IMF Country Report No. 19/303

NEW ZEALAND

2019 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

September 2019

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 2019 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- A **Press Release**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on June 25, 2019, 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 September 6, 2019.
- An **Informational Annex** prepared by the IMF staff.

The document listed below has been separately released.

Selected Issues

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

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September 20, 2019

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

IMF Executive Board Concludes 2019 Article IV Consultation with New Zealand

On September 20, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with New Zealand, and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[2]

Some key drivers of New Zealand's strong growth through 2016—reconstruction spending after the 2011 earthquake, a sustained wave of high net migration, a housing boom, and strong terms of trade—weakened in 2017-18. Despite the long expansion, inflation has remained unusually weak, reflecting partly imported disinflation and partly the boost to labor supply from net migration.

Economic growth picked up in early 2019 after slowing in the second half of 2018. The pickup mostly reflected a rebound in private business investment growth. Residential investment also strengthened, notwithstanding cooling housing markets. The Reserve Bank of New Zealand (RBNZ)'s measures of underlying inflation remained between ½ and ¼ of a percentage point below the 2 percent midpoint of the target range. The unemployment rate declined below 4 percent in the second quarter of 2019. Wage inflation has picked up, partly reflecting the rise in the minimum wage in April 2018 and 2019.

The current account deficit widened to 3.8 percent of GDP in 2018, reflecting a decline in the terms of trade. The external position was weaker than implied by medium-term fundamentals and policy settings, while the New Zealand dollar was moderately overvalued.

Bank lending continued to slow across all sectors, growing now broadly in line with nominal GDP. Banks strengthened their lending standards, although the recent modest easing in the RBNZ's loan-to-value ratio (LVR) restrictions in January 2018 and January 2019 has led to a renewed uptick in new high-LVR loans. The RBNZ has proposed an increase in capital

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

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

requirements to lower the probability of bank failure. The ongoing Phase Two of the Review of the RBNZ Act focuses on updating its regulatory, supervisory, and macroprudential functions.

Housing markets cooled but affordability constraints remain. The cooling reflects a tightening in banks' mortgage lending standards, the tightening of LVR restrictions by the RBNZ during 2016-17, and declining affordability. The government is refocusing elements of its multi-pronged approach to improve housing affordability.

Within the greater focus on wellbeing under the Living Standards Framework, the government has a roster of policies to foster productivity growth. These include introducing an R&D tax credit regime, continuing to increase education spending, creating a New Zealand Infrastructure Commission to enhance procurement and delivery and set up of an infrastructure pipeline, using wage increases to further more inclusive growth, and fostering regional development through the Provincial Growth Fund and greater focus on regional immigration to align immigration of skilled labor with employers' needs in the regions.

Executive Board Assessment

In concluding the 2019 Article IV consultation with New Zealand, Executive Directors endorsed the staff's appraisal, as follows:

New Zealand's economic expansion is still solid. Despite the loss of momentum in economic activity and a cooling in housing markets, output has remained close to potential, and the unemployment rate has continued to decline. Broader price and wage pressures have not yet emerged even though the economy has operated close to capacity for some time. The external position was weaker than implied by medium-term fundamentals and policy settings.

Economic growth is expected to remain close to that of potential output, but risks to the growth outlook are tilted to the downside. After increasing in early 2019, growth is expected to strengthen further in 2019-20 on the back of monetary and fiscal policy support, eventually leading to a small positive output gap and a gradual acceleration of inflation towards the 2 percent midpoint of the RBNZ's target range. Downside risks to the economic outlook in New Zealand have increased, however, reflecting higher downside risks to the global economic outlook.

The recent monetary policy easing fits the subdued inflation conditions and near-term risks to the outlook. Economic growth is only expected to remain close to potential on the back of a timely increase in macroeconomic policy support. Such support remains critical until underlying domestic demand and inflation have strengthened more durably. With downside risks to growth, employment, and inflation, insufficient monetary accommodation still is a bigger concern than the upside risk to inflation if the monetary policy stance were to turn out to be too expansionary.

Fiscal policy strikes an adequate balance between near-term demand support and maintaining prudent debt levels. The FY2019/20 budget supports new wellbeing initiatives and should provide modest near-term stimulus to aggregate demand. While New Zealand has substantial fiscal space, the continued emphasis on meeting the medium-term debt objectives highlights the government's commitment to maintaining the fiscal buffers needed to respond to potential large economic downturns and other contingencies such as natural disasters. The planned move from time-bound point targets for net public debt to a target range of 15 to 25 percent of GDP as a medium-term debt anchor provides for a welcome increase in flexibility.

The New Zealand authorities should prepare contingent policy responses in the event of a severe economic downturn. With the policy rate approaching its effective lower bound, the RBNZ will likely have to resort to an unconventional monetary policy response. On the fiscal side, readiness for a timely, effective response, given long implementation lags, especially in capital spending, will be essential.

The scope for easing macroprudential restrictions is limited, given still-high macrofinancial vulnerabilities. The combined impact of the LVR settings and tighter bank lending standards has led to a decline in riskier mortgages in bank assets. While house price inflation and credit growth have moderated, any further easing of LVR restrictions should consider the possible impact on banks' prudential lending standards, as well as the risks to financial stability from high household debt.

The proposed higher capital conservation buffers would provide for a welcome increase in banking system resilience. The new requirements would increase bank capital to levels that are commensurate with the systemic financial risks emanating from the banking system. Starting from a relatively strong position, there is scope for some flexibility when setting some parameters in the revised capital framework, including the length of the phase-in period and types of capital within the buffers. The new framework should also differentiate more between large and small banks. A stronger bank supervision regime would still be needed, to complement the higher capital requirements.

The main reforms envisaged in the ongoing Phase Two of the Review of the RBNZ Act should increase financial system resilience. The upgrades to the regulatory and supervisory framework would advance key areas of reform identified in the IMF's 2017 Financial Sector Assessment Program, including enhancing the RBNZ's resources and operational independence for its supervisory and regulatory functions, broadening the macroprudential toolkit, and introducing a deposit insurance framework.

