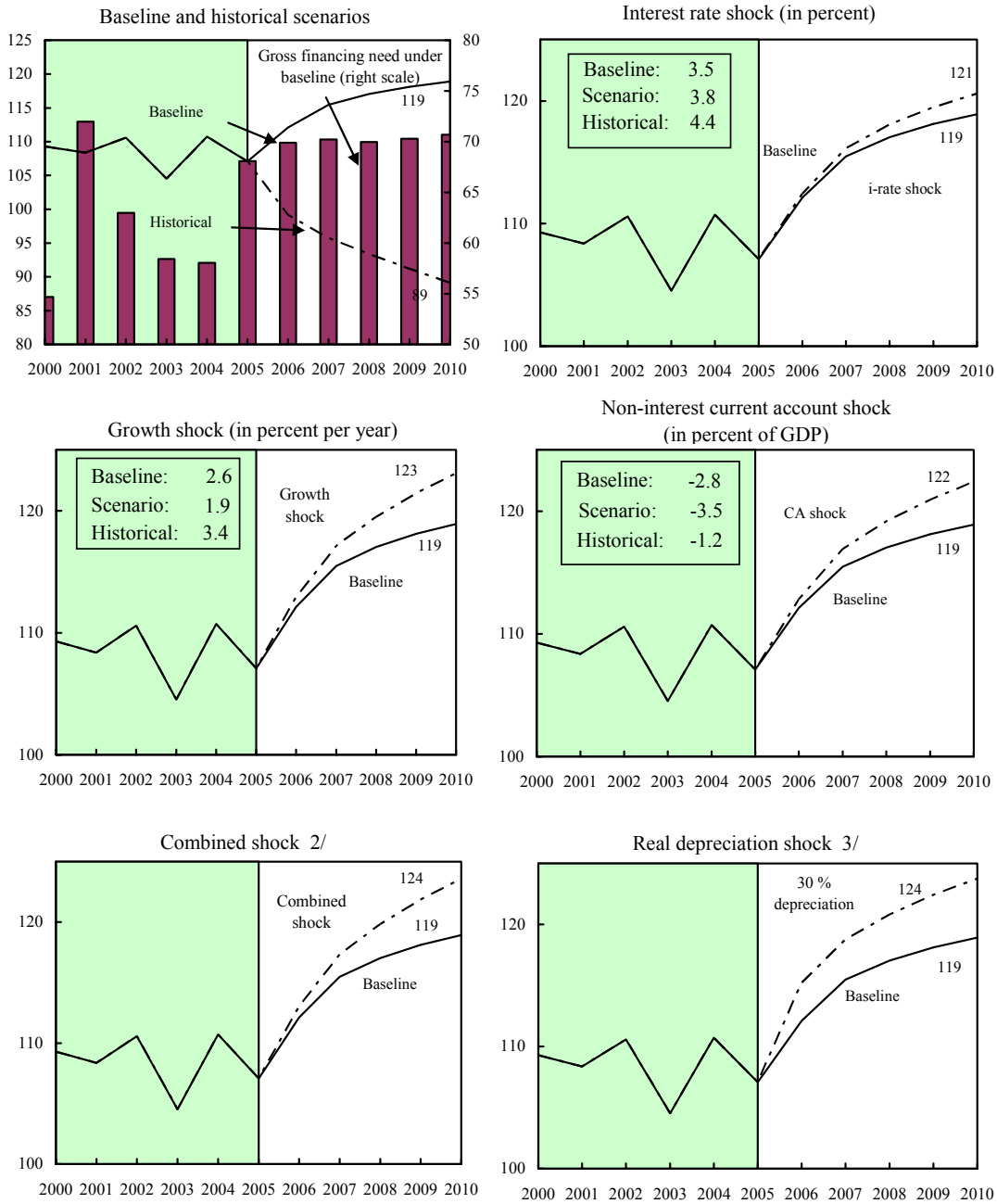


Debt instruments were a major source of external financing in 2004-05, led by New Zealand banks' funding of mortgage lending, typically by tapping international capital markets in U.S. dollars (USD). The highly liquid swap market in New Zealand dollars (NZD) enables banks to manage their exchange rate and interest rate risks. Most new mortgage loans have interest rates that are fixed, yet New Zealand banks tend to borrow at floating rates. To match liabilities and assets, the banks use cross-currency swaps, selling the USD funds they have raised for NZD, and at the same time, exchanging their USD floating rate debt for NZD debt with a fixed interest rate. The swap rate that banks pay on the NZD debt represents the marginal cost of New Zealand dollar funding for banks and is used to price fixed-rate mortgages.

The outstanding stock of NZD denominated Eurokiwi and Uridashi bonds is historically high and significant maturities are coming due. Net issues of offshore NZD denominated bonds were NZ\$23 billion in 2005, and the outstanding stock rose to NZ\$50.2 billion at end-February 2006, which is about one third as large as the foreign debt owed by New Zealanders. Maturities on these bonds are estimated at NZ\$9 billion in 2006 and NZ\$17 billion in 2007. In the past, a build up in maturities has unwound in orderly fashion with net offshore issuance of NZD denominated bonds declining in tandem with easing credit demand in New Zealand; however, maturity volumes are notably larger in this cycle.

¹ Further discussion is provided in David Drage, Anella Munro and Cath Sleeman, “An update on Eurokiwi and Uridashi bonds,” *Reserve Bank of New Zealand Bulletin*, 2005, Vol. 68 No. 3.

Figure 1. New Zealand: External Debt Sustainability: Bound Tests 1/
(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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ This scenario assumes foreign exchange hedging covers 87 percent of foreign currency debt, consistent with the findings of hedging surveys conducted by Statistics New Zealand.

