

New Zealand: 2005 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2005 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 16, 2005, 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 8, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 2, 2005 discussion of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

NEW ZEALAND

Staff Report for the 2005 Article IV Consultation Discussions

Prepared by the Staff Representatives for the 2005 Consultation with New Zealand

Approved by David Burton and Martin Fetherston

April 8, 2005

- The 2005 Article IV consultation discussions were held in Auckland, Christchurch, and Wellington between February 7–16, 2005.
- The staff team comprised Messrs. Gordon (Head), Beaumont, and Mercereau (all APD), and Mr. di Giovanni (RES). Messrs. Dunaway (APD), Oh (Executive Director), and Reddell (Alternate Executive Director) joined the discussions in Wellington.
- 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.
- New Zealand has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.
- New Zealand publishes an array of high-quality statistics, and the authorities are working to address the few outstanding issues that have precluded subscription to the Special Data Dissemination Standard (SDDS).

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EXECUTIVE SUMMARY

Economic Background

- **New Zealand's economy has continued to perform well.** Over the last 6 years, growth has averaged 4 percent a year, compared to an annual average of 2½ percent across the OECD. Job creation has been exceptional, reducing the unemployment rate to 3.6 percent, the lowest in the OECD. Government debt has been declining steadily, and inflation has generally remained within the central bank's target range.
- **Economic growth rose to almost 5 percent in 2004, bringing the economy to a high level of resource utilization.** Household consumption was buoyant reflecting strong income growth partly due to improvements in New Zealand's terms of trade. Fixed investment accelerated as firms enjoyed strong profitability and robust sales, leading to growing capacity constraints. Inflation picked up as tradable goods inflation rose, partly due to higher oil prices, while the inflation rate in nontradable goods remained high. The external current account deficit widened as imports jumped due to high domestic demand and the strength of the New Zealand dollar.

Policy Discussions

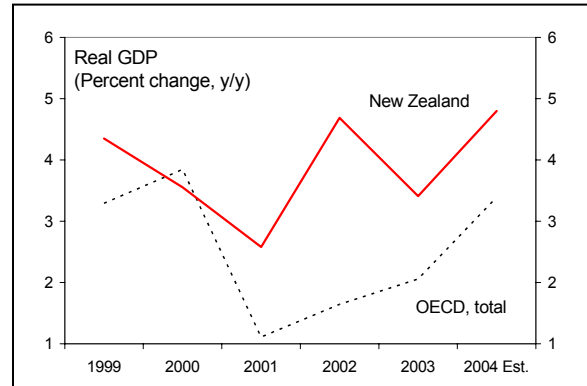
- **The authorities and Fund staff broadly agree on the settings for macroeconomic policies.** Monetary policy faces a difficult balancing act: while the strong economic momentum implies upward risks to inflation, further tightening risks aggravating a slowing in activity that may already be underway. Nonetheless, the authorities' recent decision to tighten monetary policy and to retain a tightening bias was appropriate.
- **New Zealand's fiscal position is very strong, but there are limits on the scope for an expansionary fiscal policy.** The government plans a phased rise in spending to meet health and education priorities and to support low-income families, while meeting its prudent medium-term target for reducing the debt-to-GDP ratio. A more expansionary fiscal path could exacerbate existing strains on resources. Long-term fiscal pressures from rising health care costs and population aging remain a significant challenge, and reforms of the pension and health care systems will need to be considered.
- **Raising productivity growth, and, to a lesser extent, labor participation, are key to reducing the gap between New Zealand and OECD average per capita incomes.** The priorities are to implement infrastructure improvements on schedule, to continue upgrading education and training, and to use a range of measures to facilitate the ability of individuals to move from welfare to work.
- **New Zealand's banking system remains sound, and the authorities have taken this opportunity to strengthen their crisis management framework.** Discussions on the potential integration of banking regulation with Australia are underway. At this stage it is unclear how these discussions will progress, but adequate safeguards for financial stability in New Zealand in the event of a crisis need to remain in place.

I. ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Introduction

1. **New Zealand has, in recent years, been one of the top performers among advanced economies.** Growth in New Zealand averaged 4 percent a year over the past 6 years, compared to an annual average of 2½ percent in all OECD countries.

Employment rose by 18 percent during this period, reducing the unemployment rate to the lowest in the OECD. CPI inflation has averaged 2¼ percent, consistent with the Reserve Bank of New Zealand's (RBNZ) 1 to 3 percent target range, and the budget has recorded sizeable and growing current surpluses, that have permitted a significant reduction in government debt.

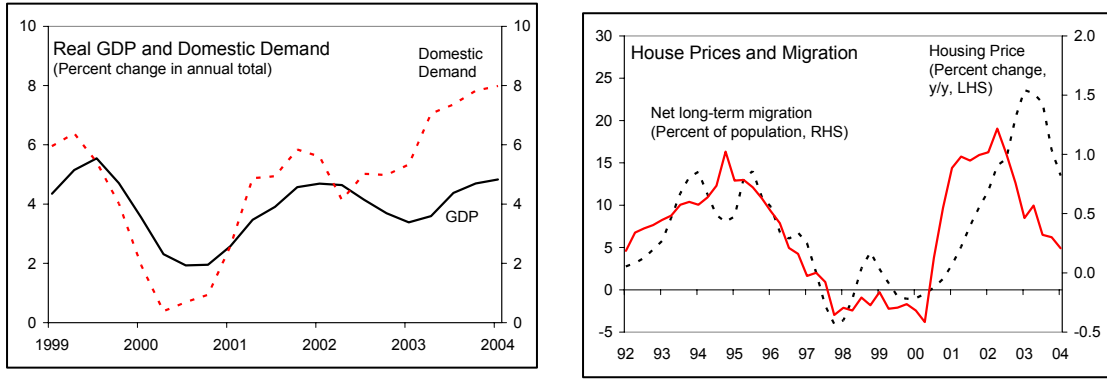


2. **During past Article IV consultations, there has been broad agreement on New Zealand's economic policies.** In recent consultations, Directors have attributed the strong performance of the New Zealand economy to the authorities' astute management of macroeconomic policies and the ongoing benefits from the extensive structural reforms since the 1980s. Directors have also fully supported the sound medium-term frameworks guiding fiscal and monetary policies, and have generally endorsed the authorities' macroeconomic policy initiatives. At the conclusion of the 2004 Article IV consultation on April 30, 2004 (IMF Country Report No. 04/128), Directors considered the decision to raise interest rates in early 2004 to have been prudent in the context of the high level of resource utilization. To support monetary policy in the near-term, Directors recommended that budgetary spending not be increased relative to the latest projections, and that unanticipated revenues be saved. Directors welcomed the partial prefunding of future pension liabilities through the New Zealand Superannuation (NZS) Fund. To fully contend with the long-term fiscal challenge of population aging, Directors emphasized that further reforms of the pension and health care systems should be adopted.

B. Recent Developments

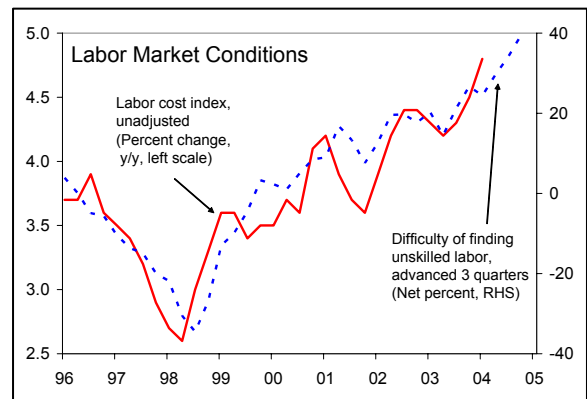
3. **Strong domestic demand was the main factor driving growth in 2004** (Table 1). GDP rose by an estimated 5 percent during the year, led by a surge in domestic demand. Private consumption was particularly strong, reflecting high employment growth, strong commodity prices, and household borrowing against rising housing values. Following a fall in net inward migration, house price increases eased to 13½ percent y/y in February 2005, from 25 percent in 2004, and residential investment slowed from the blistering pace set

in 2002–03.¹ Nonetheless, overall investment growth accelerated as business capital spending rose rapidly, powered by robust sales, strong profitability, growing capacity constraints, and declining domestic prices for imported equipment.



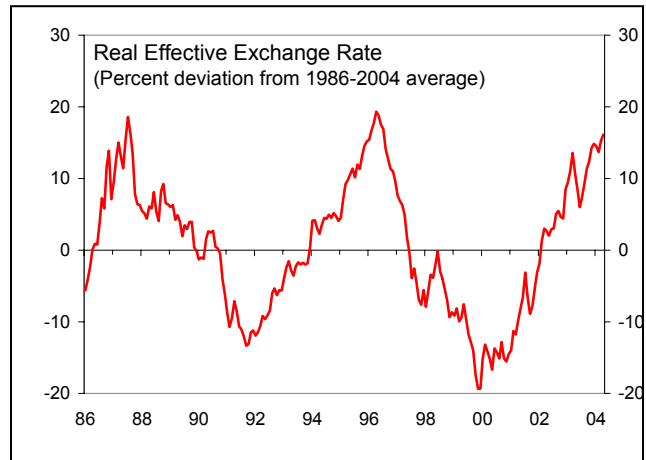
4. **The current account deficit rose to 6.4 percent of GDP in 2004** (Table 2). Import volumes jumped by 16 percent, mirroring the strength of domestic demand. Despite the strong New Zealand dollar, export volumes grew by a relatively robust 5¼ percent. Exporters' incomes were also aided by widespread foreign exchange hedging, and rising international prices for the country's major commodity exports that pushed the terms of trade to a 30-year high. Overall, the trade deficit rose by 1 percentage point of GDP, and with the profits of foreign-owned companies rising sharply, the invisibles deficit increased by a similar amount. Net foreign liabilities rose to 84½ percent of GDP at the end of 2004.

5. **Indicators of resource utilization suggest an economy that is operating at full stretch.** Even as growth in the working age population slowed due to declining migration inflows, employment rose by 4½ percent during 2004, bringing down the rate of unemployment to 3.6 percent. Indicators of the difficulty of finding labor, both skilled and unskilled, have reached historical highs. At the same time, capacity utilization is at record levels, particularly in the construction sector.



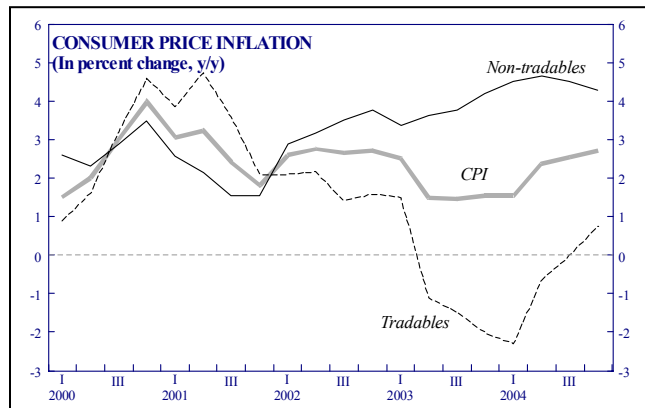
¹ Fluctuations in net migration flows make population growth more volatile from year-to-year in New Zealand compared with other advanced economies. Chapter I of the forthcoming selected issues paper examines the impact on unemployment of fluctuations in migration.

6. **The New Zealand dollar has appreciated further.** Since end-2003, the New Zealand dollar has risen by 7 percent on a trade-weighted basis, led by an 8 percent appreciation against the U.S. dollar. On a real effective basis, the exchange rate is estimated to be 16 percent above its post-float average at end-March 2005, a level similar to earlier peaks in 1988 and 1997.² The appreciation reflects a combination of strengthening global commodity prices, U.S. dollar weakness, and a widening in interest rate differentials due to New Zealand's relative cyclical position.



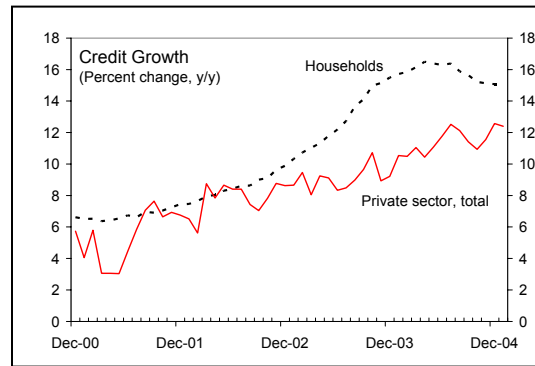
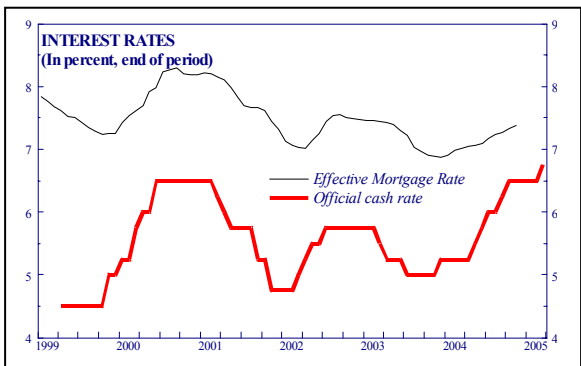
7. **Inflation stayed within the target range of 1 to 3 percent, but signs of inflationary pressure are emerging.** Headline CPI inflation rose to 2¾ percent y/y by end 2004, from 1½ percent a year earlier, led by a rise in the inflation rate for tradable goods as the effects of the exchange rate appreciation diminished and oil prices rose. Nontradable inflation remained high at 4¼ percent y/y, with the cost of constructing new dwellings continuing to be a key contributor.

While official data through 2004 show wage and salary growth remained moderate outside the construction sector, an experimental index of labor costs unadjusted for quality changes indicates that some acceleration has occurred. Rising labor turnover has reportedly increased the frequency of wage raises to recruit and retain staff, and labor unions in some sectors are also pressing for higher wage increases.



² The New Zealand dollar exchange rate is relatively volatile, partly reflecting its sensitivity to commodity prices. Chapter II of the forthcoming selected issues paper compares the volatility of the New Zealand dollar with that of other currencies, and examines the impact of exchange rate volatility on the foreign exchange hedging behavior of exporting firms.

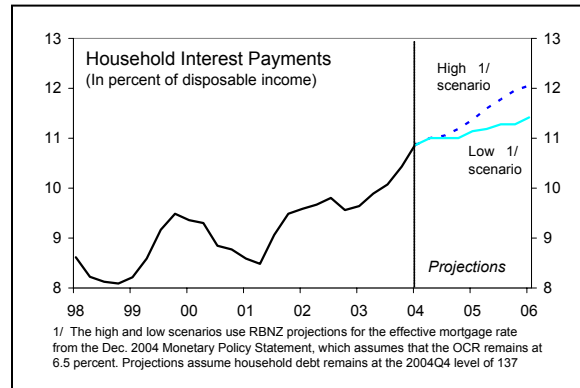
8. **Monetary policy has been further tightened.** The RBNZ raised the official cash rate (OCR) six times between January and October 2004, bringing the OCR to 6.5 percent. The resulting rise in effective mortgage interest rates has been somewhat smaller than in previous tightening cycles—partly due to a mortgage lending “war” in late 2004—but a slowing in household credit growth began in the second half of 2004. In its March 2005 *Monetary Policy Statement* (MPS), the RBNZ noted that the economy had not slowed in line with earlier projections, and the near-term outlook for activity was also stronger, implying higher underlying inflation pressures than earlier expected. As a result, the OCR was raised by a further 25 basis points.