Mitigating supply constraints is critical for housing affordability and requires further progress in the government's comprehensive housing policy agenda. The reform of the institutional structure, including the establishment of the Ministry of Housing and Urban Development, should help in implementing housing policies. Further work is needed to complete the agenda, including enabling local councils to actively plan for and increase housing supply growth. Tax reform, such as a tax on all vacant land, should also be considered.

Addressing long-standing low productivity growth continues to be a central concern. In this respect, some important first steps have been taken, including the introduction of a new R&D tax credit regime; the creation of the New Zealand Infrastructure Commission to help in closing infrastructure gaps; and the reform of the vocational education and training sector.

Table 1. New Zealand: Main Economic Indicators, 2014-2024

(Annual percent change, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
								Projections			
NATIONAL ACCOUNTS											
Real GDP (production)	3.6	3.5	3.9	3.1	2.9	2.2	2.7	2.6	2.6	2.5	2.5
Real GDP (expenditure)	3.1	4.0	4.2	2.6	2.8	2.5	2.7	2.6	2.6	2.5	2.5
Domestic demand	4.4	3.0	4.6	4.0	3.5	2.6	3.1	2.7	2.4	2.3	2.3
Private consumption	3.1	3.6	5.3	4.8	3.2	2.9	3.1	3.0	2.6	2.4	2.3
Public consumption	3.4	2.5	2.0	2.9	1.9	2.4	2.2	2.3	2.3	2.2	2.2
Investment	10.9	2.3	4.9	2.9	5.3	0.7	2.5	2.1	2.1	2.1	2.1
Public	6.5	4.6	-0.5	3.2	6.1	-1.7	3.4	1.3	1.2	1.2	1.2
Private	10.2	3.5	6.1	3.5	2.8	4.4	2.1	2.4	2.4	2.3	2.4
Private business	10.5	2.5	3.6	5.0	2.9	3.8	2.0	2.3	2.3	2.3	2.4
Dwelling	9.8	5.6	10.8	0.9	2.6	5.5	2.3	2.7	2.5	2.3	2.4
Inventories (contribution to growth, percent)	0.4	-0.3	0.1	-0.1	0.4	-0.7	0.1	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	-1.5	0.8	-0.5	-1.7	-1.1	0.2	-0.4	-0.2	0.0	0.0	0.1
Real gross domestic income	5.3	1.8	4.7	4.0	2.2	2.1	3.0	2.9	2.8	2.5	2.6
Investment (percent of GDP)	22.7	23.0	23.3	23.3	24.0	24.1	24.0	23.9	23.8	23.7	23.6
Public	5.7	5.9	5.6	5.6	5.8	5.6	5.6	5.6	5.5	5.4	5.3
Private	17.0	17.1	17.7	17.7	18.2	18.4	18.4	18.4	18.3	18.3	18.3
Savings (gross, percent of GDP)	19.6	20.0	21.1	20.4	20.2	19.9	19.7	19.7	19.6	19.5	19.3
Public	4.0	4.3	0.9	1.1	0.8	0.1	0.0	0.5	1.1	1.4	1.4
Private	15.5	16.0	20.3	19.3	19.4	19.8	19.8	19.2	18.5	18.0	17.9
Potential output	2.6	2.8	2.8	2.8	2.8	2.8	2.7	2.6	2.6	2.5	2.5
Output gap (percent of potential)	-1.4	-0.7	0.3	0.6	0.7	0.2	0.2	0.2	0.2	0.1	0.0
LABOR MARKET											
Employment	3.5	2.2	4.6	4.2	3.0	0.7	1.1	1.4	1.2	1.5	1.3
Unemployment (percent of labor force)	5.4	5.4	5.1	4.7	4.3	4.3	4.5	4.4	4.5	4.5	4.5
Wages (nominal percent change)	2.5	2.3	1.9	2.1	3.1	3.5	1.9	1.7	2.4	2.5	2.6
PRICES											
Terms of trade index (goods, % change)	5.6	-5.0	1.2	7.3	-1.7	-4.2	1.0	1.7	0.8	0.5	0.5
Consumer prices (avg, % change)	1.2	0.3	0.6	1.9	1.6	1.4	1.9	2.0	2.0	2.0	2.0
GDP deflator (avg, % change)	2.3	0.2	1.7	3.5	1.1	1.5	2.1	2.4	2.2	2.0	2.1
MACRO-FINANCIAL											
Official cash rate (policy rate, percent, avg)	3.1	3.2	2.2	1.8	1.8	1.5	1.3	1.3	1.7	2.3	2.7
Credit to the private sector (percent change)	4.0	7.5	7.0	4.9	5.4	5.2	4.6	4.5	4.8	5.0	5.0
House prices (percent change, avg)	6.5	12.1	14.1	6.4	3.3	1.5	3.0	3.0	3.0	3.0	3.0
Interest payments (percent of disposable income)	9.0	9.1	8.2	7.8	7.8	7.6	7.4	7.2	7.1	7.0	6.9
Household savings (percent of disposable income)	2.5	2.6	3.4	2.4	3.1	3.3	3.5	3.7	3.9	4.0	4.2
Household debt (percent of disposable income)	154	158	161	163	164	161	157	154	151	149	149
GENERAL GOVERNMENT (percent of GDP) 1/											
Revenue	37.2	37.6	37.5	37.3	37.5	37.4	37.3	37.3	37.4	37.5	37.5
Expenditure	37.7	37.4	36.7	36.2	36.7	37.3	37.3	36.8	36.3	36.1	36.1
Net lending/borrowing	-0.5	0.2	0.9	1.1	0.8	0.1	0.0	0.5	1.1	1.4	1.4
Operating balance	1.2	2.0	2.5	2.8	2.4	1.7	1.3	1.5	2.0	2.2	2.2
Cyclically adjusted balance	0.8	1.1	1.5	1.5	1.1	0.6	0.5	1.0	1.6	1.9	1.9
Gross debt	34.2	34.4	33.5	31.6	29.8	29.6	30.2	30.6	31.9	31.3	28.5
Net debt	10.4	9.8	9.1	8.0	8.0	8.2	8.1	7.9	7.8	6.5	3.8
Net worth	80.2	81.8	83.5	88.3	88.5	86.0	84.9	85.2	84.2	82.0	81.6
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-3.1	-3.0	-2.2	-2.9	-3.8	-4.1	-4.3	-4.2	-4.2	-4.3	-4.3
Export volume	3.3	7.4	2.1	1.8	3.1	3.8	3.3	3.7	4.3	4.0	4.4
Import volume	7.9	4.0	3.3	6.9	5.8	2.7	4.0	3.7	3.5	3.3	3.5
Net international investment position (percent of GDP)	-65.0	-60.8	-59.5	-55.4	-57.4	-58.3	-59.9	-61.2	-62.6	-64.1	-65.6
Gross official reserves (bn US$)	15.8	14.3	18.2	20.3	17.6	…	…	…	…	…	…
MEMORANDUM ITEMS											
Nominal GDP (bn NZ$)	240	250	266	282	293	305	320	336	352	368	385
Percent change	5.5	4.2	6.0	6.2	3.9	4.0	4.9	5.0	4.8	4.6	4.6
Nominal GDP per capita (US$)	43,858	37,743	38,983	41,382	41,205	40,634	42,084	43,901	45,801	47,615	49,547
Real gross national disposable income per capita (NZ$)	47,900	48,141	49,689	50,212	50,530	50,604	50,981	51,456	51,857	52,244	52,572
Percent change	3.1	0.5	3.2	1.1	0.6	0.1	0.7	0.9	0.8	0.7	0.6
Population (million)	4.5	4.6	4.6	4.7	4.8	4.9	5.0	5.1	5.2	5.3	5.4
US$/NZ$ (average level)	0.831	0.700	0.697	0.711	0.693	…	…	…	…	…	…
Nominal effective exchange rate	115.4	108.1	109.6	111.1	106.8	…	…	…	…	…	…
Real effective exchange rate	112.9	105.0	105.8	107.4	102.9	…	…	…	…	…	…