Table 1. New Zealand: Selected Economic and Financial Indicators, 2001–06

Nominal GDP (2004): US\$ 96.8 billion
 Population (2004): 4.06 million
 GDP per capita (2004): US\$ 23,826
 Quota: SDR 894.6 million

	2001	2002	2003	2004	2005	2006 Proj.
Real growth (percent change)						
GDP (production basis)	3.0	4.8	3.4	4.4	2.2	0.9
Domestic demand	1.9	5.4	5.7	8.3	4.6	0.5
Private consumption	2.5	4.0	5.5	6.6	4.5	1.1
Govt. consumption	4.3	2.5	1.9	5.7	5.3	5.6
Fixed investment	-1.5	10.4	10.5	12.8	5.3	-1.1
o/w Residential	-9.6	19.2	20.0	5.1	-4.4	-7.0
o/w Business	-3.6	3.2	12.5	12.2	7.0	-2.8
Exports of goods and services	3.5	6.3	2.7	5.5	-0.2	2.3
Imports of goods and services	2.0	9.6	8.3	16.7	6.5	0.4
Headline CPI inflation (percent change)						
End of period (percent change)	1.8	2.7	1.6	2.7	3.2	2.9
Unemployment rate (in percent)						
	5.3	5.2	4.7	3.9	3.7	4.1
Investment and saving (in percent of GDP)						
Investment	21.2	22.5	23.0	24.6	24.7	23.6
National saving 1/	18.4	18.4	18.6	18.0	15.8	14.8
Public finance (in percent of GDP) 2/						
Revenue	33.3	31.7	33.9	33.4	34.5	34.2
Expenditure	32.2	30.2	32.4	29.6	30.6	31.9
Operating balance 3/	1.2	1.9	1.5	5.3	4.6	3.7
OBERAC 4/	1.8	2.2	4.3	4.6	5.6	3.4
Net public debt	16.9	14.1	13.7	10.2	7.1	6.7
Money and credit (end of period)						
Resident M3 (percent change)	7.0	11.5	9.5	3.4	9.3	...
Private domestic credit (percent change)	8.8	9.1	8.2	12.1	9.8	...
Interest rate (90-day, in percent) 5/	4.9	5.9	5.3	6.8	7.7	7.5
Government bond yield (10-year, in percent) 5/	4.9	6.1	5.9	6.0	5.7	5.7
Balance of payments (\$NZ billion)						
Current account	-3.4	-5.2	-5.9	-9.8	-13.6	-14.2
(in percent of GDP)	-2.8	-4.0	-4.3	-6.6	-8.8	-8.9
Trade balance (goods)	3.4	0.3	-0.7	-2.1	-3.9	-3.5
Exports	33.0	31.3	28.9	30.8	31.2	33.7
Imports	-29.6	-31.0	-29.6	-32.9	-35.1	-37.3
Terms of trade (percent change)						
	7.2	-4.5	0.9	6.3	1.1	-0.7
Foreign assets and liabilities (\$NZ billion)						
Net international investment position	-92.2	-100.2	-106.1	-124.2	-136.5	-152.7
(in percent of GDP)	-75.3	-77.8	-77.9	-84.3	-88.6	-95.4
Official reserves	8.6	9.4	9.3	9.7	13.1	...
Exchange rate (end of period)						
US\$/NZ\$ 5/	0.42	0.52	0.66	0.72	0.68	0.61
Trade-weighted index (June 1979 = 100) 5/	49.9	58.2	65.1	68.8	70.6	63.1
Nominal effective exchange rate 6/	97.7	112.3	126.0	132.3	135.9	...
Real effective exchange rate 6/	98.6	114.1	127.8	134.9	139.6	...

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

1/ Based on national accounts data.

2/ Fiscal years ending June 30. Revenue and expenditure estimates from 2002 are not directly comparable with those for previous years.

3/ Equals revenue less expenditure plus net surplus attributable to state-owned and Crown entities.

4/ Operating balance net of revaluations and changes in accounting rules (excluding net NZS Fund asset returns).

5/ Data for 2006 are as of April 6.

6/ IMF Information Notice System index (1990 = 100).

Table 2. New Zealand: Balance of Payments and External Debt, 2001–06

	2001	2002	2003	2004	2005	2006 Proj.
	(In percent of GDP)					
Current account balance	-2.8	-4.0	-4.3	-6.6	-8.8	-8.9
Trade balance	2.8	0.2	-0.5	-1.4	-2.5	-2.2
Exports, f.o.b.	26.9	24.3	21.2	20.9	20.2	21.1
Imports, f.o.b.	-24.2	-24.0	-21.8	-22.3	-22.8	-23.3
Services balance	0.2	1.0	1.2	0.8	0.3	0.2
Receipts	8.6	9.0	8.5	8.2	7.9	7.8
Payments	-8.4	-8.0	-7.2	-7.4	-7.6	-7.6
Income balance	-6.0	-5.4	-5.3	-6.4	-6.8	-7.3
Receipts	1.2	1.9	1.8	1.6	1.3	1.6
Payments	-7.1	-7.3	-7.0	-7.9	-8.2	-8.9
Transfers balance	0.3	0.1	0.3	0.2	0.4	0.4
Inflows	1.1	1.1	1.1	0.9	1.1	1.1
Outflows	-0.8	-1.0	-0.8	-0.7	-0.7	-0.7
Capital and financial account balance 1/	4.3	3.0	4.9	6.2	7.7	...
Capital account (net)	0.9	1.3	0.6	0.2	-0.2	...
Financial account (net)	3.4	1.7	4.2	6.0	7.9	...
Direct investment (net)	3.7	0.9	2.7	2.1	2.7	...
Portfolio investment (net)	0.6	2.5	1.7	3.6	-0.1	...
Equity securities (net)	-1.8	-0.3	-0.2	-1.7	-1.1	...
Debt securities (net)	2.4	2.7	1.9	7.1	1.0	...
Other investment (net)	-0.9	-1.6	-0.1	0.3	5.3	...
Assets	-6.9	-1.8	0.4	-0.9	2.1	...
Liabilities	6.0	0.2	-0.5	1.5	3.2	...
Net errors and omissions 2/	-1.9	2.8	0.0	0.8	1.1	...
Overall balance	-0.4	1.8	0.6	0.4	0.1	...
	(Assets and liabilities as of end-December)					
Total external debt	108.4	110.6	104.5	110.7	107.0	111.8
Short-term	56.7	53.4	48.9	53.6	54.4	...
Long-term	51.6	57.2	55.6	57.1	52.5	...
Net international investment position	-75.3	-77.8	-77.9	-84.3	-88.6	-95.4
Net equity	-10.9	-14.0	-15.1	-14.9	-15.4	...
Net debt	-64.4	-63.9	-62.8	-69.3	-73.1	...
Official reserves (billions of NZ dollars)	8.6	9.4	9.3	9.7	13.1	...
(In months of future imports of g&s)	3.2	3.9	3.8	3.8	5.1	...
(As percent of short-term debt)	12.3	13.7	14.0	12.2	15.6	...