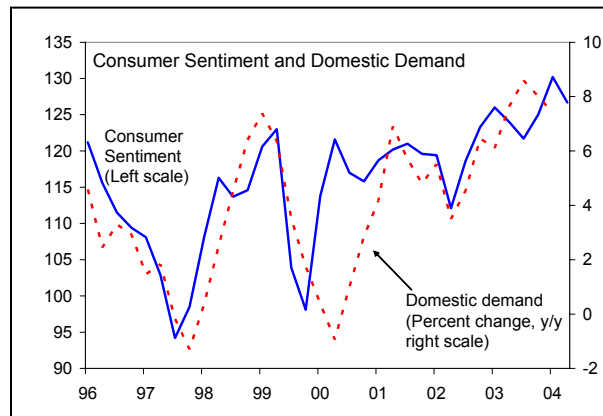
9. **The fiscal position has strengthened, aided by stronger than expected growth.** The operating surplus before revaluations and accounting changes (OBERAC) rose to 4¾ percent of GDP in 2003/04 (fiscal year ending in June), and gross government debt declined to 25¼ percent of GDP (Table 3). The *December Economic and Fiscal Update* (DEFU) released at end-2004 projected the 2004/05 OBERAC surplus at 4.3 percent of GDP, compared with a budgeted surplus of 3.9 percent, with higher projected tax revenues in 2004/05 only partly offset by higher spending plans. In the eight months to February 2005, the OBERAC was ¾ percent of GDP above the DEFU projections, owing to spending delays, and higher surpluses of state owned enterprises.

C. Economic Outlook and Risks

10. **Real GDP growth is projected to slow in the near-term** (Table 4). Growth is expected to moderate to about 2¾ percent in 2005 and 2006.³ The housing market appears to be cooling, so the fall in residential investment that began in the third quarter of 2004 is likely to continue, and lead in turn to a deceleration in consumer durable spending.⁴ Consumption growth will also be dampened by rising household debt service burdens associated with the recent OCR increases. In contrast, business fixed investment is expected to remain strong. CPI inflation will likely remain at the top of the target band through 2005, and the external current account deficit may widen slightly further in 2005–06 as the strong exchange rate weakens export growth.



11. **However, upside risks to domestic demand remain.** Clear signs of the long-awaited slowing in the economy have yet to emerge. Growth in real GDP slowed to 0.4 percent q/q, s.a., in the fourth quarter of 2004, partly reflecting one-off factors that may be reversed in early 2005. Moreover, consumer confidence is still near the ten-year highs reached at the end of 2004, with rising employment increasing disposable incomes and job security. Prices for New Zealand’s export commodities have remained high in early 2005, so income growth could be larger if these prices do not ease as projected. Business investment could also be higher than expected owing to the increasing need to substitute capital for labor.



³ The projected slowing in growth is more modest on a quarter-on-quarter basis, as the average annualized quarter-on-quarter growth rate in 2004 was slightly below 4 percent.

⁴ The RBNZ projects house prices to be flat in 2005 and to decline modestly in 2006–07. Downside risks to this outlook appear limited—some models of house prices indicate that any potential overvaluation is perhaps on the order of 10 percent. Stress-tests conducted for the FSSA (IMF Country Report No. 04/126) concluded that banks were robust to substantial falls in house prices.

12. **The possibility of a further appreciation of the exchange rate, particularly if pressure on the U.S. dollar intensifies, counterbalances some of the upside risks.** The impact of such an appreciation on export sector incomes could be felt more rapidly than has recently been the case, as RBNZ surveys indicate that the extent of foreign exchange hedging of exports has declined somewhat due to the already appreciated level of the exchange rate. An associated rise in U.S. bond yields would affect long-term interest rates in New Zealand, also tending to dampen demand.

13. **In the medium-term, real GDP growth is projected to average about 3¼ percent.** As New Zealand's relative cyclical position unwinds in coming years, the external current account deficit will tend to narrow, thus stabilizing net foreign liabilities as a share of GDP.⁵ The inflation rate is also expected to decline to about 2 percent. Given New Zealand's historically high level of labor force participation, at 67¾ percent of the population over 15 years old, employment growth is likely to moderate in the medium-term. Hence, a rise in trend productivity growth will be needed to sustain strong growth (as discussed in section II.C). The risks to these medium economic prospects are cushioned by past structural reforms, macroeconomic policy flexibility, and generally healthy balance sheets, which have proven to be resilient to large swings in exchange and interest rates in the past.⁶

⁵ The high current account deficit even as the economy returns to potential partly reflects the assumption that the real exchange rate will remain at its current level. In contrast, the latest RBNZ projections assume a 15 percent depreciation on a trade-weighted basis by end-2007. In such a scenario the current account deficit would return toward historic average levels (about 4½ percent of GDP) more quickly.

⁶ Annex I provides a fuller analysis of economic vulnerability based on an assessment of private sector balance sheets. Stress tests using the standard external sustainability framework template do not suggest major concerns (Table 5). A large exchange rate depreciation produces (in a relatively static and mechanical fashion) a sizable jump in the external debt to GDP ratio. However, the experience in the late 1990s underscores the flexibility of the New Zealand economy in handling such shocks without significant dislocation. Moreover, the mitigating influence of having foreign currency debt positions that are predominantly hedged (either by natural hedges or by financial derivatives) is not captured in the framework.

II. POLICY DISCUSSIONS

The authorities and staff were in general agreement on the settings for macroeconomic policies in the period immediately ahead, and the discussions focused on the policy priorities for sustaining strong growth in the medium term.

A. Monetary Policy and the Exchange Rate

14. **With the economy continuing to show considerable momentum, the RBNZ recognized that current monetary settings might not be sufficient to contain inflationary pressures.** At the time of the December MPS, the RBNZ considered that a further tightening might not be necessary given that the full effects of interest rates increases in 2004 had yet to work their way through the economy. In particular, increased competition between mortgage lenders in late 2004 had probably extended the usual lags with which interest rates affected activity. An additional drag on the economy would also emerge during 2005 as foreign exchange hedges rolled off and exporters became more exposed to the appreciated exchange rate. Nonetheless, given that inflation was already at the top of the band, the RBNZ considered there to be little headroom to absorb additional inflationary pressures should the data continue to surprise on the upside.

15. **The staff agreed with the RBNZ's diagnosis that further monetary tightening would probably be required.** Staff noted that the stage was set for the economy to slow, with the high exchange rate already appearing to affect export industries like forestry and seafood. Substantial interest effects were also in the pipeline. Nonetheless, the timing of the slowdown was highly uncertain, particularly given the difficulty of predicting the behavior of consumers who are experiencing strong income growth and record high job security. Indeed, in the staff's view, inflation might edge above the 3 percent band in 2005. This was not inconsistent with the medium-term inflation objective providing that inflation fell back within the band fairly quickly, thus underscoring the importance of monetary policy retaining a tightening bias.

16. **Continued strong data led to another interest rate increase in March.** Economic activity has continued to be buoyant in 2005, further increasing inflation prospects, and in the March MPS, the RBNZ pushed out the timing of the expected slowdown to late 2005. In deciding to raise the OCR again, the authorities carefully weighed the risk of unduly exacerbating the eventual slowing of activity against that of a rise in inflationary expectations that would make the task of containing inflation more difficult in future. With inflation expected to remain near the top of the target band in the medium-term, the authorities judged there to be little scope for an easing of monetary policy in the foreseeable future, a view with which staff concur.

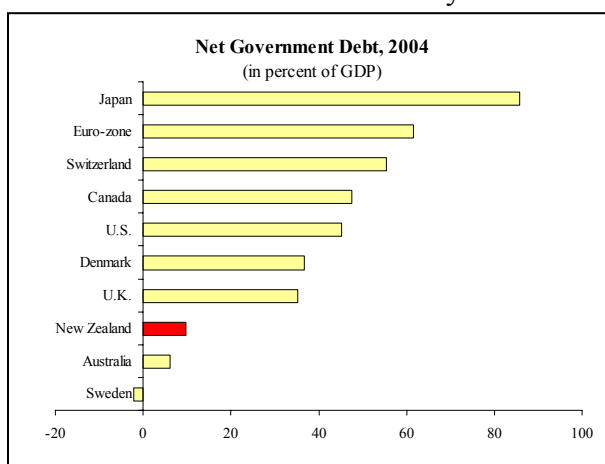
17. **The authorities have not intervened in the foreign exchange market since the recent review of intervention policy.** Although the RBNZ remains committed to a freely floating exchange rate, it announced in March 2004 that it would contemplate intervention if the exchange rate was exceptionally and unjustifiably high or low, and if an opportunity existed that would ensure such intervention would be effective. The RBNZ noted that the

exchange rate was high by historical standards—IMF staff estimates the New Zealand dollar to be some 15 percent above medium-term equilibrium levels according to a macroeconomic balance methodology. Nonetheless, the RBNZ considered that the strength of the currency was largely attributable to the relatively high level of commodity prices and interest differentials. It was also unclear that current foreign exchange market dynamics were such that intervention would be effective. Staff viewed the criteria guiding foreign exchange intervention to be well-considered, and likely to have the intended effect of making intervention an effective, but rare, occurrence.

B. Fiscal Policy

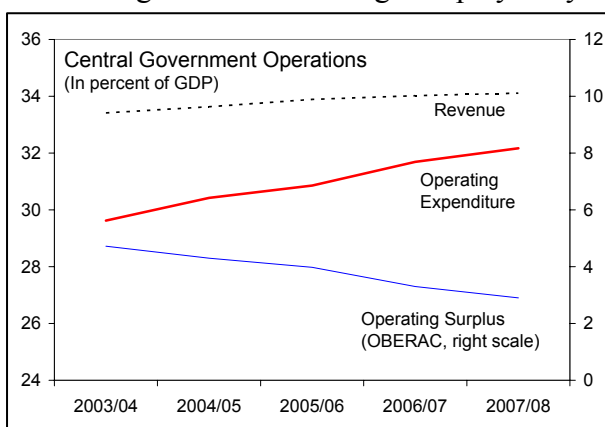
18. **New Zealand’s strong fiscal position stems from its implementation of sound policy in a transparent and predictable medium-term framework.** In the May 2004

Fiscal Strategy Report (accompanying the 2004/05 Budget) the government set out its longer-term fiscal objectives, which are to: (i) maintain government debt at prudent levels, with gross debt to be brought below 20 percent of GDP before 2015; (ii) run operating surpluses on average over the economic cycle sufficient to meet contributions to the NZS Fund; and (iii) meet capital spending pressures and priorities. The debt target is more stringent than the 30 percent of GDP specified in previous budgets and a specific timeframe for its achievement has been introduced in order to strengthen the anchoring role played by this objective.



19. **The current fiscal projections are consistent with these medium-term objectives, while meeting the authorities’ economic and social priorities.** The

authorities noted that there were significant underlying pressures to raise spending, especially in health and education, along with the implementation of the Working for Families (WFF) package.⁷ They explained that the projected phased increase in operating spending over the budget horizon—by about 2 percentage points of GDP from

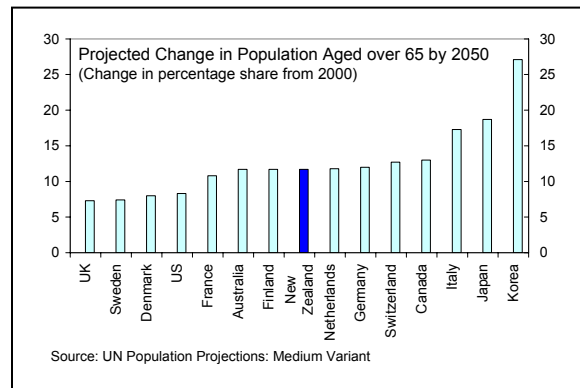


⁷ This package announced in the 2004/05 budget aims to support low income families while also promoting the shift from welfare to work, including through the introduction of in-work benefits in 2006. The total cost of the package rises to $\frac{3}{4}$ percent of GDP by 2006/07.

its 2004/05 level—would help to address these priorities. Revenues were projected to remain broadly stable relative to GDP, as earlier increases in the revenue ratio have proven to be persistent suggesting they are largely structural, while downside revenue risks were more limited than in the past, due in part to unutilized tax losses being at low levels. Consistent with the medium-term objectives, the OBERAC surplus is projected to decline to 3 percent of GDP by 2007/08, and gross debt is projected to fall below 20 percent of GDP in 2008/09, with net debt including the NZS Fund becoming negative at that time.

20. **Staff agreed with the authorities that despite the current strength of the fiscal position, there were limits on the scope for expansionary fiscal policy.** Staff noted that the latest DEFU projections involved a moderate stimulus in coming years, and that a more expansionary path (whether through additional spending or tax cuts) could aggravate existing short-term strains on resources.⁸ Moreover, spending growth in a number of categories, including health and education, had been rapid in recent years, and if such growth was sustained, the objective of keeping the ratio of debt-to-GDP on a gradually declining path would not be achievable in the longer run. In the *Budget Policy Statement 2005* (accompanying the DEFU), the Minister of Finance expressed the government’s intention to avoid a fiscal expansion that would put undue pressure on interest and exchange rates, and also noted that it was prudent not to spend an increase in revenues that resulted from cyclical factors. Staff fully endorsed these policy intentions, and encouraged the authorities to maintain the fiscal prudence that has served New Zealand well.

21. **New Zealand faces significant long-term spending pressures owing to rising health care costs and population aging.** Per capita health spending has risen at an average annual rate of 5 percent in real terms in the last five years. Recent estimates suggest that the demographic changes in prospect, which are broadly typical of OECD countries, could push government spending on pensions and health care from the current level of around 11 percent of GDP to some 19 percent of GDP by 2051.⁹ Moreover, allowing for higher cost assumptions, pension and health spending could rise to as much as 34 percent of GDP. The budgetary impact of anticipated pension-related pressures is expected to be partially smoothed over time by the use of the NZS Fund to prefund a portion of future pension liabilities. While this was an important step, staff noted that the challenges of keeping public spending



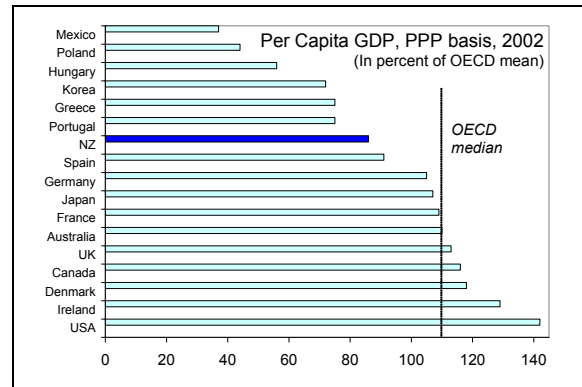
⁸ Staff estimate that the fiscal projections in the DEFU imply a cumulative fiscal impulse in 2005/06 to 2006/07 of about 1½ percent of GDP.

⁹ Creedy, J. and Scobie, G. “Population Ageing and Social Expenditure in New Zealand,” *The Australian Economic Review*, 38, 19-39, March 2005.

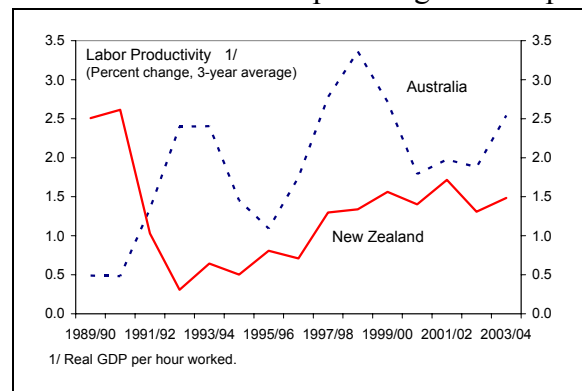
on a sustainable path remained substantial. Among measures that would need to be considered were parametric changes in the pension and health care systems. The authorities have recently decided to start publishing long-run fiscal reports at least every four years to help inform the public debate about these issues.

C. Growth and Structural Policy Issues

22. **New Zealand is aiming to sustain strong growth to raise living standards and ensure the economy is better placed to manage population aging.**¹⁰ Despite the economy's dynamism in recent years, New Zealand's per capita income remains some 20 percent below the OECD median level. In 2002, the government set the objective of closing this gap, and has begun monitoring progress on factors that will contribute to this goal.¹¹ The key finding is that labor productivity is at the lower end of the OECD range, and while labor productivity growth has increased from the second half of the 1990s, it remains below the OECD median.