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

1/ Calendar year.

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

September 6, 2019

KEY ISSUES

Context. New Zealand's expansion lost momentum in 2017-18, as some key drivers started to weaken. Despite the long expansion, inflation remains weak, reflecting imported disinflation as well as strong net inward migration, which has boosted labor supply. Macrofinancial vulnerabilities have increased with a housing boom but have been contained through macroprudential policy intervention.

Outlook and risks. After recent declines, growth picked up in early 2019 and is expected to remain close to trend in 2019-20 on the back of increased policy support, despite external headwinds. Inflation should pick up gradually. Downside risks to the growth outlook have increased, reflecting: higher global risks; prospects for a weaker fiscal impulse given recent implementation lags; and the housing market cooling morphing into an actual downturn.

Policy recommendations

- **Macroeconomic policies**. With a still substantial probability for inflation to remain below the mid-point of the target range, the monetary policy stance should remain appropriately accommodative. Fiscal policy strikes an adequate balance between supporting demand in the short term, increasing spending on social and infrastructure needs, and meeting medium-term debt objectives. The government should not hesitate to use New Zealand's substantial fiscal space to support activity in the event of an economic downturn.
- **Financial sector policies**. The scope for further easing macroprudential restrictions is limited, given still high macrofinancial vulnerabilities. The proposed increase in bank capital adequacy requirements and the introduction of deposit insurance provide for a welcome reduction in systemic financial risks.
- **Housing**. The housing market has cooled but affordability constraints remain. The policy agenda appropriately seeks to raise housing affordability. The institutional structure for housing policy has been strengthened, but key programs still need to be calibrated.
- **Structural policies**. The government's policy agenda appropriately focuses on reducing infrastructure gaps, increasing human capital and lifting productivity, while seeking to make growth more inclusive.

Approved By
Jonathan D. Ostry (APD) and Kristina Kostial (SPR)

Discussions were held in Auckland and Wellington during June 13-25, 2019. The staff team comprised Thomas Helbling (head), Geoffrey Bannister, Dirk Muir, and Yu Ching Wong (all APD). Jonathan Ostry (APD) participated in the concluding meetings. Grant Johnston and Chris White (OED) joined the discussions. Ioana Hussiada and Nadine Dubost assisted from HQ.

CONTENTS

ANNEXES

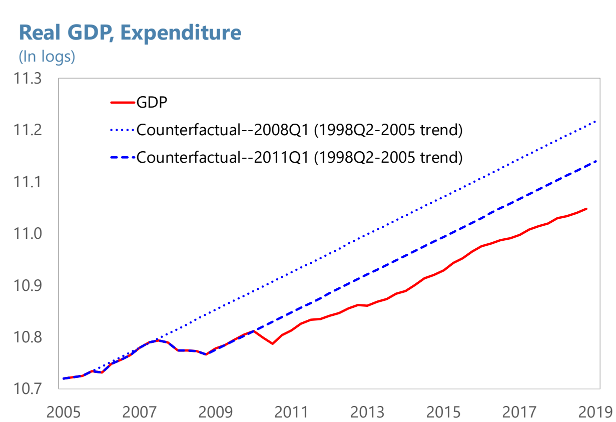
CONTEXT

1. **New Zealand's expansion lost momentum in 2017–18.** Some key drivers of the strong growth through 2016—reconstruction spending after the 2011 earthquake, a sustained wave of high net migration, a housing boom, and strong terms of trade—weakened. Despite the long expansion, inflation has remained unusually weak, reflecting partly imported disinflation and partly the boost to labor supply from net migration.