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

1/ For 2001-04, based on IFS data.

2/ Calculated as a residual.

Table 3. New Zealand: Summary of Central Government Budget, 2000/01–2005/06 1/

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06 HYEFU 2/
(In billions of New Zealand dollars)						
Revenue	39.5	39.9	43.6	46.9	52.1	54.3
Tax revenue	36.7	36.5	39.8	42.5	46.6	49.2
Direct taxation	23.9	24.5	26.8	28.6	32.7	34.6
Indirect taxation	12.9	12.0	13.0	14.0	14.0	14.7
Nontax revenue	2.8	3.5	3.8	4.4	5.4	5.1
Expenditure	38.2	38.0	41.7	41.6	46.2	50.7
Social security and welfare	13.2	13.5	13.9	14.3	14.3	14.7
New Zealand Superannuation	5.3	5.5	5.6	5.9	6.1	6.4
Other	7.9	8.0	8.3	8.4	8.2	8.3
Health	7.3	7.0	7.5	8.1	8.8	9.8
Education	6.7	6.5	7.0	7.6	7.6	7.9
Finance costs	2.5	2.1	2.4	2.3	2.3	2.3
Other	8.5	8.9	11.0	9.4	13.3	16.0
Net surplus from SOEs and Crown entities	0.1	0.5	0.1	2.1	0.4	1.9
Operating balance 3/ OBERAC 4/	1.4 2.1	2.4 2.7	2.0 5.5	7.4 6.4	6.2 8.4	5.6 5.4
Cash balance 5/ Capital investment 6/	0.2 1.7	1.4 2.3	5.7 2.0	6.0 3.0	10.3 1.9	8.1 2.5
Gross Sovereign-issued debt	36.8	36.2	36.1	34.7	35.0	33.3
Net Core Crown debt	20.0	17.8	17.6	14.4	10.8	10.6
Net worth 7/	11.5	18.7	23.8	35.5	50.0	55.6
(In percent of GDP)						
Revenue	33.3	31.7	33.1	33.0	34.5	34.2
Tax revenue	31.0	29.0	30.2	29.9	30.9	31.0
Expenditure	32.2	30.2	31.6	29.2	30.6	31.9
Social security and welfare	11.2	10.7	10.5	10.0	9.4	9.2
Health	6.2	5.6	5.7	5.7	5.8	6.2
Education	5.6	5.1	5.3	5.3	5.0	5.0
Finance costs	2.1	1.7	1.8	1.6	1.5	1.4
Other	7.1	7.0	8.3	6.6	8.8	10.0
Net surplus from SOEs and Crown entities	0.1	0.4	0.1	1.5	0.3	1.2
Operating balance 3/ OBERAC 4/	1.2 1.8	1.9 2.2	1.5 4.2	5.2 4.5	4.1 5.6	3.5 3.4
Cash balance 5/ Capital investment 6/	0.1 1.5	1.1 1.9	4.4 1.5	4.2 2.1	6.8 1.2	5.1 1.6
Gross Sovereign-issued debt	31.0	28.8	27.4	24.4	23.2	20.9
Net Core Crown debt	16.9	14.1	13.3	10.1	7.1	6.7
Net worth 7/	9.7	14.9	18.0	24.9	33.1	35.0
<i>Memorandum item</i> (in billions of NZ dollars)						
Contributions to NZ Superannuation Fund	...	0.6	1.2	1.9	2.1	2.3

Sources: New Zealand Treasury; HYEFU (Half Year Economic and Fiscal Update, 2005).

1/ Fiscal year ending June 30. Accounts follow New Zealand Generally Accepted Accounting Practices (GAAP).

Changes have been made to the compilation of fiscal data starting in 2001/02; data prior to that date are not fully comparable.

2/ A write-down of student loans raises expenditure (other) by 1 percent of GDP, and reduces the OBERAC by 0.6 percent of GDP.

3/ Equals revenue less expenditure plus net surplus attributable to state-owned and Crown entities.

4/ Operating balance net of revaluations and changes in accounting rules, and excluding net NZS Fund asset returns.

5/ Fund staff estimate; equals cash flows from operations less cash flows on physical investment and advances.

6/ Excludes contribution to the New Zealand Superannuation Fund.

7/ Includes financial assets of the New Zealand Superannuation Fund, which are excluded from net core Crown debt.

Table 4. New Zealand: Central Government Operations, SNA Estimates, 1999/00 - 2007/08 ¹