23. **Hence the authorities intend to make the promotion of productivity growth a focus of future policy.** Even though rapid growth in employment has probably depressed the average skill level of the workforce, New Zealand's labor productivity growth has averaged 1½ percent per annum in recent years (Box 1). Nonetheless, the RBNZ has estimated that trend productivity growth would need to rise to about 2 percent in order to maintain the recent pace of growth in per capita incomes. Sustaining the recent strength of business investment would be crucial to achieving stronger productivity growth, and staff highlighted the importance of implementing planned improvements in the transportation and energy infrastructure on schedule, and of continuing to upgrade education and training to ensure the availability of people with the necessary skills. Staff welcomed proposed amendments to the



¹⁰ Chapter III of the forthcoming selected issues paper discusses the challenge of raising New Zealand's living standards as the population ages.

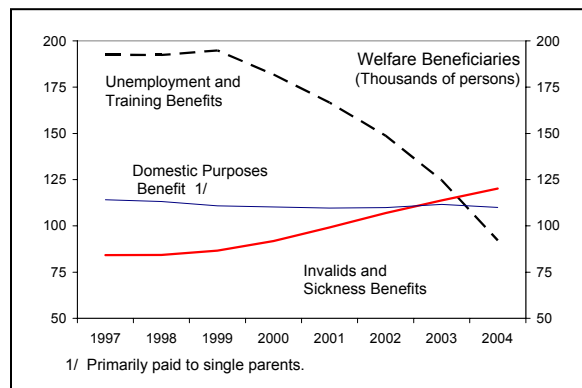
¹¹ "Growth through Innovation: Progress to Date," Ministry of Economic Development, February 2005.

Resource Management Act, since reducing uncertainties in the resource consent process would also be beneficial for investment.

24. **Maintaining New Zealand’s labor market flexibility is a critical element in sustaining high medium-term growth.** Amendments to the Employment Relations Act come into effect in 2005, including requirements to bargain in good faith, to limit “free-riding” of individual agreements on collective negotiations, and to facilitate increased use of multi-employer collective agreements. Significant minimum wage increases and the Holidays Act, which includes an extension in annual paid leave from three to four weeks by 2007, have also been adopted. While the authorities did not expect the functioning of the labor market to be impeded by these changes, staff recommended that the effects be reviewed after a suitable period. As the pool of available workers declines, the risk of making a poor employment match may become a higher barrier to hiring, and staff encouraged the authorities to review the adequacy of current arrangements for probationary periods.

25. **Current strong labor market pressures present an ideal opportunity for reforms to further expand labor participation.** The authorities explained that while New Zealand has relatively high overall labor participation, there are still some groups for whom reducing barriers to participation would help meet the pressing labor needs of employers. Hence staff welcomed recent measures to increase the opportunity for women to participate by expanding access to childcare. Staff noted that the WFF package had been carefully designed to avoid significant adverse impacts on labor participation, and by making returning to work more worthwhile for those on welfare benefits, it also provided a platform for other reforms to boost labor participation.

26. **The authorities outlined how more active case management was being used to help people make the shift from welfare to work.** The government was seeking to help people on benefits move back into work within their abilities by increasing resources for case management, including by simplifying benefit administration. It had also introduced trial employment periods for persons on the invalids benefit and pilot projects taking a case-by-case approach to addressing the health needs of those on sickness benefits. Staff welcomed these steps, especially as the sharp fall in unemployment has been partly offset by a 21 percent increase in the number of people receiving invalids and sickness benefits in the last three years. Staff suggested that the authorities’ efforts could be reinforced by utilizing elements of Denmark’s “right and duty” welfare model, where the right to benefits comes with the duty to participate in suitable training or work programs. This system has enabled Denmark to combine a strong welfare system with high labor participation.



27. **The authorities were developing a program to facilitate household savings.** A recent report proposed that employers should offer access to a savings plan, with voluntary employee participation via an ‘opt-out’ system.¹² The authorities were refining this proposal, with the aim of reducing the costs associated with saving, especially for those on lower incomes. Staff suggested that any budgetary incentives for saving should be time limited and income targeted. The authorities recognized that large saving incentives were not affordable, and indicated that the focus would likely be on offering “sweeteners” to join and stay in the scheme for a reasonable period. The staff noted that for many employees, such a program would not increase their saving, and even if total household savings rose, this was unlikely to much affect investment and growth, as the financial system has access to international capital.

28. **The authorities have long recognized the importance of an open international trade regime in promoting competition, innovation, and growth.** As New Zealand faces substantial foreign trade barriers in agricultural exports, it has a significant stake in the success of the Doha round, and has been active in discussions across the full range of issues. On the bilateral front, New Zealand concluded a closer economic partnership with Thailand in November 2004, and recent studies of bilateral free trade agreements (FTAs) with China and Malaysia reached positive conclusions. Current trade negotiations include those concerning a four-way partnership with Brunei Darussalam, Chile, and Singapore. Negotiations on an ASEAN-Australia and New Zealand Free Trade Area will commence in 2005.

29. **New Zealand’s official development assistance is focused on the Pacific.** Overall, New Zealand provided 0.23 percent of Gross National Income for ODA in 2003, close to the average for industrial countries, but well below the 0.7 percent United Nations target, which New Zealand remains committed to achieve.

D. Financial Sector Issues

30. **The RBNZ has been working to strengthen the regulatory framework for the banking system.** The banking sector has remained sound in recent years, with strong capital, low nonperforming assets, and well-managed risks. Policy initiatives in banking regulation include: (i) strengthening the RBNZ’s ability to monitor banks’ risks by adopting a framework for independent reviews of banks’ systems and controls, with the first use of this tool already made; (ii) reviewing the disclosure regime, particularly in light of Basel II, which includes a framework for strengthening market discipline that goes beyond the current New Zealand disclosure requirements; and (iii) enhancing the capacity to manage financial stresses, by operationalizing the RBNZ’s lender of last resort role and finalizing options for responding to bank failures. Furthermore, to ensure banks can operate on a stand-alone basis in a crisis, the RBNZ has developed a policy to limit the outsourcing of key functions. Staff

¹² “A Future for Work-based Savings in New Zealand,” Final Report of the Savings Product Working Group, August 2004.

welcomed these policy developments, which also represented substantial progress in addressing the main recommendations of the FSSA (IMF Country Report No. 04/126).

31. **The potential for closer integration of banking regulation with Australia is being discussed.** The New Zealand banking system is dominated by four large Australian-owned banks which account for some 85 percent of banking assets, and as a result, the RBNZ and the Australian Prudential Regulation Authority (APRA) have undertaken to build an enhanced home-host supervisory relationship.¹³ In addition, the Australian and New Zealand authorities have recently established a high-level council on banking supervision to coordinate trans-Tasman regulatory issues and guide the development of policy advice to the respective governments. While staff welcomed these efforts to strengthen supervisory coordination, it nonetheless stressed that it would be crucial that the final regulatory scheme adopted incorporate adequate safeguards for financial stability in New Zealand in the event of a crisis.

32. **Staff welcomed the publication of the first *Financial Stability Report*.** The October 2004 report notes that a slowing in the housing market could pose some difficulties for those nonbank financial institutions which have exposure to speculative developments, and staff supported the planned review of the regulation and disclosure of this class of institutions. Household debt has risen to 137 percent of disposable income, double its level 12 years ago, and household interest payments are projected to rise above previous highs in 2005–06 (Box 2). The stress-tests conducted as part of the FSSA found that the banking system was robust in the face of shocks to the household sector, including a substantial decline in housing prices. Nonetheless, staff endorsed the RBNZ's plans to use household-level data to further analyze the potential vulnerability of the household sector to higher interest rates or other shocks.

¹³ In this context, in March 2005, the RBNZ and APRA agreed on terms of engagement that establish high level principles for the cross border implementation of the Basel II capital framework.

III. STAFF APPRAISAL

33. **New Zealand has maintained its recent record of outperforming other advanced economies.** Over the last 6 years, growth has averaged 4 percent a year, compared to an annual average of 2½ percent across the OECD. Job creation has continued at a rapid pace, reducing unemployment to the lowest in the OECD. These macroeconomic achievements are underpinned by the sustained implementation of sound monetary and fiscal policies and the wide-ranging structural reforms undertaken in the past.

34. **Growth has continued to surprise on the upside.** Activity was expected to slow in 2004 as a result of the appreciation of the New Zealand dollar, combined with a substantial fall in net migration inflows that was expected to reduce pressures in the housing market and slow durable consumption as residential investment declined. However, exporters' incomes have held up, aided by strong commodity prices and widespread foreign exchange hedging. The strength of the labor market has also supported consumption, while promoting strong business investment to help overcome capacity pressures and the difficulty of finding labor.

35. **Clear signs of the anticipated decline in inflationary pressures have yet to emerge.** Since the beginning of 2004, domestic demand has been consistently stronger than envisaged, and with the potential pressure on prices not coming off as expected, the RBNZ has appropriately raised rates seven times. Yet even though resource utilization has risen to record high levels, inflation has remained inside the target range with strong upward pressures on nontraded goods prices being offset by low inflation in non-oil traded goods prices. However, labor markets are now exceptionally tight and inflation, already near the top of the band, may rise above 3 percent in 2005.

36. **In this environment, monetary policy faces a difficult balancing act.** While there continue to be upside risks to the inflation outlook, a further tightening could exacerbate a slowdown that may already be underway. It is expected that resource pressures will ease once lower net migration translates into a decisive cooling of the housing market, and the lagged effects on activity of higher interest rates and the more appreciated exchange rate come into play. On the other hand, high consumer confidence, strong investment intentions, and the highest terms of trade in 30 years, together pose a risk that domestic demand could again exceed expectations, in which case, resource pressures would not abate. On balance, given the underlying momentum in household consumption and business investment, staff agree with the RBNZ that the risks to inflation are predominantly on the upside and that monetary policy should retain a tightening bias.

37. **Fiscal performance has been very strong and prospects remain favorable, but there is limited scope for expansionary fiscal policy.** Policy objectives are to achieve operating surpluses over the economic cycle sufficient to cover contributions to the NZS Fund, and to meet capital spending requirements while bringing gross government debt down below 20 percent of GDP by 2015. The Treasury's December 2004 forecasts show operating surpluses over the next few years that are larger than previously anticipated. The higher than expected fiscal surpluses reflect buoyant revenues, and staff strongly endorse the authorities'

intention not to use the cyclical component of these revenues to raise spending. The new projections already imply a small stimulus over the next few years, and a more expansionary policy would risk adding to current resource pressures, while potentially complicating the attainment of the government's medium-term fiscal policy objectives. Moreover, the recent rapid growth in a number of spending categories, including health and education, is unlikely to be sustainable for much longer. In this light, the prudence and discipline that the government has shown over many years in making its expenditure decisions should be maintained.

38. **Rising health care costs and population aging will pose significant long-term challenges for fiscal policy.** Estimates made by the Treasury suggest that demographic changes over the next half century are likely to double or triple government spending on pensions and health care from the current level of 11 percent of GDP, depending on cost assumptions. The creation of the NZS Fund to prefund part of the future pension liabilities has been an important step to smooth out the effect on the budget of expected increases in pension obligations. However, if public spending is to be kept on a sustainable path, the challenges remain substantial, and parametric changes in the pension and health care systems will need to be considered. In this context, staff welcome the decision to start publishing long-run fiscal reports at least every four years since this will help inform public debate about the need for reforms.

39. **New Zealand has the potential for continued strong economic growth in the medium-term.** Despite the strong performance of the economy in recent years, per capita income remains some 20 percent below the OECD median. The challenge for New Zealand is to sustain high growth that will narrow this gap, while positioning the economy to manage the problems of population aging. In this endeavor, increasing labor productivity will be key, since there is no longer scope for the substantial gains in labor utilization that have occurred over the past decade. Indeed, the task for the next decade is to maintain high GDP growth in a period when the labor input is set to grow more slowly.

40. **Higher productivity growth will be crucial to sustaining medium-term growth.** A rise in productivity growth appears to be feasible if business investment remains high, thereby deepening the capital used by workers and bringing in new technology. The government can facilitate continued high investment by upgrading transportation and energy infrastructure, and ensuring that the education system equips the workforce with the requisite skills. Improving the Resource Management Act to reduce investor uncertainties will also assist in this regard.

41. **New Zealand's labor market flexibility is a key advantage that should be carefully preserved.** A range of measures affecting the labor market have recently been adopted, including the Holidays Act, amendments to the Employment Relations Act, and increases in the minimum wage. These measures are generally not expected to impair labor market flexibility, although the effects should be kept under close review. Given the tightness of the labor market, the risk of making a poor employment match may be deterring some

firms from hiring new staff. The adequacy of existing arrangements for probationary periods should therefore be reviewed.

42. **Using more active case management to help people transition from welfare to work is a promising approach to expand labor participation.** Although participation is already relatively high, there appears to be scope for increasing participation among certain groups, thus helping to meet the pressing labor needs of employers and cushion the impact of slowing net immigration. Recent measures to increase the opportunity for women to participate by expanding access to childcare are welcome, and the Working for Families package provides a useful foundation for further reforms to raise participation rates. The government has adopted significant new initiatives aimed at helping people on benefits back into work within their abilities, including trial employment periods for recipients of invalids benefit and taking a case-by-case approach to addressing the health problems of those receiving sickness benefit. These efforts could be reinforced by strengthening requirements for those on benefits to participate in training or work programs.

43. **The main benefits from schemes to promote savings probably lie in improving the resilience and economic opportunities of households.** Even if the proposals currently being debated do lead to an increase in aggregate savings, the effects on investment and growth are unlikely to be large as New Zealand already has easy access to international capital. Nonetheless, workplace savings systems can help households build financial assets that provide a buffer against shocks and expand their opportunities to invest in education, housing, small business, and retirement. As the authorities well recognize, the design of such schemes should take account of the administrative costs, while the incentives offered should be carefully designed so as to limit the impact on the budget.

44. **Reforms to banking regulation are underway.** The adage that roof mending is best done while the sun shines has been taken to heart in the reforms being made to New Zealand bank regulation. The financial sector is fundamentally sound, and the banking sector is blessed with strong capital, low nonperforming assets, and well-managed risks. In these favorable circumstances, the authorities' efforts to strengthen their regulatory and crisis management capacity are especially commendable. The planned review of the regulation and disclosure of nonbank financial institutions is also an important step. At this stage, it is unclear how discussions with Australia on the closer integration of banking regulation will progress, but the priority should be to ensure that adequate safeguards for financial stability in New Zealand remain.

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

Box 1. Rapid Employment Expansion and Productivity Growth

New Zealand's growth over the last decade has been primarily a labor utilization story, as the table below summarizes. With the employment ratio already at a historical high, labor input growth is set to decline in coming years, and New Zealand will need to increase productivity growth to sustain strong rates of GDP growth. Since labor input can be expected to rise by only about 1¼ percent a year over the medium-term, compared to 2½ percent over 1992-2004, productivity growth will need to increase to 2 percent a year (from about 1¼ per during 1992-2004) for the economy to achieve annual growth in potential output of 3¼ percent. To some extent these data overstate the required jump in productivity growth, since productivity growth has been higher in recent years than in the first half of the 1990s, at some 1½ percent.

Sources of Growth in New Zealand (annual averages, percentage points)

Time Period	GDP = growth	Labor productivity growth (output per hour worked)	+ Labor input growth (hours worked)	Contributions to labor input growth			
				Working age population	Participation rate	Change in unemployment	Total hours worked per person
1992 to 2004	3.7	1.2	2.5	1.3	0.4	0.6	0.2
1999 to 2004	3.9	1.5	2.4	1.4	0.5	0.8	-0.3
Medium term projections	3.3	2.0	1.3	1.3	0.1	-0.1	0.0

Source: IMF staff calculations, adapted from OECD (New Zealand 2003 Economic Survey).