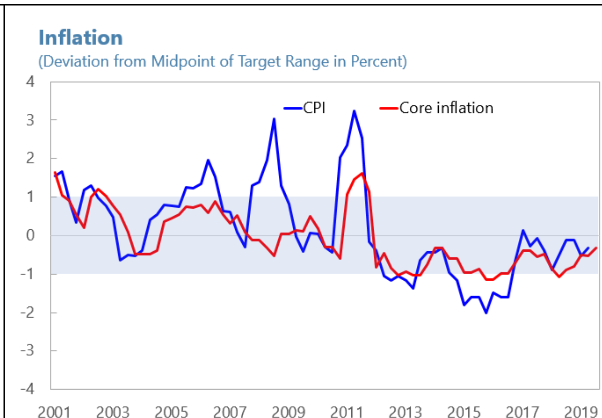
2. **A housing boom has reduced housing affordability and engendered macrofinancial vulnerabilities.** Rising house prices have coincided with rapid household credit growth, and the household debt ratio has risen to high levels in international comparison. Macroprudential tightening in 2014-17 served to mitigate vulnerabilities and house price overvaluation.

3. **The New Zealand economy faces a longstanding productivity challenge.** Labor productivity growth has remained low, and the level of productivity has been below the average of high-income OECD countries.

4. **The government's policy agenda aims at a fairer and more inclusive economy, and sustainable growth.** Priorities are regional development, lower economic inequality, and improved housing affordability. The FY2019/20 budget has been framed as the first wellbeing budget under the Living Standards Framework (LSF) and encapsulates these priorities. The multi-year Review of the RBNZ Act has already resulted in an update of the monetary policy framework and is now in Phase Two, which will consider an update of the financial policy and regulatory framework.[1]



Sources: Haver Analytics and IMF staff calculations.



Sources: Haver Analytics and IMF staff calculations.

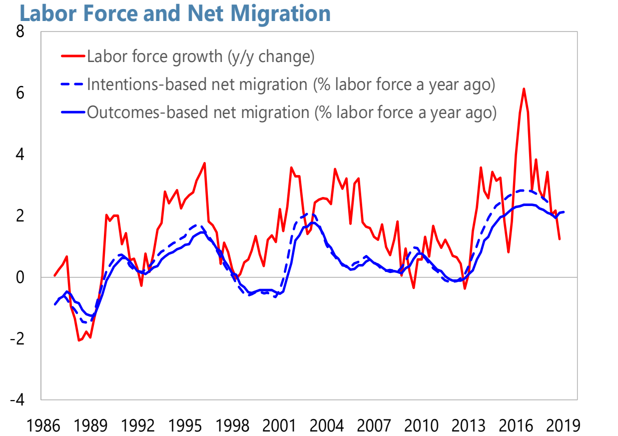
[1] The updates to the monetary policy framework (introduction of a maximum sustainable employment objective alongside the inflation objective and decision-making by a monetary policy committee) were discussed in the 2018 Article IV Staff Report.

RECENT DEVELOPMENTS, OUTLOOK AND RISKS

A. Developments Over the Past 12 Months

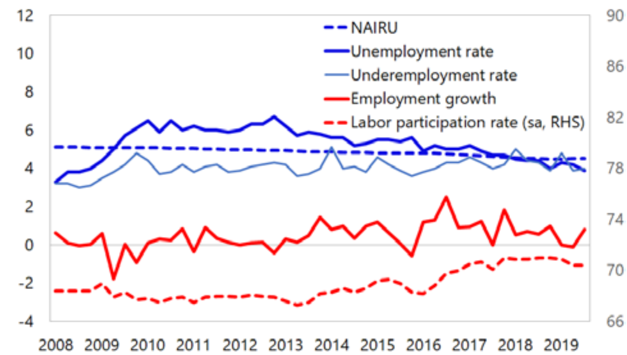
5. Economic growth picked up in early 2019 after slowing in the second half of 2018. The pickup mostly reflected a rebound in private business investment growth, which had contracted at times in 2018 in the context of low business confidence (Figure 1). Residential investment also strengthened, notwithstanding cooling housing markets. Employment growth slowed markedly in late-2018 but has strengthened more recently. The unemployment rate declined below 4 percent in the second quarter of 2019.

Labor Force and Net Migration



Source: Haver Analytics and Statistics New Zealand.

Employment Growth, Unemployment, Underemployment and Participation Rate



Sources: Haver Analytics and IMF staff calculations.

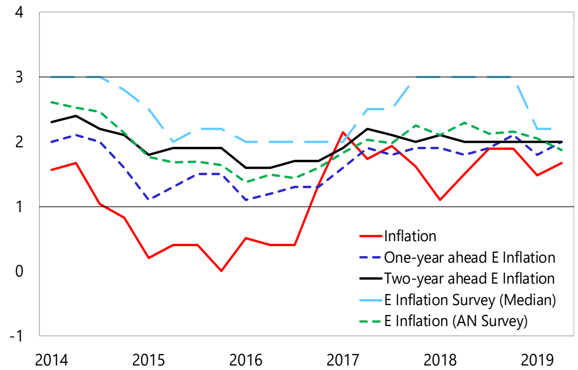
6. Inflation continued to fluctuate mostly below the midpoint of the target range. Headline inflation rose to 1.7 percent in 2019Q2, up from 1.5 percent in 2019Q1, mostly because the impact of declining fuel prices wore off. The RBNZ's measures of underlying inflation remained between ½ and ¼ of a percentage point below the 2 percent midpoint of the target range. Wage inflation has picked up, partly reflecting the rise in the minimum wage in April 2018 and 2019.[2]

7. The economy is close to but likely still below internal balance. With the slowing growth, staff estimates suggest that output was broadly at potential in early 2019 (Figure 2), while unemployment was below the NAIRU.[3] Nevertheless, general price and wage pressures have been contained, while underemployment remains at elevated levels. Cost pressure and capacity constraints have emerged at sectoral levels, notably in construction.

[2] A three-year increase in minimum wage to NZ$20 on April 1, 2021 from NZ$15.75 in Apr 1, 2018 are being phased in.