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.
(In New Zealand dollars, billions)									
Current revenue	38.0	41.0	42.9	47.0	50.2	55.1	57.2	59.1	60.4
Income taxes	21.0	23.3	24.0	26.6	28.4	31.8	33.9	35.2	35.8
Taxes on goods and services	12.1	12.4	13.3	14.5	15.6	16.4	16.5	16.8	17.4
Other taxes and contributions	1.5	1.7	1.9	2.1	2.0	2.2	2.1	2.2	2.3
Sales and operating surpluses	2.7	2.8	3.0	3.3	3.6	3.8	3.9	3.9	4.0
Dividends, profits, rents	0.7	0.7	0.8	0.5	0.6	1.0	0.7	0.9	0.9
Primary current expenditure	35.6	36.6	38.2	39.8	42.1	44.5	48.2	51.3	54.8
Goods and services	6.6	6.2	6.9	6.9	7.5	8.2	8.9	8.8	8.9
Compensation of employees	8.9	9.3	9.9	10.4	11.3	12.1	13.1	13.4	13.6
Social assistance	16.8	17.5	17.9	18.5	19.3	19.9	21.7	23.5	25.0
Subsidies and other	2.0	2.2	2.2	2.5	2.5	2.8	2.9	2.8	2.8
New current spending	0.0	0.0	0.0	0.0	0.0	0.0	0.1	1.3	3.0
Depreciation	1.3	1.3	1.4	1.5	1.5	1.4	1.5	1.5	1.6
Interest payments, net	1.5	1.4	1.0	1.0	0.8	0.6	0.9	0.9	1.0
Saving	0.9	2.9	3.7	6.1	7.4	10.1	8.1	6.9	4.6
Capital spending, net	0.7	0.3	0.8	1.0	1.2	1.8	3.1	2.7	2.8
o/w Capital spending, gross	2.0	1.6	2.2	2.6	2.7	3.3	4.6	4.2	4.4
Net lending(-borrowing)	0.2	2.7	2.9	5.1	6.1	8.2	5.0	4.2	1.8
(Percent change)									
Current revenue	4.0	7.9	4.7	9.5	6.9	9.7	3.7	3.4	2.2
Primary current spending	4.5	2.7	4.4	4.2	5.7	5.6	8.3	6.5	6.8
Capital spending, gross	1.9	-19.0	37.5	16.3	6.9	19.2	41.1	-8.0	3.4
(In percent of GDP)									
Current revenue	34.5	35.0	34.5	36.0	35.8	36.5	36.0	36.2	35.6
o/w Income taxes	19.1	19.9	19.2	20.4	20.3	21.1	21.4	21.6	21.1
o/w Taxes on goods and services	11.0	10.6	10.7	11.1	11.1	10.8	10.4	10.3	10.3
Primary current expenditure	32.4	31.2	30.7	30.5	30.0	29.4	30.3	31.5	32.3
o/w Social assistance	15.3	15.0	14.4	14.2	13.7	13.2	13.6	14.4	14.7
o/w New current spending	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.8	1.8
Interest, net	1.3	1.2	0.8	0.8	0.5	0.4	0.6	0.6	0.6
Saving	0.8	2.5	3.0	4.7	5.3	6.7	5.1	4.2	2.7
Capital spending, net	0.6	0.2	0.6	0.8	0.9	1.2	2.0	1.7	1.6
o/w Capital spending, gross	1.8	1.4	1.8	2.0	2.0	2.2	2.9	2.6	2.6
Net lending(-borrowing)	0.2	2.3	2.3	3.9	4.4	5.5	3.1	2.5	1.1
Memo items									
Primary balance ²	1.5	3.5	3.2	4.7	4.9	5.9	3.7	3.1	1.7
Primary spending ³	33.0	31.5	31.3	31.3	30.9	30.7	32.3	33.1	34.0
Nominal GDP (NZ\$ billions)	110.0	117.2	124.6	130.5	140.2	151.0	158.9	163.1	169.4

Source: New Zealand Treasury, Half Year Economic and Fiscal Update, December 2005.

¹ Accounts follow New Zealand System of National Accounts standards. See: <http://www.treasury.govt.nz/snaforecasts/default.asp>

² Net lending excluding net interest payments, or current revenue net of current primary expenditure and net capital spending.

³ Sum of current primary spending (excluding depreciation) and gross capital spending.

Table 5. New Zealand: Medium-Term Scenario, 2005–11

	Average	Projections						
	1995-2004	2005	2006	2007	2008	2009	2010	2011
Real growth (percent change)								
GDP (production basis)	3.4	2.2	0.9	2.1	3.4	3.4	3.2	3.1
Domestic demand	4.2	4.6	0.5	0.8	2.6	3.2	3.2	3.2
Consumption	3.7	4.7	2.1	1.4	2.3	2.8	3.0	3.0
Private consumption	3.8	4.5	1.1	0.3	1.9	2.7	3.0	3.0
Govt. consumption	3.2	5.3	5.6	5.1	3.5	2.9	2.8	2.8
Fixed investment	6.4	5.3	-1.1	-2.6	2.0	4.0	3.9	3.7
Exports of goods and services	4.6	-0.2	2.3	4.4	5.3	5.1	4.7	4.5
Imports of goods and services	6.8	6.5	0.4	0.4	2.8	4.4	4.6	4.6
Saving and investment (percent of GDP)								
Gross capital formation	22.4	24.7	23.6	22.7	22.5	22.5	22.4	22.3
Fixed investment	21.4	23.8	23.5	22.4	21.9	21.8	21.8	21.6
Increase in stocks	1.0	0.8	0.1	0.4	0.6	0.7	0.7	0.7
National saving 1/	17.4	15.8	14.8	15.1	16.4	17.0	17.2	17.4
Private	14.9	11.5	10.9	12.1	13.9	14.4	14.6	14.8
Public	2.5	4.3	3.9	3.0	2.5	2.6	2.7	2.7
Inflation and unemployment								
Headline CPI inflation	2.0	3.0	3.1	2.8	2.3	2.0	2.0	2.0
Unemployment rate	5.8	3.7	4.1	4.6	4.6	4.5	4.5	4.5
Government budget (percent of GDP) 2/								
Revenue	34.5	34.5	34.2	34.4	33.9	33.3	34.1	34.1
Expenditure	32.6	30.6	31.9	31.8	32.6	32.5	32.4	32.4
SOE and Crown entity surplus, net	0.5	0.3	1.2	1.0	1.1	1.1	1.0	1.0
Operating balance 3/	2.4	4.6	3.7	3.9	2.9	2.3	2.7	2.7
OBERAC 4/	...	5.6	3.4	3.2	1.9	1.3	2.0	2.0
Gross Crown debt	...	23.2	20.9	20.4	19.4	20.0	19.2	19.2
Net Crown debt	...	7.1	6.7	6.4	7.0	8.0	8.0	7.6
Net Worth 5/	...	33.1	35.0	37.7	38.6	38.5	39.4	40.1
Terms of trade (percent change, goods)								
Export prices	0.7	1.1	-0.7	-0.8	-0.7	-0.1	0.6	1.0
Export prices	0.5	1.3	5.1	0.2	-0.8	0.0	0.7	1.1
Import prices	-0.3	0.2	5.8	1.1	-0.1	0.0	0.1	0.1
Balance of payments (percent of GDP)								
Current account balance	-5.0	-8.8	-8.9	-7.6	-6.1	-5.5	-5.2	-4.9
Balance on goods and services	0.7	-2.2	-2.0	-0.9	-0.1	0.2	0.5	0.9
Balance on income and transfers	-5.7	-6.4	-6.9	-6.7	-5.9	-5.7	-5.7	-5.7
Net foreign liabilities (percent of GDP) 6/								
Gross external debt	79.7	88.6	95.4	100.1	102.3	103.9	105.0	105.7
Gross external debt	99.7	107.0	111.8	115.1	116.7	117.8	118.6	119.1