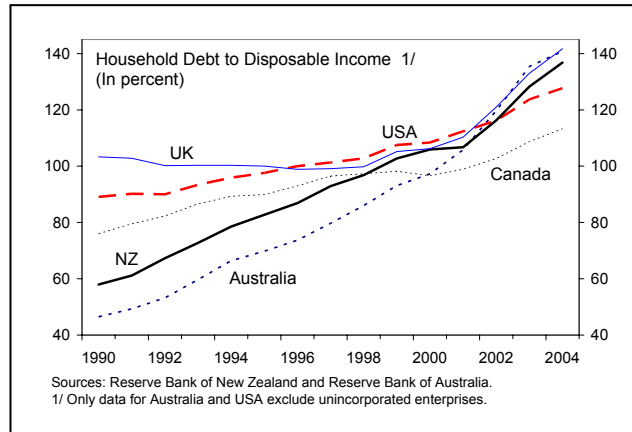
However, a significant increase in employment, as recently experienced in New Zealand, can itself lead to lower measurements of average productivity. When the employment rate increases, the newly employed workers tend to be less productive than existing workers, which mechanically reduces average productivity. BÉlorgey et al. (2004) estimate the impact of the employment rate on labor productivity for a panel of 25 industrial economies.¹ They find that a 1 percent increase in the employment rate decreases average productivity by ½ percent.

The increase in productivity growth required to maintain high GDP growth thus may be less daunting than it appears. The employment rate in New Zealand rose from 57 percent in 1992 to 64 percent in 2004, implying an average increase in the rate of about 1 percent a year. Extrapolating the results of BÉlorgey et al. (2004) to New Zealand suggests that this rapid growth in employment may have lowered measured average labor productivity growth by as much as ½ percent a year. This would suggest that in the absence of further growth in the employment ratio in the period ahead, measured productivity growth should be boosted by the end of the dampening effect on average productivity noted above. Moreover, the productivity of newly-hired workers can be expected to rise as they gain work experience, and it might do so more rapidly than the average worker given their lower initial level of productivity on average.

1/ BÉlorgey, N., Lecat, R., and T. Maury, 2004, "Determinants of Productivity per Employee: an Empirical Estimation Using Panel Data," *Bulletin de la Banque de France Digest*, No. 123, March 2004, pp. 59-84.

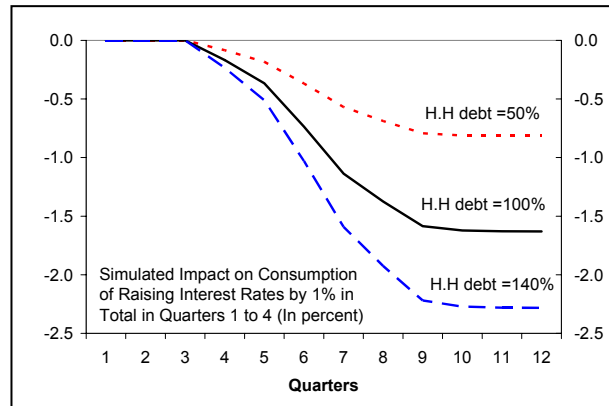
Box 2. Rising Household Indebtedness and Monetary Policy¹

As in other advanced economies, household debt levels have risen strongly in the last two decades in New Zealand. Following financial deregulation in the mid-1980s, and aided by the decline in nominal interest rates permitted by disinflation, the ratio of household debt to income in New Zealand doubled to 100 percent by the end of the 1990s. Borrowing accelerated in 2002-04, primarily due to the rise in housing prices, lifting the debt ratio to an estimated 137 percent at the end of 2004, a level broadly similar to the U.S., U.K., and Australia.



Higher indebtedness could increase the sensitivity of household spending to interest rates, potentially allowing monetary policy to achieve its goals with smaller interest rate adjustments. The negative impact of interest rates on the incomes of households that are debtors will be greater at higher debt levels (see Debelle, 2004). New Zealand households are relatively exposed to interest rate effects on their disposable income; at the end of 2004, some 85 percent of mortgage loans were at interest rates fixed for less than two years, or were at floating rates.

An analysis of consumer spending in New Zealand supports the hypothesis that interest sensitivity has increased. Real interest rates on housing mortgages are found to have a negative impact on consumption, and a model allowing this effect to depend on the level of household indebtedness has greater explanatory power. With household debt at 50 percent of disposable income, a 1 percentage point rise in the interest rate is estimated to reduce consumption by some ¾ percent after 2 years. With the household debt ratio near 140 percent, as at the end of 2004, the same interest rate increase is estimated to lower consumption by 2¼ percent.



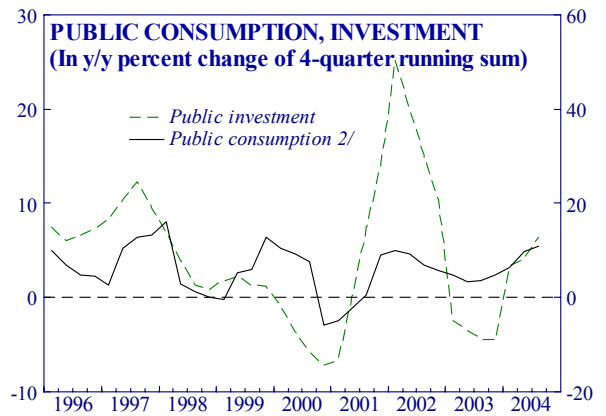
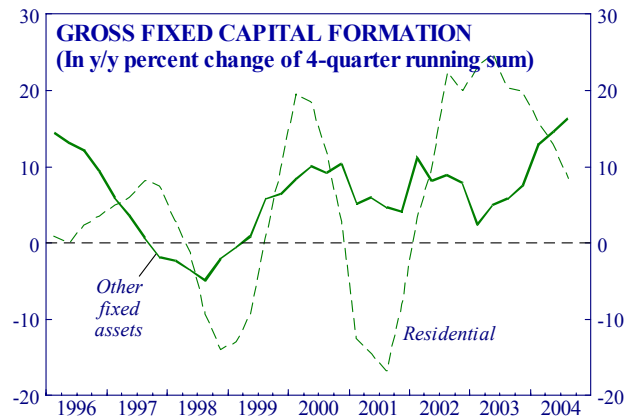
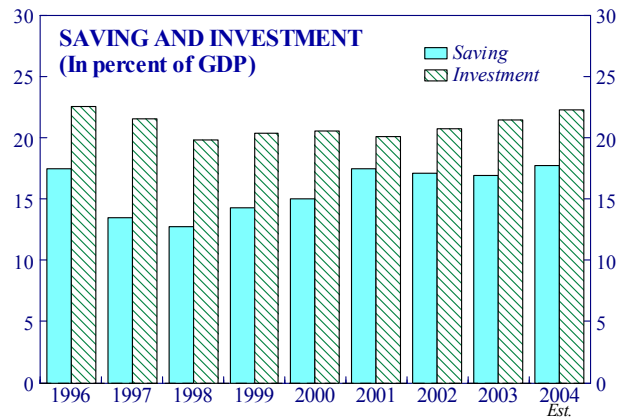
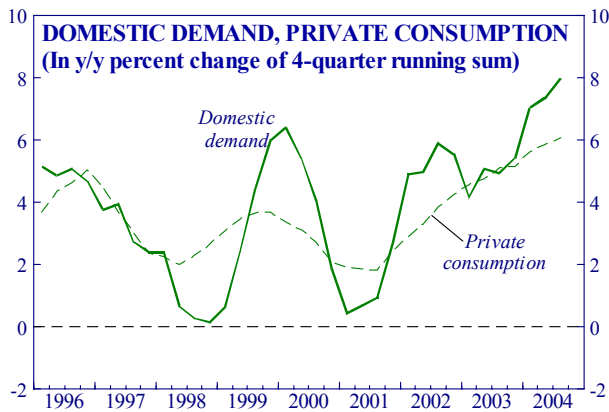
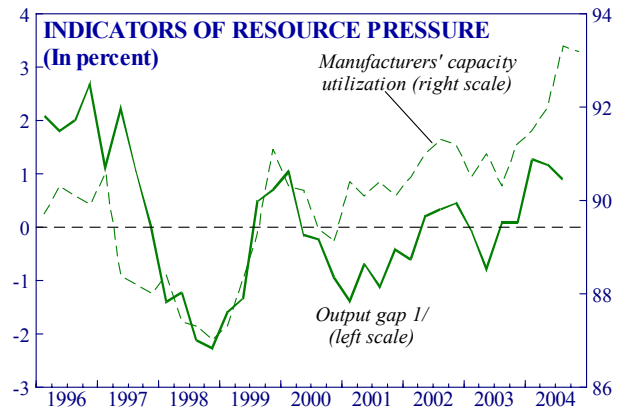
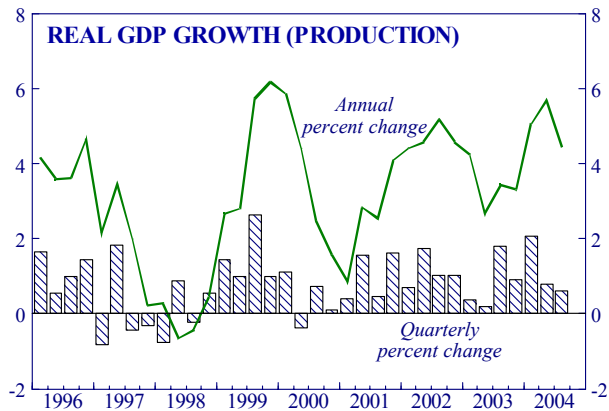
Nonetheless, the recent rise household's equity in housing could moderate the interest rate sensitivity of consumption looking forward. Recent U.S. research finds that households can better hedge income shocks when collateral for borrowing is more abundant (Lustig *et al*, 2004). Housing equity has risen by some 100 percentage points of income in recent years in New Zealand, so the scope for households to smooth income shocks from interest rate changes may have risen significantly.

¹ This topic is discussed further in Chapter IV of the forthcoming selected issues paper.

Debelle, Guy, 2004, "Macroeconomic implications of rising household debt," BIS Working Paper No. 153.

Lustig, Hanno and Stijn Van Nieuwerburgh, 2004, "Housing Collateral and Consumption Insurance Across US Regions," NBER Working Paper 10505.

Figure 1. New Zealand: Selected Real Economic Indicators, 1996–2004

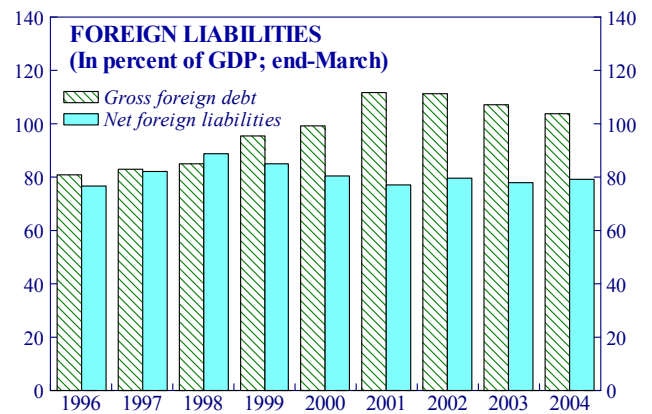
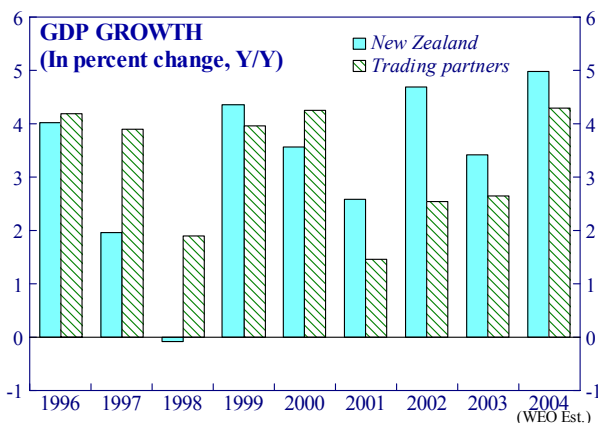
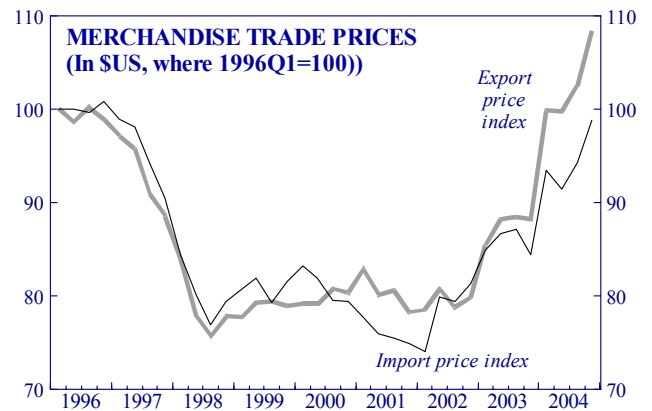
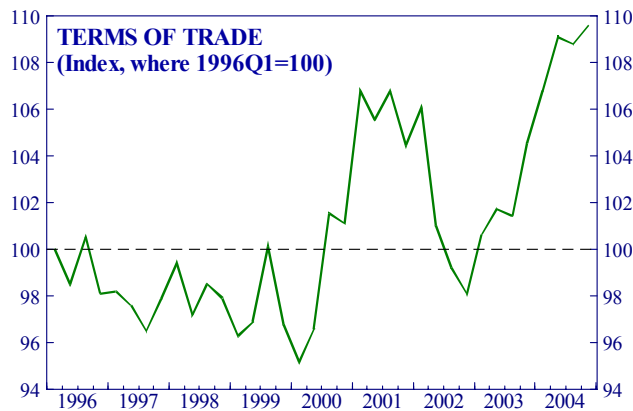
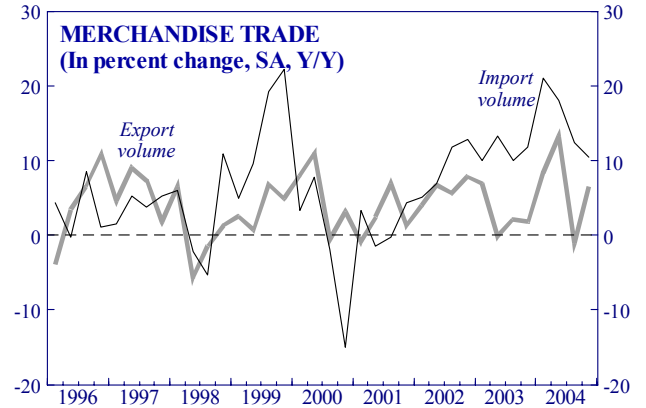
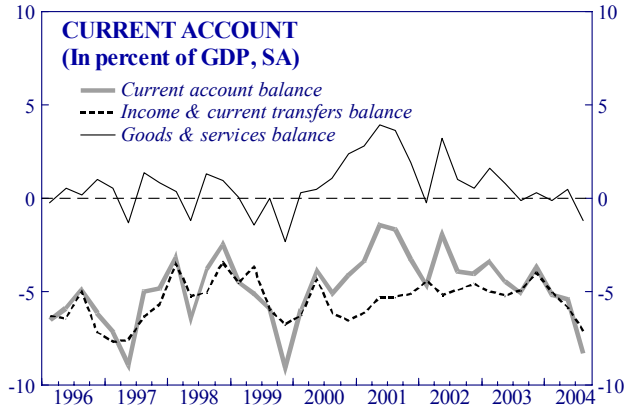


Sources: Statistics New Zealand; and staff estimates.

1/ Based on staff estimate of potential output.