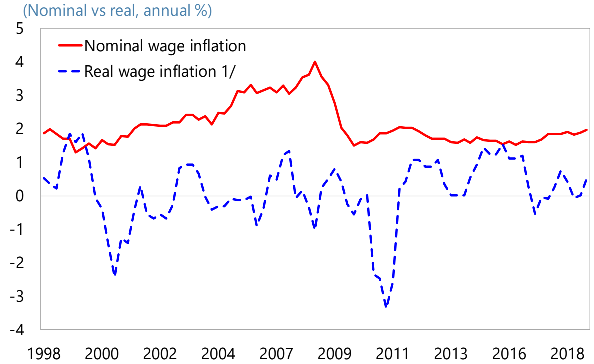
[3] The potential output estimates are based on a multivariate filter that considers unemployment and inflation developments, but not other indicators of labor market slack.

Inflation Expectations
(%, annual change in CPI)



Sources: Haver Analytics and IMF staff calculations.

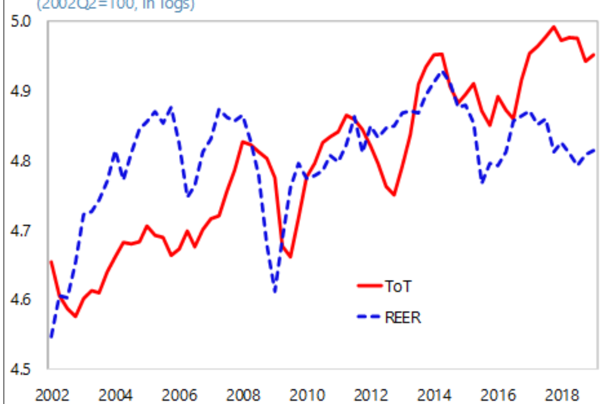
Wage Inflation
(Nominal vs real, annual %)



Sources: Haver Analytics and IMF staff estimates.
1/ Defined as nominal wage inflation minus CPI inflation.

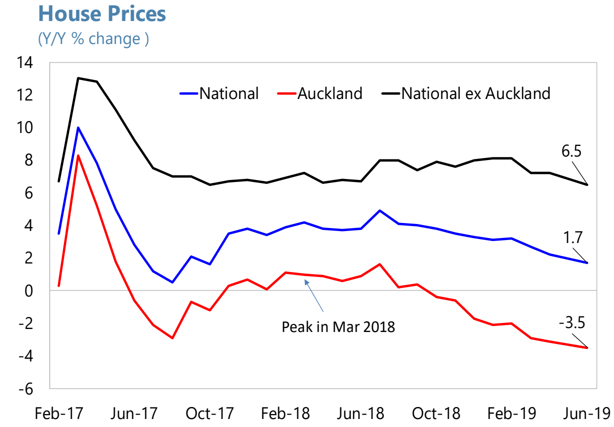
8. The external position was weaker than implied by medium-term fundamentals and policy settings, while the New Zealand dollar was moderately overvalued. The backdrop to this assessment is a mostly domestic demand-driven current economic expansion, with generally negative contributions from net exports to growth, and broad terms-of-trade improvements. The current account deficit widened to 3.8 percent of GDP in 2018, reflecting a small decline in the terms of trade (Figure 3). The real effective exchange rate (REER) was around 10 percent above its long-term average in 2018 (Annex I).

Goods Terms of Trade and REER
(2002Q2=100, in logs)

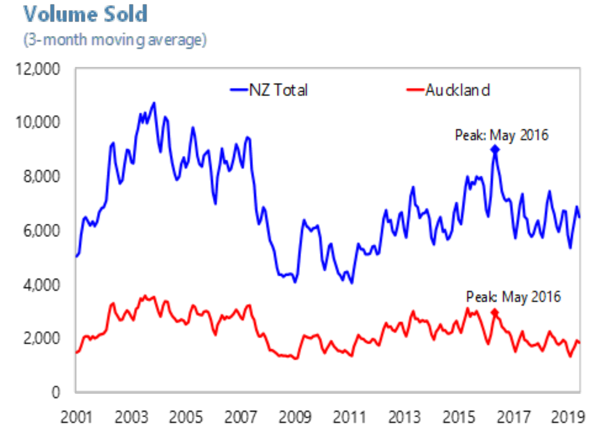


Sources: Haver Analytics and IMF staff calculations.

9. Housing markets cooled but affordability constraints remain. House sales have declined by about 30 percent from their peak in mid-2016. House price inflation stabilized at 1.5 percent y/y nationally by 2019Q1, while prices have declined in Auckland since mid-2018. The cooling reflects a tightening in banks' mortgage lending standards, the tightening of loan-to-value ratio (LVR) restrictions by the Reserve Bank of New Zealand (RBNZ) during 2016-17, and declining affordability. In Auckland, improved supply prospects because of zoning reforms and weaker foreign demand also played a role (Figures 5-7). Growth in residential investment has picked up, however, consistent with still robust underlying demand and some supply constraints.



Source: REINZ.

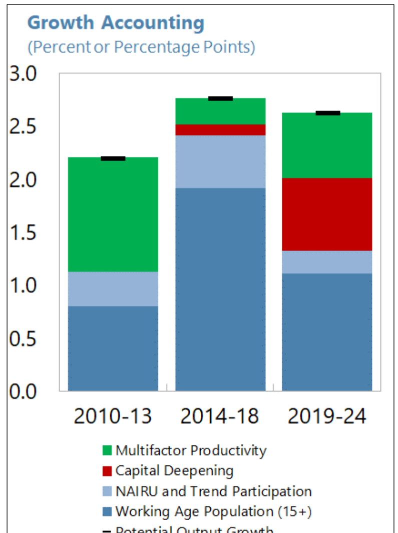


Sources: REINZ and IMF staff calculations.

10. Key financial soundness indicators have improved further. Bank lending continued to slow across all sectors, growing now broadly in line with nominal GDP. Banks strengthened their lending standards, although the recent modest easing in the RBNZ's LVR restrictions in January 2018 and January 2019 has led to a renewed uptick in new high LVR loans (Figures 7 and 8). While shorter-term U.S. dollar interest rates increased over the past year, the funding costs of New Zealand banks remained broadly stable (Figure 8).