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

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

2/ Fiscal years ending June 30. Figures from 2002 are not directly comparable with the historical data.

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

4/ Operating balance net of revaluations and changes in accounting rules (excluding net NZS Fund asset returns). In 2006, the OBERAC is reduced by \$1024 million, or 0.6 percent of GDP, by accounting write downs of student loans.

5/ Includes the financial assets of the New Zealand Superannuation Fund, which are excluded from net Crown debt.

6/ Data for end-December. Data from 2001 comply with BPM5 and are not directly comparable with prior data.

NEW ZEALAND: FUND RELATIONS
(As of February 28, 2006)

I.	Membership Status: Joined: 08/31/1961; Article VIII		
II.	General Resources Account:	SDR Million	Percent Quota
	Quota	894.60	100.00
	Fund Holdings of Currency	784.32	87.67
	Reserve position in Fund	110.30	12.33
III.	SDR Department:	SDR Million	Percent Allocation
	Net cumulative allocation	141.32	100.00
	Holdings	24.00	16.98
IV.	Outstanding Purchases and Loans:	None	
V.	Financial Arrangements:	None	
VI.	Projected Obligations to Fund:	None	
VII.	Exchange Arrangement:		
	<p>New Zealand accepted the obligations of Article VIII on August 5, 1982. The New Zealand dollar has floated freely since March 1985. New Zealand maintains an exchange system that is free of restrictions on international payments and transfers for current and capital transactions.</p>		
VIII.	Article IV Consultation:		
	<p>New Zealand is on the 12-month consultation cycle. The 2005 Article IV consultation discussions were held during February 7–16, 2005, the Executive Board discussed the staff report (IMF Country Report No. 05/152) and concluded the consultation on May 2, 2005.</p>		
IX.	FSAP Participation and ROSCs:		
	<p>FSAP mission took place during October 30–November 18, 2003. The FSSA and the Detailed Assessment of Observance of IOSCO Objectives and Principles of Securities Regulation were published under Country Reports No. 04/126 and No. 04/417, respectively.</p>		
X.	Technical Assistance:	None	
XI.	Resident Representative/Advisor:	None	

NEW ZEALAND: STATISTICAL ISSUES

The New Zealand authorities publish an array of high-quality statistics which are fully adequate for surveillance purposes. The frequency, timeliness, and availability of common indicators required for Fund surveillance are summarized in the attached table. Economic and financial data are readily available electronically from the websites of Statistics New Zealand, the Reserve Bank of New Zealand, and the New Zealand Treasury.

The authorities are continuing to enhance data quality and expand the range of data products available. For example, Statistics New Zealand has undertaken a range of projects to improve balance of payments statistics in the areas of travel debits, trade in other services (services excluding transport, travel, and insurance), and debt securities transactions. To increase the range of information available, investigations into inward foreign affiliate trade statistics and ultimate investors using available data have been undertaken and results published. The New Zealand Treasury is leading a project to publish fiscal data consistent with the *Government Finance Statistics Manual 2001 (GFSM 2001)* and regularly submits annual general government sector data for inclusion in the GFS Yearbook. Stocks of financial assets and liabilities are reported for all levels of government, and related flows are reported for levels except local government.

New Zealand has made further progress toward becoming a subscriber to the Special Data Dissemination Standard (SDDS). All SDDS requirements are being met for monetary data, and timeliness requirements for central government fiscal data were met in 2005. While external debt data continue to be collected and published in official series on the basis of residual maturity, estimates of external debt by original maturity—as required by SDDS—are prepared. The remaining issues are the requirement for publication of an industrial production index, re-dissemination of 3- and 6-month forward exchange rates, and the timeliness of local government data, where the authorities are exploring the feasibility of earlier publication.

New Zealand: Table of Common Indicators Required for Surveillance
(As of April 7, 2006)

	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶
Exchange Rates	4/7/06	4/7/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	Dec. 2005	3/23/06	M	M	M
Reserve/Base Money	Jan. 2006	3/22/06	M	M	M
Broad Money	Jan. 2006	3/22/06	M	M	M
Central Bank Balance Sheet	Jan. 2006	3/22/06	M	M	M
Consolidated Balance Sheet of the Banking System	Jan. 2006	3/22/06	M	M	M
Interest Rates ²	4/7/06	4/7/06	D	D	D
Consumer Price Index	Dec. 2005	1/18/06	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	2004	9/13/05	A	A	NA
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	Feb. 2006	4/7/06	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Feb. 2006	4/7/06	M	M	M
External Current Account Balance	Dec. 2005	3/23/06	Q	Q	Q
Exports and Imports of Goods and Services	Dec. 2005	3/23/06	Q	Q	Q
GDP/GNP	Dec. 2005	3/24/06	Q	Q	Q
Gross External Debt	Dec. 2005	3/23/06	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 nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. The New Zealand Treasury is leading a project to prepare fiscal data on a GFSM 2001 basis.

⁵ Including currency and maturity composition.