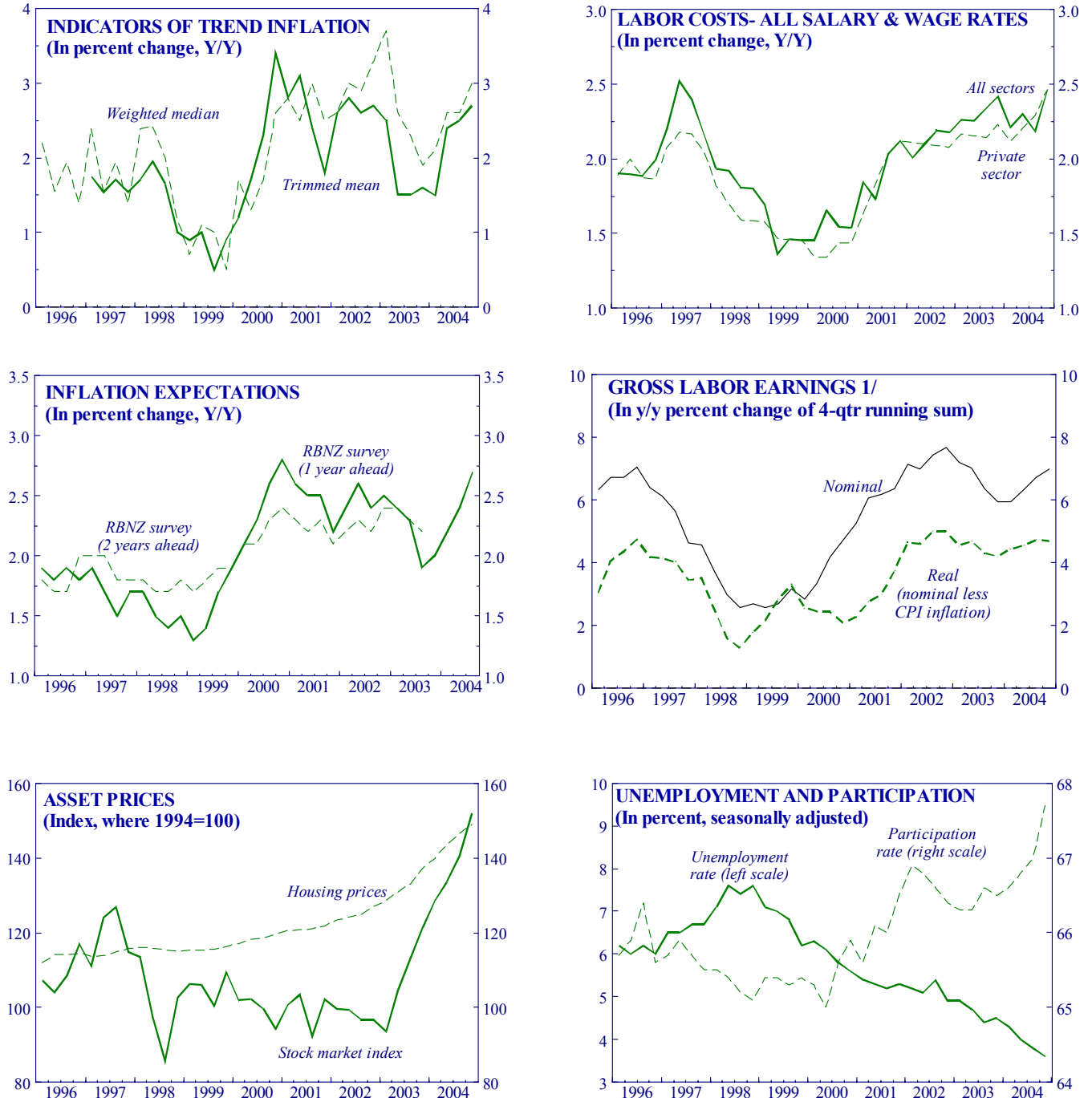
2/ 1999Q4 excludes purchases of naval frigate equipment, equivalent to 0.6 percent of GDP.

Figure 2. New Zealand: Balance of Payments and External Indicators, 1996-2004



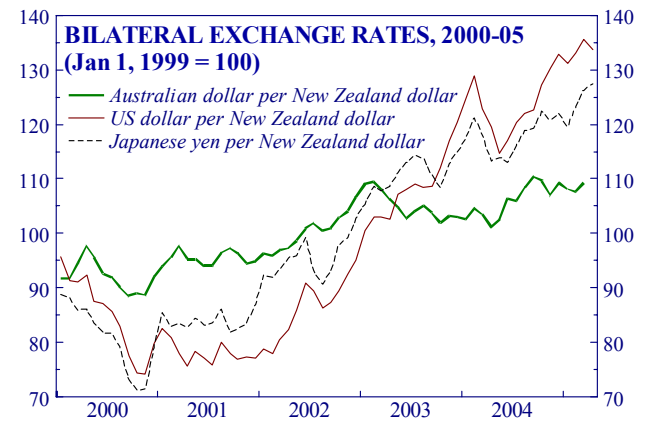
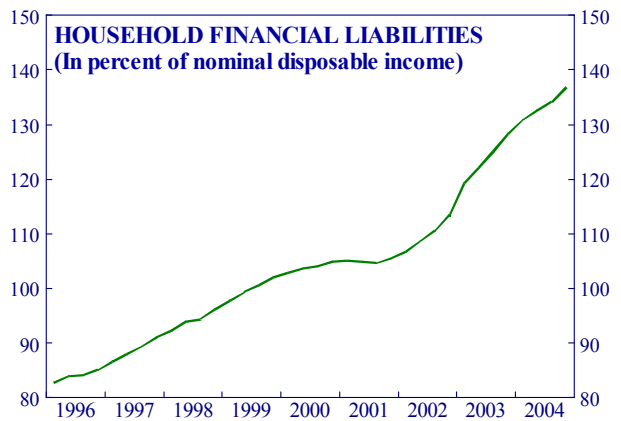
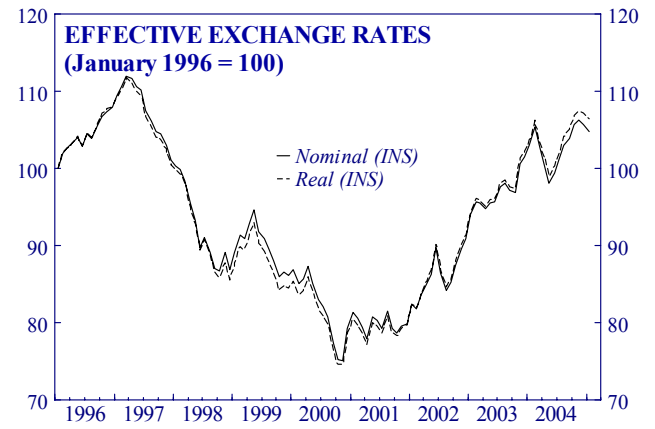
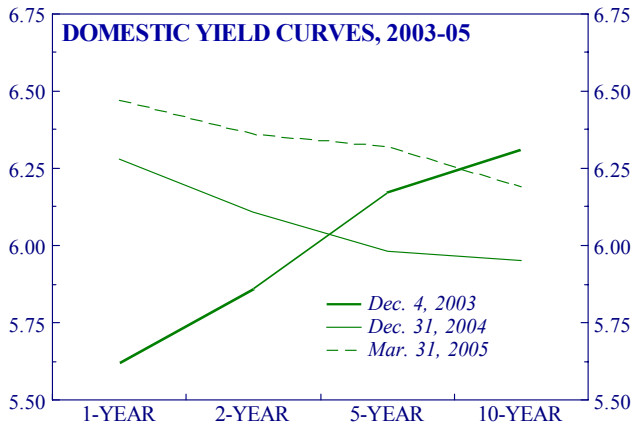
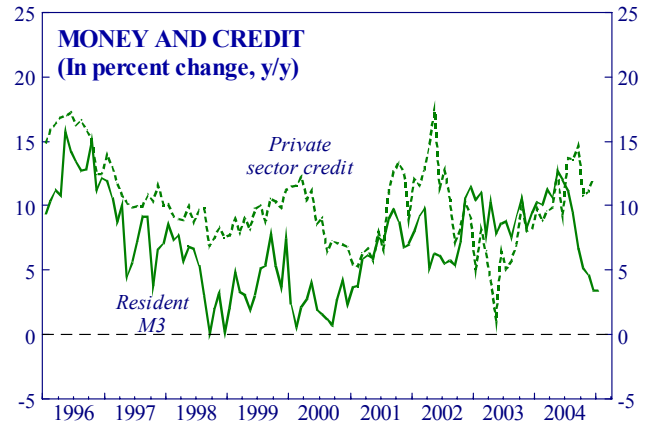
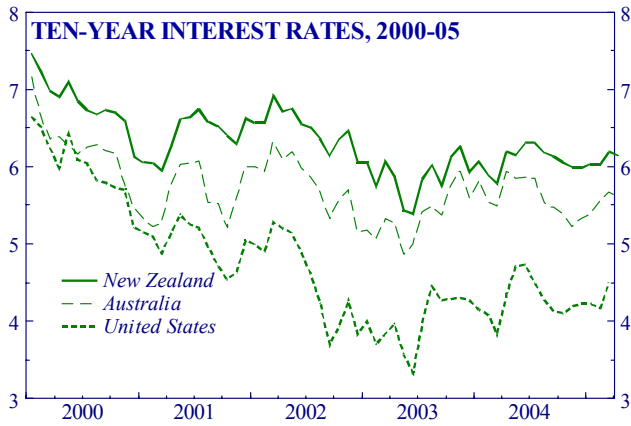
Sources: Statistics New Zealand; IMF, World Economic Outlook; and staff estimates.

Figure 3. New Zealand: Inflation and Labor Market Indicators, 1996-2004



Sources: Statistics New Zealand; Reserve Bank of New Zealand; and staff estimates.
 1/ Based on Quarterly Employment Survey (QES).

Figure 4. New Zealand: Monetary and Financial Indicators, 1996-2005



Sources: Statistics New Zealand; and staff estimates.

Table 1. New Zealand: Selected Economic and Financial Indicators, 2000–05

Nominal GDP (2003):	US\$ 78.8 billion					
Population (2003):	4.0 million					
GDP per capita (2003):	US\$ 19,603					
Quota:	SDR 894.6 million					
	2000	2001	2002	2003	2004	2005 Proj.
Real growth (percent change)						
GDP (production basis)	3.6	2.6	4.7	3.4	4.8	2.8
Domestic demand	1.9	2.6	5.6	5.3	8.0	3.6
Private consumption	2.1	2.3	4.2	5.1	6.1	3.2
Govt. consumption	-2.9	4.5	2.9	2.3	6.4	2.9
Fixed investment	8.3	0.9	10.8	10.0	12.4	3.8
o/w Residential	3.6	-8.7	19.8	20.1	5.1	-12.1
o/w Business	17.3	-1.9	4.5	13.6	15.8	8.6
Exports of goods and services	6.0	2.5	6.3	1.7	5.2	2.6
Imports of goods and services	0.3	1.7	9.6	7.9	15.8	5.1
Headline CPI inflation (percent change)						
End of period (percent change)	4.0	1.8	2.7	1.6	2.7	2.8
Unemployment rate (in percent)	6.0	5.3	5.2	4.6	3.9	3.8
Investment and saving (in percent of GDP)						
Investment	21.2	20.8	22.0	22.2	24.0	24.4
National saving 1/	14.9	18.3	18.3	18.1	17.6	17.4
Private saving	10.8	13.3	12.3	10.9	9.0	9.2
Public saving	4.1	5.0	6.0	7.1	8.6	8.2
Public finance (in percent of GDP) 2/						
Revenue	33.2	33.6	31.8	33.9	33.4	33.6
Expenditure	32.9	32.5	30.3	32.4	29.6	30.4
Operating balance 3/	1.3	1.2	1.9	1.5	5.3	3.7
OBERAC 4/	0.8	1.8	2.2	4.3	4.7	4.3
Estimated structural balance 5/	0.5	1.9	2.3	4.4	4.4	3.8
Net public debt	19.5	17.0	14.2	13.7	10.8	8.7
Money and credit (end of period)						
Resident M3 (percent change)	2.3	7.0	11.5	9.5	3.4	...
Private domestic credit (percent change)	6.8	8.9	9.0	8.2	12.1	...
Interest rate (90-day, in percent) 6/	6.7	4.9	5.9	5.3	6.8	7.1
Government bond yield (10-year, in percent) 6/	6.1	6.6	6.1	5.9	6.0	6.2
Balance of payments (\$NZ billion)						
Current account	-5.4	-3.0	-4.7	-5.6	-9.3	-10.8
(in percent of GDP)	-4.8	-2.4	-3.7	-4.2	-6.4	-7.0
Trade balance (goods)	1.5	3.5	0.4	-0.7	-2.1	-2.6
Exports	29.8	33.1	31.3	28.9	30.8	31.9
Imports	-28.3	-29.6	-31.0	-29.6	-32.9	-34.4
Terms of trade (percent change)	1.2	7.2	-4.5	0.9	6.4	1.0
Foreign assets and liabilities (\$NZ billion) 7/						
Net international investment position	-92.5	-92.2	-100.2	-106.1	-123.5	-133.9
(in percent of GDP)	-81.5	-75.7	-78.4	-78.7	-84.5	-86.6
Gross short-term external debt 8/	71.6	70.3	71.5	67.0	80.9	...
Gross foreign currency denominated debt 9/	73.9	76.2	70.0	70.6	81.7	...
Official reserves	9.0	8.6	9.4	9.3	9.7	...
Exchange rate (end of period)						
US\$/NZ\$ 6/	0.44	0.42	0.52	0.66	0.72	0.71
Trade-weighted index (June 1979 = 100) 6/	49.7	49.9	58.2	65.1	68.8	70.0
Nominal effective exchange rate 10/	85.9	86.5	98.5	110.1	114.6	...
Real effective exchange rate 10/	81.9	83.1	95.3	106.5	111.6	...

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 accounting changes.

5/ Fund staff estimates; equals operating balance net of cyclical effects, revaluations and changes in accounting rules.

6/ Data for 2005 are as of March 25.

7/ Data from 2001 are not directly comparable with the historical data due to adoption of BPM5 methodology.

8/ Residual maturity basis. Total Overseas Debt data until 2000, and International Investment Position data thereafter.

9/ Includes debt that is unallocated in terms of foreign currency denomination.

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

Table 2. New Zealand: Balance of Payments and External Debt, 2000–04

	2000	2001	2002	2003	2004
	(In percent of GDP)				
Current account balance	-4.8	-2.4	-3.7	-4.2	-6.4
Trade balance	1.3	2.9	0.3	-0.5	-1.4
Exports, f.o.b.	26.3	27.2	24.5	21.5	21.1
Imports, f.o.b.	-24.9	-24.3	-24.2	-22.0	-22.5
Services balance	-0.3	0.2	0.8	1.1	1.1
Receipts	8.5	8.5	8.8	8.2	8.2
Payments	-8.8	-8.4	-7.9	-7.1	-7.1
Income balance	-6.4	-5.8	-5.1	-5.0	-6.1
Receipts	1.4	1.2	1.8	1.8	1.6
Payments	-7.7	-7.0	-6.9	-6.7	-7.7
Transfers balance	0.5	0.4	0.2	0.2	0.1
Inflows	1.2	1.1	1.0	1.0	0.9
Outflows	-0.8	-0.8	-0.8	-0.8	-0.8
Capital and financial account balance 1/	2.1	4.3	3.0	4.9	6.0
Capital account (net)	-0.3	0.9	1.3	0.6	0.3
Financial account (net)	2.4	3.4	1.8	4.3	5.7
Direct investment (net)	4.0	3.7	0.9	2.7	3.0
Portfolio investment (net)	-1.5	0.6	2.5	1.7	1.7
Equity securities (net)	-4.5	-1.8	-0.3	-0.3	...
Debt securities (net)	3.0	2.4	2.8	1.9	...
Other investment (net)	-0.1	-0.9	-1.6	-0.1	1.0
Net errors and omissions 2/	2.5	-2.2	2.5	-0.2	1.1
Overall balance	-0.3	-0.4	1.8	0.6	0.8
	(Assets and liabilities as of end-December) 3/				
Total external debt 4/	109.5	105.5	107.9	101.8	104.2
Short-term 5/	63.1	57.7	55.9	49.7	55.4
Long-term	46.4	47.8	51.9	52.1	48.8
Net international investment position	-81.5	-75.7	-78.4	-78.7	-84.5
Net equity	-15.1	-14.4	-18.4	-19.1	-23.3
Net debt	-66.4	-61.3	-60.0	-59.6	-61.3
Official reserves (billions of NZ dollars)	9.0	8.6	9.4	9.3	9.7
(In months of future imports of g&s)	3.3	3.2	3.9	3.8	3.9
(As percent of short-term debt)	12.5	12.2	13.2	13.9	11.9

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

1/ Based on IFS data, except for 2003 (where IFS data are unavailable as yet). For 2003, data are from Statistics New Zealand.