B. Outlook

11. After the recent pickup, growth is expected to remain close to trend on the back of increased policy support. It is forecast to weaken somewhat in mid-2019 given external headwinds, but the recent monetary policy easing and increased government spending are expected to lift domestic demand. With this boost, a small positive output gap is expected to emerge, and inflation should move towards the 2 percent midpoint of the RBNZ's target range. In the medium term, output growth is expected to moderate to that of potential, which itself will slow modestly, mostly because of labor supply growth decreasing with the expected further gradual decline in net migration from recent highs.[4]



Sources: Statistics New Zealand; Authorities' data; and IMF staff calculations

12. Potential output growth is projected to slow over a 5-year horizon, mostly because of lower labor supply growth. This reflects lower working age population growth because of the expected gradual decline in net migration. Total factor productivity is expected to strengthen, reflecting cost control and efficiency gains,

[4] Statistics New Zealand has moved to using outcomes-based data, replacing data based on the stated intentions of travelers on passenger cards, to measure permanent and long-term arrivals and departures.

as broader capacity constraints, primarily related to construction and public infrastructure provision, are expected to emerge under the baseline outlook.

13. Household macrofinancial vulnerabilities are forecast to decline under the baseline scenario. House price inflation is expected to stabilize at rates slightly above consumer inflation. Residential investment is expected to rise at recent rates, consistent with continued strong housing approvals data and underlying housing supply shortfalls. With prices slowing relative to incomes, the household debt to disposable income ratio is expected to decline from 164 percent in 2018 to 149 percent in 2024.

C. Risks

14. Risks to the outlook are increasingly tilted to the downside. On the domestic side, the fiscal policy stance could be less expansionary if policy implementation were to be more gradual than expected, a risk given recent patterns. The domestic housing market cooling could morph into a downturn, either because of external shocks or diminished expectations. On the external side, global financial conditions could be tighter and dairy prices could be lower. Risks to global trade and growth from rising protectionism have increased, and this could have negative spillovers to the New Zealand economy, including through the impact on China and Australia, two key trading partners. High household debt remains a risk to economic growth and financial stability, and it could amplify the effects of large, adverse shocks. On the upside, in the near term, growth could be stronger if net migration were to decrease more slowly than expected or if the terms of trade were to be stronger (Annex II).

Authorities' Views

15. The authorities broadly agreed with staff's assessment of the outlook and risks. They anticipated a pick-up in growth in mid-2019 and through 2020, supported by accommodative monetary policy and the near-term fiscal impulse. Unemployment was seen as being close to the natural rate. The pickup in growth should put further pressure on wages and prices, bringing inflation to the mid-point of the target range. Net migration flows should also continue to support growth in the near term. In the medium-term, growth will slow to potential, as policy stimulus fades and net migration declines to levels that are closer to longer-term averages. The authorities were concerned about risks from trade tensions and other global downside risks. These could result in slower global growth and adverse spillovers into the New Zealand economy via their impact on business confidence and investment, resulting in a scenario in which inflation remains below the mid-point of the target range. Another concern was uncertainty about the potentially disruptive effects of digital and other technologies in product and labor markets.

POLICY DISCUSSIONS

16. The policy discussions focused on four issues: (i) macroeconomic policies to reach internal and external balance; (ii) policies to manage macrofinancial risks and reforms to strengthen financial regulation; (iii) policies to strengthen housing affordability; and (iv) policies to foster stronger and more inclusive growth.

A. Macroeconomic Policies for Internal and External Balance

Context

17. With recent rate cuts, monetary policy is more accommodative. The RBNZ reduced the policy rate—the overnight cash rate (OCR)—by 25 basis points in May 2019 and by 50 basis points in August responding to the weaker growth and inflation outlook. With the OCR at 1.0 percent, the two-step easing has lowered the real policy rate from around 0 to -¾ of a percent compared to an estimated neutral rate of 1-2 percent.

18. The FY2019/20 budget strikes a balance between supporting policy priorities and maintaining prudent debt levels. A small increase in operating and capital allowances compared to the December 2018 *Budget Policy Statement* addresses cost and capacity pressure in the delivery of essential infrastructure and services with a rapidly growing population.[5] The 2019 Budget is the first *Wellbeing Budget*, using Treasury's Living Standard's Framework (Annex III). The *Wellbeing Budget* targets five priorities through new and repurposed spending programs, including mental health, child wellbeing and poverty, Māori and Pasifika aspirations, productivity, and digital transformation of the economy.

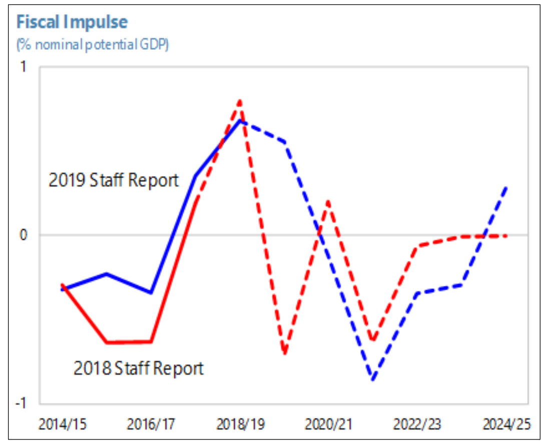
Staff's Views

19. The accommodative monetary policy stance fits the subdued inflation conditions. Even though the economy appears close to internal balance, monetary policy still faces asymmetric risks. Downside risks to growth, employment, and inflation because of insufficient accommodation remain a bigger concern than upside risks to inflation if the monetary policy stance turns out to be too expansionary. Further cuts would be appropriate if further downside risks with impacts on New Zealand are realized.