⁶ Daily (D); Weekly (W); Monthly (M); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 06/50
FOR IMMEDIATE RELEASE
May 4, 2006

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

IMF Executive Board Concludes 2006 Article IV Consultation with New Zealand

On April 28, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with New Zealand.¹

Background

Following a vigorous expansion in recent years, a cyclical slowing in New Zealand's economy commenced in 2005, with growth declining to 2¼ percent. Economic growth had averaged 4¼ percent annually in 2002–04, with domestic demand boosted by large migration inflows, wealth effects from rising house prices, and income effects from high commodity prices. Unemployment fell to 3½ percent, but resources became increasingly stretched. In this environment, CPI inflation rose slightly above the medium-term target range of 1 to 3 percent by end-2005, although higher international oil prices also played a role.

The slowdown in 2005 fell most heavily on the tradable sector, and domestic demand growth remained strong for much of the year, hence the external current account deficit rose to 9 percent of GDP, double its 20–year average. The New Zealand dollar reached a post-float record high in December 2005, supported by large capital inflows associated with exceptional demand for New Zealand dollar denominated bonds from retail investors in Japan and Europe. The appreciated exchange rate was a key contributor to the decline in export volumes in 2005 despite strong global growth. At the same time, domestic demand was sustained by an unexpected revival of the housing market in 2005, with annual house price inflation of about 15 percent facilitated by mortgage rates remaining relatively low despite rising official interest rates.

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. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Monetary policy has been on hold so far in 2006, after being tightened in 2005, while the fiscal position remains strong. The official cash rate (OCR) was raised by 75 basis points during 2005 to 7¼ percent. The central government's operating surplus before revaluations and accounting changes (OBERAC) climbed to 5½ percent of GDP in 2004/05 (fiscal year ending in June), and gross government debt declined to 23 percent of GDP. The OBERAC surplus is expected to fall to 4 percent of GDP in 2005/06 (excluding write-downs of student loans), partly reflecting an expansion in support for low income families.

Domestic demand has slowed more recently and the exchange rate has declined substantially. The downturn in domestic demand is expected to continue, reflecting the upward repricing of mortgage rates in 2006, and also owing to an expected leveling out of house prices. Hence growth is likely to be sluggish in 2006, at around 1 percent. Nonetheless, growth is projected to recover to about 2 percent in 2007, led by exports, which will benefit from the adjustment underway in the exchange rate, which has so far retraced 16 percent on a trade-weighted basis from its December 2005 peak.

With slower growth easing resource pressures, inflation is expected to moderate, allowing an eventual easing in monetary policy. A substantial narrowing of the external current account deficit should occur over time as the economy rebalances. In the medium term, growth is expected to return to 3 to 3½ percent, underpinned by the extensive structural reforms undertaken in the 1980s and 1990s, and the sustained implementation of sound macroeconomic policies.

Executive Board Assessment

Executive Directors commended the New Zealand authorities on their continued implementation of sound macroeconomic policies during a challenging phase in the business cycle. Directors noted that following a number of years of strong economic growth, New Zealand's economy slowed in 2005. The external current account deficit widened markedly as the exchange rate appreciated, and with resources stretched, a strong housing market, and higher oil prices, inflation edged to the top of the medium-term target range. Nonetheless, inflation expectations going forward remain well contained, and underlying inflation is expected to decline as resource pressures ease. Accordingly, Directors agreed that the current stance of macroeconomic policies should be appropriately supportive of a soft landing for the economy, although downside risks remain.

Looking ahead, Directors noted that the recent depreciation of the exchange rate will help rebalance demand in the economy and contribute subsequently to a pick-up in growth. They also considered that the government's budgetary plans will help cushion downside risks to the outlook. Directors fully endorsed the government's farsighted conduct of fiscal policy, which has allowed the operating surplus to rise substantially during the years of strong growth. The expected decline in the operating balance in coming years is consistent with the government's prudent medium-term fiscal objectives, as the balance will remain in surplus, and net assets will continue to increase relative to GDP. Directors judged that the associated fiscal

stimulus should not exacerbate inflationary pressures in view of the expected slowing in activity. In the case of a sharper-than-expected downturn, Directors supported allowing full play of the automatic fiscal stabilizers.

Directors considered that following the significant tightening over the past two years, monetary policy should continue to steer a steady course in the near term. They regarded the current pause in official interest rate adjustments to be appropriate. Directors also considered monetary policy to be well placed to accommodate the one-off effects on headline inflation from the recent exchange rate depreciation and the jump in international oil prices, particularly as the slowing economy helps anchor inflation expectations. At the same time, with the labor market remaining tight, they saw little room to cut interest rates in the near term, but noted that there is scope for monetary policy easing if the economy slows more abruptly.

Directors welcomed the recent advances in the financial sector regulatory framework, which will help to entrench financial and macroeconomic stability. They considered New Zealand's financial sector to be fundamentally sound, and supported the authorities' efforts to strengthen the monitoring of households' debt service capacity, in view of the notable rise in household indebtedness in recent years. Directors welcomed the agreement with Australia to lay the legislative foundations for enhanced cooperation in banking supervision between the two countries. They also supported the government's decision to develop a new regulatory framework for non-bank financial institutions.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The [Staff Report](#) for the 2006 Article IV Consultation with New Zealand is also available.