2/ Calculated as a residual.

3/ Data from 2001 are not fully comparable with the historical data due to methodology changes to comply with BPM5.

4/ Data based on Total Overseas Debt statistics until 2000, and on the International Investment Position thereafter.

5/ Remaining term until interest rate adjustment of less than one year, rather than residual maturity.

Table 3. New Zealand: Summary of Central Government Budget, 1999/00–2004/05 1/

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05 DEFU
	(In billions of New Zealand dollars)					
Revenue	36.5	39.5	39.9	43.6	46.9	50.6
Tax revenue	34.0	36.7	36.5	39.8	42.5	45.7
Direct taxation	21.5	23.9	24.5	26.8	28.6	30.9
Indirect taxation	12.5	12.9	12.0	13.0	14.0	14.7
Nontax revenue	2.5	2.8	3.5	3.8	4.4	4.9
Expenditure	36.2	38.2	38.0	41.7	41.6	45.8
Social security and welfare	12.9	13.2	13.5	13.9	14.3	14.7
New Zealand Superannuation	5.1	5.3	5.5	5.6	5.9	6.1
Other	7.8	7.9	8.0	8.3	8.4	8.6
Health	6.9	7.3	7.0	7.5	8.1	8.8
Education	6.3	6.7	6.5	7.0	7.6	8.2
Finance costs	2.4	2.5	2.1	2.4	2.3	2.2
Other	7.7	8.5	8.9	11.0	9.4	11.8
Revenue less expenditure	0.4	1.3	1.9	1.9	5.3	4.8
Net surplus from SOEs and Crown entities 2/	1.1	0.1	0.5	0.1	2.1	0.8
Operating balance 3/	1.4	1.4	2.4	2.0	7.4	5.6
OBERAC 4/	0.9	2.1	2.8	5.6	6.6	6.5
Cash balance 5/	-0.4	0.3	0.2	5.3	6.0	5.6
Capital investment 6/	1.3	1.6	3.6	2.4	3.0	3.8
Gross Sovereign-issued debt	36.0	36.8	36.2	36.1	35.5	33.8
Net Core Crown debt	21.4	20.0	17.8	17.6	15.2	13.1
Net worth 7/	8.6	11.5	18.7	23.8	35.5	41.1
	(In percent of GDP)					
Revenue	33.2	33.6	31.8	33.4	33.4	33.6
Tax revenue	30.9	31.3	29.1	30.4	30.3	30.4
Direct taxation	19.5	20.3	19.6	20.5	20.3	20.6
Indirect taxation	11.4	11.0	9.5	9.9	9.9	9.8
Nontax revenue	2.3	2.3	2.8	2.9	3.1	3.3
Expenditure	32.9	32.5	30.3	31.9	29.6	30.4
Social security and welfare	11.7	11.3	10.8	10.6	10.1	9.8
New Zealand superannuation	4.6	4.5	4.3	4.3	4.2	4.0
Other	7.1	6.8	6.4	6.3	6.0	5.7
Health	6.2	6.3	5.6	5.7	5.8	5.9
Education	5.7	5.7	5.2	5.4	5.4	5.5
Finance costs	2.2	2.1	1.7	1.8	1.6	1.5
Other	7.0	7.2	7.1	8.4	6.7	7.8
Revenue less expenditure	0.3	1.1	1.5	1.4	3.8	3.2
Net surplus from SOEs and Crown entities	1.0	0.1	0.4	0.1	1.5	0.5
Operating balance 3/	1.3	1.2	1.9	1.5	5.3	3.7
OBERAC 4/	0.8	1.8	2.2	4.3	4.7	4.3
Cash balance 5/	-0.4	0.3	0.2	4.0	4.3	3.7
Capital investment 6/	1.2	1.3	2.8	1.9	2.1	2.5
Structural cash balance 8/	-0.3	0.5	1.4	4.4	3.9	4.0
Gross Sovereign-issued debt	32.8	31.3	28.9	27.6	25.3	22.5
Net Core Crown debt	19.4	17.0	14.2	13.4	10.8	8.7
Net worth 7/	7.8	9.8	14.9	18.2	25.2	27.3
<i>Memorandum item</i> (in billions of NZ dollars)						
Contributions to NZ Superannuation Fund	...	...	0.6	1.2	1.9	2.1

Sources: New Zealand Treasury; DEFU (December Economic and Fiscal Update) 2004 and Fund staff estimates.

1/ Fiscal year ending June 30. Changes have been made to the compilation of fiscal data starting in 2001/02; data prior to that date are not fully comparable.

2/ The value for 1999/00 includes \$NZ 0.519 billion corresponding to movements in ACC valuations.

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.

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

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.

8/ Fund staff estimate; equals overall cash balance net of cyclical effects as a percent of potential GDP.

Table 4. New Zealand: Medium-Term Scenario, 2002–10

	Average	2002	2003	2004	Projections					
	1995-2004				2005	2006	2007	2008	2009	2010
Real growth (percent change)										
GDP (production basis)	3.4	4.7	3.4	4.8	2.8	2.6	3.0	3.2	3.2	3.3
Domestic demand	4.2	5.6	5.3	8.0	3.6	2.4	2.8	3.1	3.1	3.2
Consumption	3.7	3.9	4.5	6.1	3.1	2.3	2.5	3.0	3.0	3.0
Private consumption	3.8	4.2	5.1	6.1	3.2	2.2	2.4	3.0	3.0	3.0
Govt. consumption	3.3	2.9	2.3	6.4	2.9	2.8	2.8	2.8	2.8	2.8
Fixed Investment	6.3	10.8	10.0	12.4	3.8	4.1	4.1	3.4	3.3	3.6
o/w Business	7.0	4.5	13.6	15.8	8.6	7.8	6.0	4.6	4.4	4.9
Exports of goods and services	4.3	6.3	1.7	5.2	2.6	3.9	4.6	5.1	5.1	4.9
Imports of goods and services	6.7	9.6	7.9	15.8	5.1	3.0	4.0	4.4	4.3	4.4
Saving and investment (percent of GDP)										
Gross capital formation	21.7	22.0	22.2	24.0	24.4	24.2	24.1	23.9	23.7	23.6
Fixed investment	20.7	20.8	21.4	22.8	22.8	23.0	23.0	22.8	22.6	22.5
o/w Business	11.5	11.0	11.1	11.6	12.2	13.0	13.3	13.4	13.5	13.7
Increase in stocks	1.0	1.2	0.8	1.2	1.6	1.2	1.1	1.1	1.1	1.1
National saving 1/	16.6	18.3	18.1	17.6	17.4	17.2	17.5	17.9	18.4	18.7
Private	10.7	12.3	10.9	9.0	9.2	9.3	10.3	10.9	11.4	11.9
Public	5.9	6.0	7.1	8.6	8.2	7.9	7.2	7.0	6.9	6.8
Inflation and unemployment										
Headline CPI inflation	2.0	2.7	1.8	2.3	2.9	2.7	2.4	2.1	2.0	2.0
Unemployment rate	5.8	5.2	4.6	3.9	3.8	4.2	4.4	4.5	4.5	4.5
Government budget (percent of GDP) 2/										
Revenue	34.7	31.8	33.9	33.4	33.6	33.9	34.0	34.1	34.3	34.3
Expenditure	32.8	30.3	32.4	29.6	30.4	30.9	31.7	32.2	32.3	32.3
Net surplus from SOEs and Crown entities	0.5	0.4	0.1	1.5	0.5	0.9	1.0	1.0	1.0	1.0
Operating balance 3/	2.4	1.9	1.5	5.3	3.7	4.0	3.3	2.9	3.0	3.0
OBERAC 4/	...	2.2	4.3	4.7	4.3	4.0	3.3	2.9	3.0	3.0
Cash balance 5/	...	0.2	4.1	4.3	3.7	2.7	2.2	2.2	2.4	2.4
Gross Crown debt	...	28.9	28.0	25.3	22.5	21.4	20.4	20.1	19.6	19.2
Net Crown debt	...	14.2	13.7	10.8	8.7	8.0	7.8	7.6	7.4	7.3
Net Worth 6/	...	14.9	18.5	25.3	27.3	30.4	32.6	34.0	35.4	36.9
Terms of trade (percent change, goods)										
Export prices	0.7	-4.5	0.9	6.4	1.0	-0.2	1.1	1.9	1.9	1.6
Import prices	0.5	-10.4	-10.9	1.2	0.9	0.8	1.2	2.3	2.6	2.4
Import prices	-0.3	-6.2	-11.7	-4.9	-0.1	1.0	0.1	0.4	0.7	0.8
Balance of payments (percent of GDP)										
Current account balance	-4.9	-3.7	-4.2	-6.4	-7.0	-7.0	-6.6	-6.0	-5.3	-4.8
Balance on goods and services	0.7	1.1	0.6	-0.3	-0.6	-0.5	-0.1	0.5	1.0	1.4
Balance on goods	0.7	0.3	-0.5	-1.4	-1.7	-1.5	-1.1	-0.6	0.0	0.5
Balance on services	0.0	0.8	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.0
Balance on income and transfers	-5.6	-4.9	-4.8	-6.1	-6.4	-6.5	-6.5	-6.5	-6.4	-6.3
Balance on income	-6.0	-5.1	-5.0	-6.1	-6.5	-6.7	-6.6	-6.6	-6.5	-6.4
Balance on transfers	0.4	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net foreign liabilities (percent of GDP) 7/										
Gross external debt	80.3	78.4	78.7	84.5	86.6	89.3	91.1	92.0	92.3	92.1
Gross external debt	98.5	107.9	101.8	104.2	105.7	107.6	108.8	109.5	109.7	109.5

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

1/ Fund staff estimates; based on national accounts data.

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 accounting changes.

5/ Fund staff estimates; equals cash flows from operations less cash flows on investment.

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

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

Table 5. New Zealand: External Debt Sustainability Framework, 2000–10
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing non-interest current account 6/ -0.4	
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		2010
I. External debt	109.5	105.5	107.9	101.8	104.2	105.6	107.5	108.7	109.3	109.5	109.4	
2 Change in external debt	5.8	-4.0	2.4	-6.1	2.4	1.4	1.8	1.3	0.6	0.2	-0.1	
3 Identified external debt-creating flows (4+8+9)	6.6	-6.2	-6.4	-10.8	-7.4	4.0	3.9	3.2	2.2	1.6	1.1	
4 Current account deficit, excluding interest payments	0.0	-1.9	0.0	0.9	2.7	2.9	2.8	2.2	1.3	0.5	-0.2	
5 Deficit in balance of goods and services	-1.1	-3.0	-1.1	-0.6	0.3	0.6	0.4	0.1	-0.5	-1.0	-1.4	
6 Exports	34.8	35.7	33.3	29.7	29.3	28.8	29.0	29.3	29.9	30.5	31.1	
7 Imports	33.7	32.7	32.2	29.1	29.6	29.4	29.4	29.3	29.4	29.5	29.7	
8 Net non-debt creating capital inflows (negative)	-7.4	-6.6	0.4	0.7	0.1	-0.4	-0.4	-0.4	-0.4	-0.4	-0.3	
9 Automatic debt dynamics 1/	14.0	2.2	-6.8	-12.4	-10.3	1.5	1.5	1.4	1.3	1.4	1.6	
10 Contribution from nominal interest rate	4.8	4.4	3.7	3.3	3.6	4.1	4.2	4.4	4.6	4.8	5.0	
11 Contribution from real GDP growth	-4.0	-2.9	-4.3	-2.8	-4.0	-2.6	-2.7	-3.1	-3.4	-3.4	-3.4	
12 Contribution from price and exchange rate changes 2/	13.2	0.7	-6.2	-12.9	-9.9	...	...	...	...	...	...
13 Residual, incl. change in gross foreign assets (2-3) 3/	-0.8	2.2	8.8	4.7	9.9	-2.6	-2.0	-1.9	-1.6	-1.4	-1.2	
External debt-to-exports ratio (in percent)	314.9	295.3	324.3	342.8	355.7	366.3	370.8	371.4	366.2	358.8	351.3	
Gross external financing need (in billions of US dollars) 4/	28.4	37.9	37.7	47.5	56.7	73.2	76.4	80.2	83.6	86.9	90.3	
in percent of GDP	54.7	73.9	63.6	60.5	58.4	67.3	67.7	68.2	68.3	68.1	67.9	
Key Macroeconomic Assumptions												
Real GDP growth (in percent)	3.6	2.6	4.7	3.4	4.8	2.8	2.6	3.0	3.2	3.2	3.3	
GDP deflator in US dollars (change in percent)	-11.3	-4.0	10.7	27.9	18.3	9.1	1.1	1.1	1.0	1.0	0.9	
Nominal external interest rate (in percent)	4.2	3.9	4.0	4.0	4.4	4.4	4.2	4.3	4.4	4.6	4.8	
Growth of exports (US dollar terms, in percent)	5.8	1.4	7.8	18.1	22.0	10.3	4.3	5.1	6.4	6.6	6.3	
Growth of imports (US dollar terms, in percent)	-0.5	-4.3	13.9	19.6	26.0	11.2	3.9	3.7	4.4	4.7	4.9	
Current account balance, excluding interest payments	0.0	1.9	0.0	-0.9	-2.7	-2.9	-2.8	-2.2	-1.3	-0.5	0.2	
Net non-debt creating capital inflows	7.4	6.6	-0.4	-0.7	-0.1	0.4	0.4	0.4	0.4	0.4	0.3	
A. Alternative Scenarios												
A1. Key variables are at their historical averages in 2005-09 5/						105.6	101.6	97.8	94.4	91.2	88.3	
B. Bound Tests												
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006						105.6	109.0	111.8	112.4	112.6	112.4	
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						105.6	109.9	114.0	114.6	114.7	114.6	
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006						105.6	124.9	146.5	146.8	146.9	146.8	
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006						105.6	108.8	112.0	112.6	112.8	112.7	
B5. Combination of B1-B4 using one standard deviation shocks						105.6	122.3	141.5	142.3	142.5	142.3	
B6. One time 30 percent nominal depreciation in 2005						105.6	129.0	130.0	130.5	130.6	130.5	
II. Stress Tests for External Debt Ratio												
Debt-stabilizing non-interest current account 6/												-4.3

1/ Derived as $[r - g - \rho(1+r)] / (1+g+r) + \alpha\alpha(1+r)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms; g = real GDP growth rate; α = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \alpha\alpha(1+r)] / (1+g+r)$ times previous period debt stock; ρ increases with an appreciating domestic currency ($\alpha > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes, which is large in 2005 due to the exchange rate appreciation during 2004. The impact of price and exchange rate changes falls to negative 1 percent of GDP in later years.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Economic Vulnerability Assessment

1. **New Zealand does not appear to face major economic vulnerabilities.**¹⁴ Overall, the economy remains well placed to manage adverse economic shocks. While net foreign liabilities remain high, they have declined from their peak. Foreign debt has become more concentrated in the banking sector and its maturity has shortened, reflecting increased intermediation of capital flows by banks. About half of the debt remains denominated in foreign currency, but exchange rate risk is mitigated through substantial hedging. Corporate and banking sector balance sheets continue to look strong, and they have proven in the past to be resilient to large swings in exchange rates and interest rates. Household balance sheets and finances also look reasonably sound. Housing remains the main household asset, and mortgage debt is the major household liability and a major asset of the banking system. Higher leverage has recently increased debt servicing costs of households, and a substantial increase in interest rates or unemployment or a correction in housing prices could potentially strain the finances of some households.