20. The expected fiscal policy stance under the FY2019/20 budget strikes an adequate balance between a near-term boost to demand and maintaining prudent debt levels. At a projected 1.5 percent of GDP, the fiscal impulse expected in 2019 is helpful, given the recent slowing in economic growth and the current cyclical position. Subsequently, the fiscal policy stance is expected to turn mildly contractionary from mid-2020, as the government follows its *Budget Responsibility Rules*, which aim for a reduction in net debt to 20 percent of GDP by FY2021/22. Given the low level of debt, and good access to credit coupled with a strong sovereign rating, New Zealand has substantial fiscal space and is at low risk of public debt distress (Annex IV).

[5] The *Budget Policy Statement* sets out the government's overall strategy for the Budget, including strategic priorities and targets for spending, revenue, the projected fiscal surplus and public debt intentions. The statement has to be tabled in Parliament before March 31 each year. Usually, it is published alongside the *Half Year Economic and Fiscal Update* in December.

21. The expected rebalancing of the macroeconomic policy mix is appropriate under the baseline scenario. The expected balance of the policy mix toward moderate fiscal consolidation and accommodative monetary policy under the baseline is well suited for restoring internal and external balance, given current indications of exchange rate overvaluation and excess external imbalances. If the fiscal stance continued to be expansionary, it would require earlier monetary policy tightening, likely amplifying the currency overvaluation.



22. New Zealand could face the effective lower bound on nominal policy rates should downside risks materialize but it has the space for a macroeconomic policy response. In the discussions, the authorities noted that they were discussing their choice of fiscal and monetary policy responses in the event of a severe economic downturn. Staff observed that the impact of a slowdown could be mitigated through expansionary fiscal policy given limited conventional monetary policy space (Annex V). The main concern is the readiness for a timely, effective response, given long implementation lags, especially in capital spending. The RBNZ has several options for unconventional monetary policy, including forward guidance and negative interest rates on its liquidity facilities to asset purchases, with the choice of instruments likely to depend on the underlying shocks and the extent of stress in the banking system.

23. New Zealand's sound fiscal framework has been strengthened further. The introduction of a target band for net public debt beyond FY2021/22 will provide a transparent medium-term public debt anchor for budget decisions, while avoiding the drawbacks of a narrow, time-bound debt target. The target range of 15 to 25 percent of GDP is prudent and maintains the fiscal buffer needed for the potentially large-scale fiscal policy response that might be required, given New Zealand's vulnerabilities. At the same time, the range also provides the flexibility to let automatic stabilizers operate over the cycle and accommodate productive spending when appropriate. The new wellbeing budget framework allows the government to establish spending priorities that will further living standards. The prioritization of spending in the context of broader socio-economic and environmental indicators should also facilitate setting program objectives to ensure and monitor effectiveness. There should be decisions made on how to evaluate the outcomes of those objectives in relation to wellbeing to provide guidance to government spending.[6]

Authorities' Views

24. A sustained lift in the inflation path toward the mid-point of the inflation target range will require a period of sustained above-trend growth. RBNZ officials noted that core inflation measures had increased to rates close to 2 percent—the mid-point of the target range, consistent

[6] See the accompanying Selected Issues Paper, Bannister, 2019, "Quantifying Consumption Equivalent Welfare in New Zealand."

with the economy operating broadly at capacity and labor markets tightening gradually. Nevertheless, with global growth slowing, additional easing might be required for growth to remain strong enough to generate the desired upward pressure on prices and wages. In the RBNZ's assessment, the exchange rate is broadly in line with fundamentals, taking into account the wide range of uncertainty around fair value assessments. Nevertheless, with major central banks expected to ease policy again, unhelpful downward pressure on inflation from renewed appreciation of the New Zealand dollar was a concern.

25. The conduct of fiscal policy will remain prudent even with greater focus on fostering wellbeing and related spending increases. The *Wellbeing Budget* is a framework to ensure improved targeting of government spending with a multi-year horizon. However, the new spending priorities have not replaced earlier ones. In particular, higher spending for infrastructure and the *Provincial Growth Fund* for regional development continues. The authorities also underscored the government's continued commitment to the Budget Responsibility Rules, including the aim to reduce net public debt to 20 percent of GDP by FY2021/2022. While recognizing that New Zealand had substantial fiscal space, the authorities did not see a need for modifying the Budget Responsibility Rules, as they allow for deviations subject to any significant shocks to the economy. Cyclical conditions did not call for such an increase, and they also doubted the capacity to increase productive spending further, given the higher spending already in train. Beyond the net debt target for FY2021/22 under the current rules, the government is looking to move to a medium-term net debt anchor, with a range between 15 and 25 percent of GDP. This will provide more flexibility over the cycle, while still allowing for a large debt buffer for use in emergencies, such as another extensive natural disaster or a large economic downturn.

26. Preparations for a policy response in the event of a severe economic downturn are underway. The RBNZ is considering how to use its balance sheet most effectively, given the small amount of government debt outstanding. On the fiscal side, the main concern is readiness for a timely, effective response, given implementation lags, especially in capital spending.

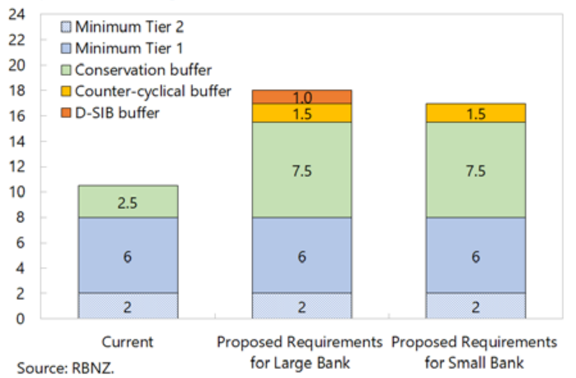
B. Managing Macrofinancial Risks and Strengthening Financial Regulation

Context

27. The RBNZ relaxed macroprudential policy further as macrofinancial risks continued to ease. The LVR restrictions on banks' new mortgage loans were relaxed on the assessment that both mortgage credit growth and house price inflation had eased to more sustainable rates, reducing the riskiness of banks' new housing lending (Text Table).