New Zealand: Selected Economic Indicators

	2001	2002	2003	2004	2005	Proj. 2006
Real economy (percent change)						
GDP (production basis)	3.0	4.8	3.4	4.4	2.2	0.9
Domestic demand	1.9	5.4	5.7	8.3	4.6	0.5
Exports of goods and services	3.5	6.3	2.7	5.5	-0.2	2.3
Imports of goods and services	2.0	9.6	8.3	16.7	6.5	0.4
Headline CPI inflation (end of period)	1.8	2.7	1.6	2.7	3.2	2.9
Unemployment rate (in percent)	5.3	5.2	4.7	3.9	3.7	4.1
National saving (in percent of GDP) 1/	18.4	18.4	18.6	18.0	15.8	14.8
Investment (in percent of GDP)	21.2	22.5	23.0	24.6	24.7	23.6
Government budget (in percent of GDP) 2/						
Revenue	33.3	31.7	33.9	33.4	34.5	34.2
Expenditure	32.2	30.2	32.4	29.6	30.6	31.9
OBERAC 3/	1.8	2.2	4.3	4.6	5.6	3.4
Net public debt	16.9	14.1	13.7	10.2	7.1	6.7
Money and credit (end of period)						
M3, resident (change in percent)	7.0	11.5	9.5	3.4	9.3	...
Private domestic credit (change in percent)	8.8	9.1	8.2	12.1	9.8	...
Interest rate (90-day, in percent) 4/	4.9	5.9	5.3	6.8	7.7	7.5
Government bond yield (10-year, in percent) 4/	4.9	6.1	5.9	6.0	5.7	5.8
Balance of payments (in percent of GDP)						
Current account balance	-2.8	-4.0	-4.3	-6.6	-8.8	-8.9
Trade balance	3.4	0.3	-0.7	-2.1	-3.9	-3.5
External assets and liabilities (in percent of GDP)						
Official reserves	8.6	9.4	9.3	9.7	13.1	...
Gross external debt	108.4	110.6	104.5	110.7	105.9	109.7
Net external liabilities	75.3	77.8	77.9	84.3	88.6	95.4
Exchange rate (end of period)						
US\$/NZ\$ 4/	0.42	0.52	0.66	0.72	0.68	0.64
Trade-weighted index (June 1979 = 100) 4/	49.9	58.2	65.1	68.8	70.6	64.1
Nominal effective exchange rate 5/	97.7	112.3	126.0	132.3	135.9	...
Real effective exchange rate 5/	98.6	114.1	127.8	134.9	139.6	...

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

1/ Based on national accounts data.

2/ Fiscal years ending June 30. Revenue and expenditure estimates from 2002 are not directly comparable with those for earlier years.

3/ Operating balance net of revaluations and changes in accounting rules.

4/ Data for 2006 are as of May 3.

5/ IMF Information Notice System index (1990 = 100).

**Statement by Oh Jong Nam, Executive Director for New Zealand
and Andrew Blazey, Advisor to Executive Director
April 28, 2006**

Key Points

- After a period of sustained buoyancy, the economy entered a period of slow growth in the second half of 2005. Year-on-year GDP growth is expected to moderate further over 2006 before rebounding in 2007 and 2008.
- The period of slower growth, driven by an easing in domestic demand growth, is expected to see an easing in underlying inflation pressures. This combined with a stronger contribution from net exports on the back an expected decline in the exchange rate is expected to result in a decline in the current account deficit.
- Following the re-election of a Labour-led government in August 2005, key fiscal policy settings are unchanged with operating surpluses expected to decline from recent high levels to levels more consistent with long-term fiscal objectives.
- While capacity pressures are now easing, high and rising oil prices and the depreciation of the exchange rate still represent risks to inflation expectations and pose ongoing challenges for monetary policy. Official interest rate cuts are not expected for some time.
- Eurokiwi and Uridashi issuance is likely to diminish this year as interest rate differentials narrow. Maturing issues are likely to be handled smoothly, but could result in a further fall in the exchange rate.

Recent Economic Developments and Outlook

New Zealand has experienced a sustained period of economic buoyancy over the first half of this decade, with real GDP growth averaging 3.5 percent (2.3 percent in per capita terms). High commodity prices, a period of exchange rate undervaluation, low interest rates and an unusually strong net inward migration were amongst the initial catalysts of robust growth. More recently, rapid house price growth appears to have supported strong consumption expenditure alongside strong labour income growth - best estimates suggests housing equity withdrawal of the order of 3-4 percent of disposable income.

The period of strong growth has put considerable pressure on resources. Unemployment has fallen markedly notwithstanding rising labour force participation. At 3.7 percent at the end of 2005, unemployment was slightly off its multi-decade low. Other indicative measures of capacity utilization reached multi-decade highs during the first half of last year.

There is now clear evidence, however, that the economy has entered a period of slower growth. A cyclical slowing of the economy has been expected for some time, but slower economic growth finally took hold only in the second half of 2005, and for domestic demand only in the last quarter. Real GDP growth of 2.2 percent for 2005 as a whole masked a marked divergence in performance between the first half of the year and the second. Domestic demand is slowing and net migration (which is both large and quite variable by OECD country standards) fell to 8,220 people for the year to February 2006 after reaching a high of 42,540 people in the year to May 2003. Residential building activity has slowed, although the housing market, while slowing, remains active. As the housing market moves to lower activity levels this source of support for consumer demand will dissipate.

My authorities expect year-on-year growth to slow further over 2006 led by an easing in domestic demand growth, before rebounding in 2007 and 2008 to trend or above trend growth rates. The depreciation of the New Zealand dollar, coupled with strong global demand, is expected to support an export-led recovery in GDP growth, although lags in the agricultural sector are among the factors that mean the full benefit of the lower exchange rate will not be seen until well into next year. By most estimates, the output gap is likely to have closed by around the middle of this year.

The New Zealand authorities share the views of the staff that the current slowdown in growth is cyclical in nature. They continue to view New Zealand's trend growth performance as robust, and the Government has an ongoing policy agenda to ensure that remains the case.

At close to 9 percent of GDP, the current account deficit is higher than at the time of the 2005 consultation. The increase in the deficit reflects a combination of factors. The cyclical strength in the economy, in particular, the strength of domestic demand growth has been a key driver, but the rise in global oil prices and a poor 2004/05 agricultural production season has also played a part (of the order of 2 to 3 percent of GDP).

Some drivers of the increase are not necessarily a cause for concern. The strong business investment cycle has resulted in high demand for imported capital goods. Similarly, in response to the strong domestic currency in 2004-05, consumer purchases of imported durable goods contributed to the high level of imports. Further, profits and dividends paid on foreign investment in New Zealand have been growing. All of these have strong cyclical characteristics.

Despite a couple of years of large current deficits there has not been any dramatic deterioration in New Zealand's net international investment position (IIP), with the IIP and net debt position having not moved much over the last decade.

Most recently, there has been no evidence of any unease among investors regarding either the level of the current account or the net international investment position (for example, bond spreads to major markets have narrowed this year, consistent with the proposition that the exchange rate fell as short-term monetary policy expectations changed).