A. External Position

New Zealand: Key External Vulnerability Statistics

	1998	1999	2000	2001	2002	2003	2004
	(In percent of GDP at end-March)						
Current account (annual)	-5.5	-4.2	-6.5	-4.1	-2.7	-3.4	-4.6
Net foreign liabilities	88.7	85.1	80.2	76.8	79.8	78.1	79.5
Gross external debt	85.0	95.4	98.9	111.5	111.6	107.2	104.0
<i>Of which:</i>							
Local currency denominated	45.4	45.0	42.8	40.8	47.5	53.4	50.7
Short-term (residual maturity)	35.0	40.7	49.1	56.7	59.0	54.1	52.7
Official government	20.1	17.0	16.4	14.8	16.2	13.7	13.3
Foreign-currency denominated external debt	39.6	50.4	56.1	70.7	64.1	53.8	53.3
Share of which hedged (in percent)	94.9	97.2	96.6	99.8	94.4	89.0	87.9
Financial derivatives	54.1	50.3	52.8	50.8	57.7	61.5	62.2
Naturally hedged	40.7	25.5	25.5	30.1	27.6	27.5	25.8
Unhedged	5.1	24.2	21.6	19.1	14.6	11.1	12.2
	(Annual percentage growth at end-December)						
Exports of goods and services (y-o-y volume)	1.8	8.1	6.0	2.5	6.3	1.7	5.2
Imports of goods and services (y-o-y volume)	1.3	11.8	0.3	1.7	9.6	7.9	15.8
Terms of trade (quarterly index)	-0.7	-1.1	1.5	4.9	-4.1	9.2	6.4
Real effective exchange rate (1990=100)	89.2	88.0	81.9	83.1	95.3	106.5	111.6

Sources: Statistics New Zealand; Fund staff estimates.

2. **Net external liabilities have remained broadly unchanged over the last four years, as assets have kept pace with the rise in debt.** Gross external debt increased from 85 percent of GDP at end-March 1998 to 111 percent at end-March 2001, and has since declined to 104 percent at end-March 2004 (Table 1).¹⁵ Banks account for a growing proportion of external debt, as their external debt more than doubled from 25 percent of GDP

¹⁴This annex updates the vulnerability assessment provided in *New Zealand: 2004 Article IV Consultation*, IMF Staff Country Report No. 04/116, 2004, which concluded that there were no major vulnerability concerns.

at end-March 1997 to 59 percent at end-March 2004, and they now account for some 57 percent of total gross external debt. It is notable that this debt is generally owed to the Australian banks that own the New Zealand banks, reducing the rollover and other risks associated with external debt. At the same time, foreigners' holdings of New Zealand government debt have declined, representing only some 13 percent of total debt at end-March 2004.

3. **The maturity profile of the external debt has been shortening, while there has recently been a decline in the foreign currency component.** As the financial sector raises most of its funds at shorter maturities than the government and corporate sectors, the rise in the share of banks' external debt has caused a shortening of the maturity. The foreign currency component of the external debt has declined to 51 percent of total debt at end-March 2004, after rising to 63 percent at end-March 2001. The risks from foreign currency exposure are mitigated by a substantial degree of hedging. Recent survey data indicate that exchange rate risk for a large though declining share of the foreign currency debt is hedged (Table 2).¹⁶ For the debt covered by the survey, some 88 percent has been hedged either through natural hedges or using financial derivatives. Dependence on financial derivatives for hedging has increased sharply since end-March 1998. The market for these instruments appears to be reasonably deep and has proven to be rather resilient, given the large swings in the value of the New Zealand dollar in recent years.

¹⁵ Data from 2001 are not fully comparable to earlier data due to methodological changes in the New Zealand balance of payments accounts.

¹⁶ Hedging information is collected by Statistics New Zealand from a survey of corporations. In 2003, the survey covered some 80 percent of foreign currency debt.

B. Sectoral Balance Sheets

Banks

New Zealand: Banks' Balance Sheet Indicators					
End of March Year	2000	2001	2002	2003	2004
<i>Assets (in share of total) 1/</i>					
Financial investments	11.6	15.1	13.0	12.8	10.2
Residential mortgage loans	42.0	39.0	41.4	40.2	42.9
Other lending	40.6	37.1	40.7	41.3	39.3
Other assets	5.8	8.8	4.9	5.6	7.7
<i>Profitability indicators (year average)</i>					
Lending Margin	2.4	2.3	2.3	2.5	2.6
Return on Average Assets	1.1	1.1	1.1	1.4	1.3
<i>Capital adequacy ratio measures</i>					
Total	10.3	10.6	10.9	11.5	10.4
Tier one	7.0	7.2	7.8	8.4	7.9
Impaired assets (as a percentage of total lending)	0.4	0.6	0.4	0.3	0.2
Source: RBNZ Financial Stability Report (October 2004 issue).					
1/ For systemically important banks.					

4. **New Zealand's banking sector performance remains very strong.** With a robust domestic economy, New Zealand banks remained solidly profitable in 2004; their return on assets was 1.3 percent.¹⁷ The banks are well capitalized, maintaining total capital of more than 10 percent and tier-one capital of about 8 percent of risk-weighted assets.¹⁸ The overall asset quality of the banking system remains high, with the ratio of impaired assets to total assets at about ¼ percent, a historic low and well below levels in other developed countries. The overall strength of the banks in New Zealand is reflected in their ratings by the independent credit rating agencies.¹⁹ All of the major banks have strong ratings; the five largest banks, which account for 90 percent of total assets and deposits, have credit ratings of AA-.

¹⁷ Stress tests from the FSAP concluded in 2004 indicate that banks would be resilient to significant market and credit risk shocks, including a major decline in demand for agricultural exports, a large fall in housing prices coupled with a rise in unemployment, or a substantial increase in the cost of foreign capital inflows.

¹⁸ Registered banks in New Zealand are required to maintain a minimum tier-one capital ratio of 4 percent and a total capital ratio of 8 percent of risk-weighted assets.

¹⁹ All New Zealand banks are required to have credit ratings independent of their foreign parents.

Corporations

New Zealand: Business Indicators (Median of Non-Financial Companies, in Percent)						
	1998	1999	2000	2001	2002	2003
Debt to assets	28.1	29.4	27.9	21.4	22.3	24.1
Debt to sales	32.1	38.6	33.4	22.2	20.3	19.9
Interest coverage ratio 1/	5.1	3.9	4.1	3.4	5.4	5.6
Return on equity	10.7	13.3	10.4	8.7	10.7	12.4
Return on assets	7.6	7.3	7.1	6.5	6.6	8.0

Source: Worldscope, Datastream and Staff calculations.
1/ Earnings before interest, taxes and depreciation divided by interest payments

5. **Overall financial indicators for the corporate sector in New Zealand remain sound.** Rates of return on assets and on equity rose in 2003, and they continue to be strong. Leverage ratios remain in line with Australia's and interest coverage remains healthy, although it may decline as the effect of higher interest rates kick in.

Households

New Zealand-- Household Sector Balance Sheet Indicators (in percent of annual disposable income)						
	1998	1999	2000	2001	2002	2003
Net Wealth	373	377	361	352	373	431
Net financial wealth:	161.6	165.5	160.2	155.5	147.5	153.0
Assets	178.0	184.0	179.0	175.0	170.0	176.0
Liabilities	16.4	18.5	18.8	19.5	22.5	23.0
Net housing wealth	212.4	211.5	199.8	196.5	225.5	278.0
Housing value	296.0	300.0	291.0	289.0	323.0	387.0
Housing loan	83.6	88.5	91.2	92.5	97.5	109.0
Debt Servicing Costs	8.5	8.0	9.3	8.5	9.3	9.5
Savings Rate 1/	-4.0	-4.8	-0.8	-4.4	-3.1	-8.2

Source: RBNZ, Statistics New Zealand, and staff estimates
1/ Figures refer to year ending in March.

6. **The strong real estate market contributed to a significant increase in household net worth in 2002–04.** Net housing wealth increased as housing prices rose substantially faster than disposable income. Meanwhile, mortgage debt has gradually risen from 84 percent of disposable income in 1998 to 109 percent in 2003, supported by lower interest rates, lower inflation, and financial deregulation. Net financial wealth rose slightly in 2003 relative to disposable income, as the equity market rebounded.

7. **Higher interest rates and lower housing prices could result in financial strain for some households.** Increased leverage led to a rise in interest costs from 8 percent of disposable income in 1999 to 10¼ percent in 2004. Sensitivity analysis conducted by the Reserve Bank suggests that an increase by 1 percentage point in the residential mortgage rate would increase these interest costs to 11.5 percent of disposable income. The number of rental properties owned by households has risen from less than 20 percent of urban privately-owned dwellings in 1991 to over 25 percent in 2004.²⁰ If interest rates rise relative to rental returns, some households who borrowed to invest in rental properties could find themselves under some financial strain. The extent to which downside risks to housing prices and consumption may have increased is unclear, as real estate investors are also more likely to have other assets and income that can help absorb shocks.

²⁰ Source: Reserve Bank of New Zealand, Stability Report, October 2004.

Table 1. New Zealand: Decomposition of Gross External Debt 1/

(In billions of New Zealand dollars)

	End-March							
	1997	1998	1999	2000	2001	2002	2003	2004
Total gross external debt	80.7	85.6	97.7	107.3	128.0	138.1	138.0	142.1
<i>By sector</i>								
Official government	20.6	20.2	17.4	17.7	16.9	20.1	17.7	18.2
Corporate sector	60.1	65.3	80.3	89.6	111.0	118.0	120.3	123.9
<i>By sub-sector</i>								
Banks	24.4	32.9	39.5	51.0	63.7	71.1	72.1	81.0
Other corporate	35.6	32.4	40.8	38.6	47.3	46.9	48.2	43.0
<i>By relation 2/</i>								
Related party	31.0	43.6	45.8	55.5	...	...	...	...
Nonrelated party	29.0	21.8	34.5	34.0	...	...	...	...
<i>By currency 3/</i>								
New Zealand dollar	44.2	45.8	46.1	46.4	46.8	58.9	68.9	69.6
Foreign currency	36.5	39.8	51.6	60.9	81.1	79.2	69.0	72.5
U.S. dollar	20.3	24.1	31.5	38.0	52.9	49.3	47.3	46.4
Japanese yen	4.0	4.3	5.2	8.0	10.4	7.3	4.9	3.0
Australian dollar	3.1	3.2	4.1	5.0	7.9	9.2	8.0	9.5
European Euro & UK Pound	5.8	6.0	5.6	5.8	4.9	6.1	6.3	8.9
Unallocated	3.3	2.2	5.2	4.0	5.0	7.3	2.6	4.8
<i>By (residual) maturity 3/</i>								
Short term (under 1 year) 4/	38.2	39.9	43.7	54.1	65.1	73.1	69.8	72.3
Medium term (1-5 years)	21.1	24.1	30.6	34.3	28.3	30.2	29.6	27.0
Long term (over 5 years)	18.7	20.8	22.7	16.6	23.8	23.2	29.4	33.3
Unallocated	2.8	0.8	0.8	2.3	10.7	11.6	9.2	9.5
Nominal GDP (in \$NZ)	97.2	100.7	102.4	108.5	114.8	124.1	129.0	137.2

Sources: Statistics New Zealand; and Fund staff estimates.

1/ Based on the International Investment Position and the "Overseas Debt Survey" comprising all official organizations known to have external debt, and corporates with external debt greater than \$NZ 50 million.

2/ Data not available for 2001 to 2004.

3/ Breakdown unavailable for data published in the IIP of March 2000. Thus, prior to 2001, ratios to total debt from the Overseas Debt Survey of March 2000 are applied to the revised total debt data.

4/ From 2001, short-term maturity data reclassified to include debt maturing in one year.

Table 1 (Continued). New Zealand: Decomposition of Gross External Debt 1/

(In percent of GDP)

	End-March							
	1997	1998	1999	2000	2001	2002	2003	2004
Total gross external debt	83.1	85.0	95.4	98.9	111.5	111.3	106.9	103.6
<i>By sector</i>								
Official government	21.2	20.1	17.0	16.4	14.8	16.2	13.7	13.3
Corporate sector	61.8	64.9	78.4	82.5	96.7	95.1	93.2	90.3
<i>By sub-sector</i>								
Banks	25.2	32.7	38.6	47.0	55.5	57.3	55.9	59.0
Other corporate	36.7	32.2	39.8	35.6	41.2	37.8	37.3	31.3
<i>By relation 2/</i>								
Related party	31.9	43.3	44.7	51.2	...	...	...	...
Nonrelated party	29.9	21.6	33.7	31.3	...	...	...	...
<i>By currency 3/</i>								
New Zealand dollar	45.5	45.4	45.0	42.8	40.8	47.5	53.4	50.7
Foreign currency	37.6	39.6	50.4	56.1	70.7	63.9	53.5	52.9
U.S. dollar	20.9	24.0	30.7	35.0	46.1	39.7	36.6	33.8
Japanese yen	4.1	4.2	5.1	7.4	9.1	5.9	3.8	2.2
Australian dollar	3.2	3.2	4.0	4.6	6.9	7.4	6.2	6.9
European Euro & UK Pound	5.9	6.0	5.5	5.4	4.2	4.9	4.9	6.5
Unallocated	3.4	2.2	5.1	3.7	4.4	5.9	2.0	3.5
<i>By (residual) maturity 3/</i>								
Short term (under 1 year) 4/	39.3	39.7	42.6	49.9	56.7	59.0	54.1	52.7
Medium term (1-5 years)	21.7	23.9	29.8	31.6	24.7	24.3	22.9	19.7
Long term (over 5 years)	19.2	20.6	22.2	15.3	20.7	18.7	22.8	24.3
Unallocated	2.8	0.8	0.8	2.1	9.3	9.4	7.1	7.0

Sources: Statistics New Zealand; and Fund staff estimates.

1/ Based on the International Investment Position and the "Overseas Debt Survey" comprising all official organizations known to have external debt, and corporates with external debt greater than \$NZ 50 million.

2/ Data not available for 2001 to 2004.

3/ Breakdown unavailable for data published in the IIP of March 2000. Thus, prior to 2001, ratios to total debt from the Overseas Debt Survey of March 2000 are applied to the revised total debt data.

4/ From 2001, short-term maturity data reclassified to include debt maturing in one year.

Table 1 (Concluded). New Zealand: Decomposition of Gross External Debt 1/

(In percent of total gross external debt)

	End-March							
	1997	1998	1999	2000	2001	2002	2003	2004
Total gross external debt	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>By sector</i>								
Official government	25.6	23.6	17.8	16.5	13.2	14.5	12.8	12.8
Corporate sector	74.4	76.4	82.2	83.5	86.8	85.5	87.2	87.2
<i>By sub-sector</i>								
Banks	30.3	38.5	40.4	47.5	49.8	51.5	52.3	57.0
Other corporate	44.1	37.9	41.7	36.0	37.0	34.0	34.9	30.2
<i>By relation 2/</i>								
Related party	38.5	50.9	46.9	51.8	...	...	...	...
Nonrelated party	36.0	25.4	35.3	31.7	...	...	...	...
<i>By currency 3/</i>								
New Zealand dollar	54.7	53.5	47.2	43.3	36.6	42.7	50.0	49.0
Foreign currency	45.3	46.5	52.8	56.7	63.4	57.4	50.0	51.1
U.S. dollar	25.2	28.2	32.2	35.4	41.4	35.7	34.3	32.7
Japanese yen	5.0	5.0	5.3	7.5	8.1	5.3	3.5	2.1
Australian dollar	3.8	3.8	4.2	4.7	6.2	6.7	5.8	6.7
European Euro & UK Pound	7.2	7.0	5.8	5.4	3.8	4.4	4.5	6.2
Unallocated	4.1	2.6	5.3	3.7	3.9	5.3	1.9	3.4
<i>By (residual) maturity 3/</i>								
Short term (under 1 year) 4/	47.3	46.7	44.7	50.5	50.9	53.0	50.6	50.9
Medium term (1-5 years)	26.1	28.1	31.3	32.0	22.1	21.8	21.4	19.0
Long term (over 5 years)	23.2	24.3	23.3	15.5	18.6	16.8	21.3	23.5
Unallocated	3.4	0.9	0.8	2.1	8.4	8.4	6.7	6.7

Sources: Statistics New Zealand; and Fund staff estimates.

1/ Based on the International Investment Position and the "Overseas Debt Survey" comprising all official organizations known to have external debt, and corporates with external debt greater than \$NZ 50 million.

2/ Data not available for 2001 to 2004.

3/ Breakdown unavailable for data published in the IIP of March 2000. Thus, prior to 2001, ratios to total debt from the Overseas Debt Survey of March 2000 are applied to the revised total debt data.

4/ From 2001, short-term maturity data reclassified to include debt maturing in one year.

Table 2. New Zealand: Hedging of Foreign Currency External Debt

(In billions of New Zealand dollars)

	End-March						
	1998	1999	2000	2001	2002	2003	2004
Foreign currency external debt 1/	43.2	48.7	57.9	69.7	68.4	62.4	67.2
<i>Of which</i> : covered by SNZ hedging supplement	32.4	38.0	47.0	56.5	61.9	50.9	54.9
Coverage of supplement (percent)	75.1	78.0	81.2	81.1	90.5	81.5	81.6
<i>Type of hedge 2/</i>							
Financial derivatives	17.6	24.5	30.6	35.4	39.5	38.4	41.8
Naturally hedged (against assets/receipts)	13.2	12.4	14.8	21.0	18.9	17.2	17.3
Unhedged	12.4	11.8	12.5	13.3	10.0	6.9	8.2
<i>By sector</i>							
Banks	15.9	23.8	31.9	37.7	39.7	36.8	43.3
Financial derivatives	11.6	19.3	26.0	27.3	27.4	26.1	32.3
Naturally hedged (against assets/receipts)	4.3	4.4	5.3	10.4	...	9.5	...
Unhedged	0.1	0.0	0.6	0.0	...	1.2	...
Corporate and official	16.5	14.2	15.0	18.8	22.2	25.7	23.9
Financial derivatives	6.0	5.2	4.6	8.1	12.1	12.3	9.5
Naturally hedged (against assets/receipts)	9.0	8.0	9.5	10.6	...	7.7	...
Unhedged	1.6	1.0	1.0	0.1	...	5.7	...

Sources: Statistics New Zealand; Fund staff estimates.

1/ Data through 2000 are as published in Total Overseas Debt. From March 2001, FX denominated overseas debt is total debt less \$NZ debt less financial derivatives in a net liability position denominated in foreign currencies.

2/ For 2003 and 2004, refers to total FX denominated overseas debt. For previous periods data are FX denominated overseas debt encompassed by the hedging supplement.

Fund Relations
(As of January 31, 2005)

I. Membership Status: Joined: 08/31/1961; Article VIII

II. General Resources Account:	SDR Million	Percent Quota
Quota	894.60	100.0
Fund Holdings of Currency	602.29	67.32
Reserve position in Fund	292.32	32.68

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	141.32	100.0
Holdings	21.99	15.56

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund: None

VII. Exchange Arrangement:

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.

VIII. Article IV Consultation:

New Zealand is on the 12-month consultation cycle. The 2004 Article IV consultation discussions were held during February 9-18, 2004, the Executive Board discussed the staff report (SM/04/116, 04/09/04) and concluded the consultation on April 30, 2004.

IX. FSAP Participation and ROSCs:

FSAP mission took place during October 30–November 19, 2003. The assessments were published under Country Reports No. 04/126 and No. 04/417.

X. Technical Assistance: None

XI. Resident Representative/Advisor: None

Statistical Issues

New Zealand publishes an array of high-quality statistics, which are fully adequate for surveillance purposes. The frequency and timeliness of the availability of the common indicators required for Fund surveillance are summarized in the attached table. Data are readily available in electronic form 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 available. For example, Statistics New Zealand has been undertaking 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), debt securities transactions, and inward foreign affiliate trade statistics. The New Zealand Treasury is leading a project to publish fiscal data consistent with the *Government Finance Statistics 2001* manual (*GFSM 2001*).

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 are expected to be met in 2005. Estimates of external debt by original maturity—as required by SDDS, rather than by remaining maturity as measured by official data—are being prepared. The remaining issues are the timeliness of local government data, where the authorities are exploring the feasibility of earlier publication, and the requirement for publication of an industrial production index.

Table of Common Indicators Required for Surveillance
(As of March 25, 2005)

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	3/25/05	3/25/05	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	Jan. 2005	2/25/05	M	M	M
Reserve/Base Money	Feb. 2005	3/14/05	M	M	M
Broad Money	Jan. 2005	2/28/05	M	M	M
Central Bank Balance Sheet	Feb. 2005	3/14/05	M	M	M
Consolidated Balance Sheet of the Banking System	Jan. 2005	2/28/05	M	M	M
Interest Rates ²	3/25/05	3/25/05	D	D	D
Consumer Price Index	Dec. 2004	1/19/05	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	Jan. 2005	3/11/05	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Jan. 2005	3/11/05	M	M	M
External Current Account Balance	Dec. 2004	3/23/05	Q	Q	Q
Exports and Imports of Goods and Services	Dec. 2004	3/23/05	Q	Q	Q
GDP/GNP	Dec. 2004	3/24/05	Q	Q	Q
Gross External Debt	Dec. 2004	3/23/05	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.

⁵ Consolidated general government data were last published for 2001. The New Zealand Treasury is leading a project to prepare fiscal data on a GFSM 2001 basis.

⁶ Including currency and maturity composition.

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. 05/60
FOR IMMEDIATE RELEASE
May 5, 2005

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

IMF Executive Board Concludes 2005 Article IV Consultation with New Zealand

On May 2, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with New Zealand.¹

Background

New Zealand's economy has performed well, recording real GDP growth of 4 percent on average since 1999, due to the extensive structural reforms undertaken in the 1980s and 1990s and the sustained implementation of sound macroeconomic policies. High net migration inflows in 2002–03 also contributed to strong growth in recent years. Unemployment has fallen to the lowest rate in the Organisation for Economic Cooperation and Development Countries, public debt has been declining, and inflation has remained within the central bank's target range.

GDP growth was particularly strong in 2004, at 4.8 percent, led by a surge in domestic demand. Private consumption grew by 6 percent, reflecting high employment growth, strong commodity prices, and household borrowing against rising housing values. Business investment also increased rapidly, powered by robust sales, strong profitability, growing capacity constraints, and declining domestic prices for imported equipment.

The current account deficit rose to 6.4 percent of GDP in 2004, as import volumes jumped by 16 percent, mirroring the strength of domestic demand. At the end of March 2005, the New

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.

Zealand dollar had appreciated 7 percent on a trade-weighted basis since end-2003, to stand about 16 percent above its twenty year average on a real effective basis. Export volumes nonetheless grew by a robust 5¼ percent in 2004, aided by widespread foreign exchange hedging that shielded exporters from the full effect of the stronger exchange rate. Meanwhile, rising international prices for the country's major commodity exports pushed the terms of trade to a 30 year high. Net foreign liabilities rose to 84½ percent of GDP at the end of 2004.

Inflation rose to near the top of the 1 to 3 percent target range as the economy reached a very high level of resource utilization. The Reserve Bank of New Zealand (RBNZ) raised the official cash rate (OCR) six times between January and October 2004, bringing the OCR to 6.5 percent. But the economy did not slow in line with earlier projections, and with the near-term outlook for activity remaining strong, the OCR was raised by a further 25 basis points in March 2005.

The fiscal position is strong, with actual budget surpluses exceeding targets consistently in recent years. The operating surplus before revaluations and accounting changes (OBERAC) rose to 4¾ percent of GDP in 2003/04 (fiscal year ending in June), and gross government debt declined to 25¼ percent of GDP. The OBERAC surplus for 2004/05 is expected to be larger than budgeted, with higher projected tax revenues only partly offset by increases in spending plans.

Growth is projected to slow in the near-term, to about 2¾ percent in 2005-06.

Consumer spending is expected to moderate due to a cooling of the housing market and the effects of higher interest rates, while, with the hedges rolling-off, export growth is likely to be dampened by the high exchange rate. Nonetheless, there are upside risks to domestic demand due to high levels of job security; and, the RBNZ has indicated that there is little scope for an easing of monetary policy in the foreseeable future. As the cyclical position of the economy unwinds, the external current account deficit and inflation are expected to decline. Real GDP growth is expected to average about 3¼ percent over the medium-term, requiring a rise in productivity growth as recent gains in labor utilization will be difficult to replicate going forward.

Executive Board Assessment

Executive Directors welcomed New Zealand's strong economic growth in recent years, which has reduced the unemployment rate to the lowest in the OECD. Directors considered these commendable economic achievements to have been underpinned by the sustained and skilful implementation of sound monetary and fiscal policies and the wide-ranging structural reforms.

Directors noted that, since the beginning of 2004, domestic demand has been consistently stronger than envisaged, partly due to continued strong export commodity prices. In this environment, the potential pressure on prices has not come off as expected, and Directors endorsed the authorities' tightening of monetary policy. Directors observed that, even though resource utilization has risen to record high levels, inflation has remained inside the target range. Strong upward pressures on nontraded goods prices have been offset by low inflation in

non-oil traded goods prices, due in large part to the appreciation of the New Zealand dollar.

Looking forward, Directors considered that monetary policy faces a difficult balancing act of responding to inflationary pressures while avoiding an unduly sharp slowing of activity.

On the one hand, growth is expected to moderate and resource pressures to ease, once the effects of higher interest rates and the more appreciated exchange rate come into play, and a decline in net migration inflows translates into a further cooling of the housing market. On the other hand, high consumer confidence, strong investment intentions, and the most favorable terms of trade in 30 years, together pose a risk that domestic demand again exceeds expectations. On balance, Directors considered that the risks to inflation are predominantly on the upside, and supported the authorities' recent decision to maintain a tightening bias in monetary policy. On the exchange rate, Directors supported the authorities' approach of limiting foreign exchange market intervention to exceptional cases that met clearly specified conditions.

Directors commended the authorities on their sound fiscal management, cast in a transparent and predictable medium-term framework, which has led to a strong fiscal performance and a substantial reduction in gross government debt. They welcomed the decision in the 2004/05 budget to lower the debt target from 30 to 20 percent of GDP, to be achieved before 2015. Directors endorsed the government's objectives of achieving operating surpluses over the economic cycle, sufficient to cover contributions to the New Zealand Superannuation (NZS) Fund, while meeting capital spending requirements and maintaining government debt at prudent levels.

Directors stressed that current fiscal projections imply a small macroeconomic stimulus over the next few years, and that a more expansionary policy would risk adding to current resource pressures. Against that background, they supported the intention not to spend the cyclical component of higher-than-expected operating surpluses. Moreover, Directors noted that the recent rapid growth in a number of spending categories, including health and education, is unlikely to be sustainable. Directors therefore encouraged the government to maintain the prudence and discipline that it has shown in the past several years in making its expenditure decisions.

Directors reaffirmed that the creation of the NZS Fund to prefund part of the future pension liabilities has been an important step toward meeting the significant long-run demands on the budget posed by population aging. While noting that health care also represents an important source of long-run pressure on fiscal resources, they emphasized the need for further parametric changes in the pension and health care systems. Directors urged that such measures be adopted sufficiently early to help smooth fiscal costs over time and allow individuals time to adapt. In this context, Directors welcomed the planned publication of long-run fiscal reports at least every four years to help inform public debate about the policy options.

Directors agreed that New Zealand has the potential for continued strong economic growth in the medium-term. They observed that New Zealand's per capita income remains about four-fifths of OECD median levels, and that narrowing this gap would leave the New Zealand economy better positioned to manage the problems of population aging. With limited scope for

further increases in labor utilization, Directors agreed with the authorities that increasing labor productivity is the key policy challenge.

Directors noted that higher labor productivity growth appears feasible if business investment remains high, thereby deepening the capital used by workers, and promoting the adoption of new technologies, and research and development. To enhance the investment environment, Directors supported plans to upgrade the transportation and energy infrastructure, and endorsed recent steps to enhance the skills of the workforce by raising the quality and relevance of tertiary education. Directors were of the view that improving the Resource Management Act would also help facilitate investment.

Directors judged New Zealand's flexible labor market to have contributed to strong employment growth and low unemployment, and recommended that this flexibility be carefully preserved. In this context, Directors advocated that close review be kept of the effects of the range of labor market measures that have been adopted in recent years, including the Holidays Act and minimum wage increases. Directors agreed that the adequacy of existing arrangements for probationary periods of employment should be reviewed.

While overall labor participation is already relatively high, Directors saw scope for increasing participation among certain groups. Directors welcomed the intention to promote participation of women by expanding access to child care, and the government's plans to use more active case management to help people make the transition from welfare to work, and recommended that these efforts be reinforced by strengthening requirements for those on benefits to participate in appropriate training or work programs.

Directors endorsed the authorities' emphasis on minimizing the administrative costs of the schemes being developed to facilitate household savings that would be operated at the workplace level. Directors recommended that any savings incentives that are offered be designed so as to contain the budgetary impact. Directors considered that such schemes can help to improve the financial resilience of households.

Directors strongly welcomed the authorities' recent efforts to strengthen the banking regulation and crisis management framework at a time when the financial sector is fundamentally sound. They considered the planned review of the regulation and disclosure of nonbank financial institutions to be an important step. Directors observed that substantial progress in addressing the recommendations of the 2004 Financial System Stability Assessment is being made, including by enhancing cooperation and coordination between the financial supervisors in Australia and New Zealand. In the discussions currently under way between the two countries on the closer integration of banking regulation, Directors urged that priority be given to ensuring that adequate safeguards for financial stability in New Zealand remain in place.

Directors recognized that New Zealand continues to face substantial trade barriers in key areas, including agricultural products, and welcomed the authorities' commitment and efforts to promote an open international trading system, not only at the bilateral and regional levels, but also at the multilateral level under the Doha round. Directors commended the authorities'

generous response to the recent tsunami and encouraged the authorities to continue to make progress towards their goal of raising overseas development assistance.

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.

New Zealand: Selected Economic Indicators

	2000	2001	2002	2003	2004	Proj. 2005
Real economy (percent change)						
GDP (production basis)	3.6	2.6	4.7	3.4	4.8	2.8
Domestic demand	1.9	2.6	5.6	5.3	8.0	3.6
Exports of goods and services	6.0	2.5	6.3	1.7	5.2	2.6
Imports of goods and services	0.3	1.7	9.6	7.9	15.8	5.1
Headline CPI inflation (end of period)	4.0	1.8	2.7	1.6	2.7	2.8
Unemployment rate (in percent)	6.0	5.3	5.2	4.6	3.9	3.8
National saving (in percent of GDP) 1/	14.9	18.3	18.3	18.1	17.6	17.4
Investment (in percent of GDP)	21.2	20.8	22.0	22.2	24.0	24.4
Government budget (in percent of GDP) 2/						
Revenue	33.2	33.6	31.8	33.9	33.4	33.6
Expenditure	32.9	32.5	30.3	32.4	29.6	30.4
OBERAC 3/	1.3	1.2	1.9	1.5	5.3	3.7
Net public debt	19.5	17.0	14.2	13.7	10.8	8.7
Money and credit (end of period)						
M3, resident (change in percent)	2.3	7.0	11.5	9.5	3.4	...
Private domestic credit (change in percent)	6.8	8.9	9.0	8.2	12.1	...
Interest rate (90-day, in percent) 4/	6.7	4.9	5.9	5.3	6.8	7.0
Government bond yield (10-year, in percent) 4/	6.1	6.6	6.1	5.9	6.0	5.9
Balance of payments (in percent of GDP)						
Current account balance	-4.8	-2.4	-3.7	-4.2	-6.4	-7.0
Trade balance	1.3	2.9	0.3	-0.5	-1.4	-1.7
External assets and liabilities (in percent of GDP)						
Official reserves	9.0	8.6	9.4	9.3	9.7	...
Gross external debt	85.6	93.5	103.7	109.5	105.5	107.9
Net external liabilities	81.5	75.7	78.4	78.7	84.5	86.6
Exchange rate (end of period)						
US\$/NZ\$ 4/	0.44	0.42	0.52	0.66	0.72	0.73
Trade-weighted index (June 1979 = 100) 4/	49.7	49.9	58.2	65.1	68.8	71.3
Nominal effective exchange rate 5/	85.9	86.5	98.5	110.1	114.6	...
Real effective exchange rate 5/	81.9	83.1	95.3	106.5	111.6	...

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 2005 are as of May 2.

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