However, the authorities acknowledge that the deficit, at its current level, is not sustainable in the medium-term. The decline in the exchange rate is seen as part of the adjustment process. The easing in domestic demand, when combined with stronger net exports, is expected to reduce the current account deficit. It is worth noting that the current account and exchange rate went through very large adjustments in the late 1990s with no adverse effects on overall economic performance.

Macroeconomic Policy

My New Zealand authorities acknowledge that recent economic performance and the current cyclical downturn makes for a challenging policy making environment.

For some time now, the authorities have been coping with a delicate balancing act. On the one hand, the pressure of resources pointed to a tighter stance on macroeconomic policy. On the other hand, forward indicators suggested that growth and the pressures themselves were likely to ease. The next year will also require similarly complex judgments to be made.

Fiscal Policy

Following the re-election of a Labour-led government in August 2005, fiscal policy settings are largely unchanged. Reflecting decisions taken in the 2004 and 2005 Budgets, latest forecasts show the Government's underlying measure of the operating surplus is expected to fall from around 4 percent of GDP in the current year, to around 3½ percent in the 2006/07 financial year and 2½ percent a year later. Although not the prime motivation, the forecast fiscal stimulus in 2006 and 2007 is expected to have a cushioning effect on the economy.

Preparing for the future impact of population ageing is the main objective of fiscal policy. The Government has already implemented initiatives such as the New Zealand Superannuation Fund (2001) and more recently the Public-sector superannuation scheme (2004) to facilitate individual saving. With assets of the New Zealand Superannuation Fund taken into account, the government is expected to move into a net financial asset position around the end of the year.

A new initiative, KiwiSaver (a voluntary savings scheme for all employees using individual accounts, administered by Inland Revenue) is due to come into operation early in 2007. KiwiSaver is designed to facilitate a change in the savings behaviour of individuals and to complement New Zealand Superannuation (the universal pay-as-you-go pensions system). The initiative is to be complemented by changes to the tax system to improve the taxation of investments in managed funds.

Monetary Policy and the Exchange Rate

New Zealand's inflation target is to keep CPI inflation between 1 and 3 percent, on average, over the medium term. In response to a sustained period of pressure on resources, linked to a period of strong commodity prices and the largest boom in house prices since the early 1970s, the Reserve Bank of New Zealand (RBNZ) gradually increased the Official Cash Rate from 5 percent at the start of 2004 to the current rate of 7.25 percent - with the two most recent 25 point increases occurring in late 2005.

A downward sloping yield curve has encouraged most mortgage borrowers to shift from floating rate mortgages (closely linked to changes in the OCR itself) to mortgages with interest rates fixed for 1-3 year terms. This has slowed the impact on households of the rising official interest rates, although as mortgage terms are renewed, debt service costs are increasing, contributing to an easing of consumption. The RBNZ has indicated that there is little room for easing monetary policy at this time, as inflationary pressures, built up over several years, remain. In particular, pressures in the labour market remain intense, and inflation expectations remain uncomfortably high. At a time when inflation is above 3 percent, direct price effects of the lower exchange rate and higher oil prices pose some risks for inflation expectations, the Reserve Bank hopes to be able to "look through" the direct price effects.

The recent depreciation of the New Zealand dollar was not unexpected given the extent to which the dollar had been overvalued in 2004-05 - on a trade-weighted basis many estimates suggested that the exchange rate was 20-30 percent above medium-term fair value. The fall in the exchange rate appears to have been triggered primarily by data that strengthened market perceptions that the stance of monetary policy would be eased, and the OCR cut, this year. The weaker exchange rate itself represents some easing in monetary conditions, and acts as less of a drag on economic activity over the next few years. Despite the depreciation over the past three months, the real effective exchange rate remains approximately 9 percent above its 20-year average value.

As staff note, retail New Zealand dollar bond issuance abroad (the Eurokiwi and Uridashi market) has been on a very large scale in 2005 in particular, and has been an important part of the mechanism by which the continuing strong demand for housing credit has been met. At a time, when most global interest rates were relatively low, New Zealand's interest rates appeared particularly attractive and this demand exacerbated the upward pressure on the exchange rate last year. The stock of such issues is now large (around NZ\$50 billion, or around one third of GDP), and most issues are for terms of 2-3 years. As credit demand eases and interest differentials are less attractive, my authorities expect that new issuance will continue to slow and net maturities will occur. Past experience (in the late 1990s) suggests that the adjustment is likely to be reasonably orderly, given that banks themselves are very well-hedged, and that any adjustment will occur largely in the level of exchange rate itself.

My authorities are of the view that New Zealand's macroeconomic framework has played a key role in the improved economic performance seen over the last decade, but they are not complacent. With this in mind, the Secretary to the Treasury and the Governor of the

Reserve Bank commissioned their officials to examine whether there were additional tools that could be applied to lend support to monetary policy in stabilizing the macro economy and reduce pressure on the exchange rate – the so-called Supplementary Stabilization Instruments project. While a number of areas of further work were identified, no immediately options for implementation were identified.

Banking and Financial Sectors

The New Zealand financial system is well placed to manage a slowdown in the economy. Stress tests from the 2004 Financial Sector Assessment Program and independent exercises have demonstrated that New Zealand's financial system is resilient to a wide range of economic and financial shocks.

In the past 12 months, the RBNZ completed two initiatives that strengthen the durability of the supervisory framework: the completion of the local incorporation policy requirement for major banks and deposit-taking smaller banks, and an outsourcing policy to ensure that core liquidity, payment and transaction services can be maintained in times of stress. In addition, the RBNZ has been working to implement Basel II. The regulatory capital requirements for banks will be calculated under Basel II from January 2008 and the work is being co-ordinated with foreign supervisors (especially APRA the Australian home supervisor for the four largest banks in New Zealand). A multi-agency process is currently underway reviewing the regulation of the non-bank financial sector and a preliminary decision was made by the government late last year that there is a case for extending prudential supervision to some classifications of non-bank financial institutions. Further, the RBNZ, Treasury and other government agencies have largely completed substantial work in planning to manage the potentially serious economic risks associated with a possible bird flu pandemic.