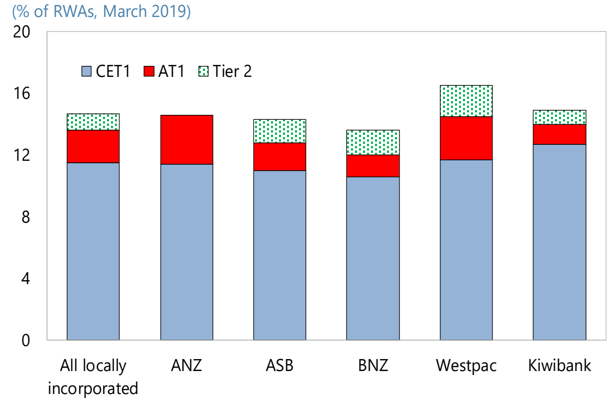
28. The RBNZ has proposed an increase in capital requirements to lower the probability of bank failure. The proposed increase would entail a rise in the required capital conservation buffer from 2½ to 7½ percent of risk-weighted assets (RWA) and increases for other buffers, raising Tier 1 minimum capital adequacy requirements from 8½ percent of RWA currently to 16 percent for domestic systemically important banks (D-SIBs) and 15 percent for smaller banks Annex VI). These new minimum requirements for high-quality capital would put New Zealand's locally incorporated banks near the top of international peers. The RBNZ is currently reviewing the proposed changes to the capital framework after a public consultation. A decision is expected in November 2019.

Proposed Capital Requirements
(In percent of risk-weighted assets)



Source: RBNZ.

Capital Ratios
(% of RWAs, March 2019)



Source: RBNZ.

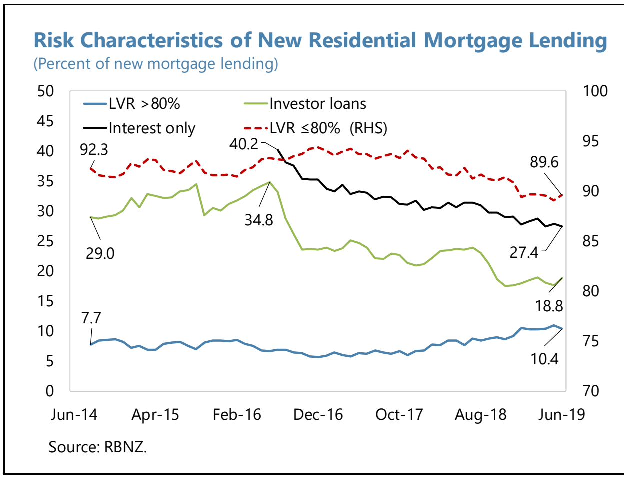
29. The ongoing Phase Two of the Review of the RBNZ Act focuses on updating its regulatory, supervisory, and macroprudential functions. The government has announced its in-principle decision after Phase 2A of the public consultation to introduce a deposit insurance framework as part of the overhaul of the crisis-management framework, a break from the past when such a framework was rejected on moral hazard grounds. The proposed limited deposit protection of up to NZ$50,000 per account per institution, would fully cover 90 percent of individual bank depositors, but only about 40 percent of the total bank deposits value. Other in-principle decisions and options considered in Phase 2B are discussed in Annex VII.

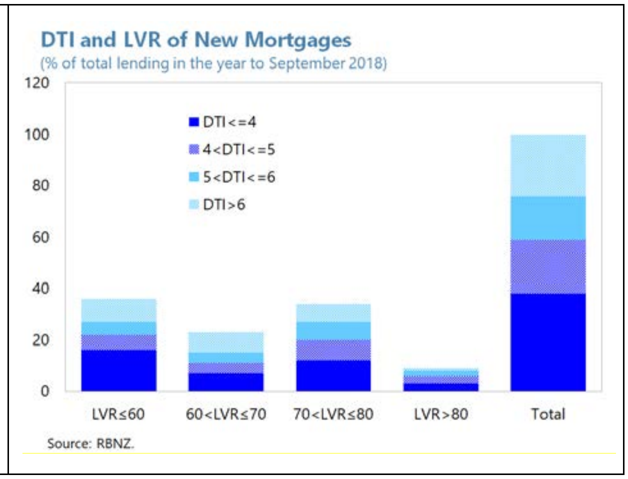
Macroprudential Measures on New Residential Mortgage Lending of Each Bank

	Loans to owner occupiers	Loans to investors
October 2013	No more than 10 percent on LVRs> 80 percent	
November 2015	Auckland: 10 percent limit on LVRs> 80 percent	Auckland: 5 percent limit on LVRs> 70 percent
	Outside Auckland: 15 percent limit on LVRs> 80 percent	
October 2016	10 percent limit on LVRs> 80 percent	5 percent limit on LVRs> 60 percent
January 2018	15 percent limit on LVRs> 80 percent	5 percent limit on LVRs> 65 percent
January 2019	**20** percent limit on LVRs> 80 percent	5 percent limit on LVRs> **70** percent

Staff's Views

30. The scope for further easing macroprudential restrictions is limited, given still-high macrofinancial vulnerabilities. The share of riskier home loans in bank assets (those with very high LVRs, high debt-to-income, investor loans, and interest-only loans) have moderated due to the combined impact of the LVR settings and tighter bank lending standards. Nonetheless, despite the positive effects of the LVR restrictions implemented over 2013-17, household debt—at 164 percent of household disposable income—continues to be a high-risk structural vulnerability as many borrowers remain highly leveraged. With the recent easing of the LVR restrictions, improvements in some macroprudential risk factors have stalled or started to reverse. Further easing of LVR restrictions should, therefore, consider the possible impact on banks' prudential lending standards, as well as on risks to financial stability from elevated household debt. Avoiding a further build-up of household balance sheet vulnerabilities would allow for the easing of LVRs in a market downturn.





31. The proposed increase in banks' capital conservation buffer would result in a welcome reduction in systemic financial risks. The material increase in the requirements is consistent with the 2017 FSAP recommendation to raise capital buffers in view of the systemic financial risks emanating from the dominance of the four large banks in the financial system, with similar concentrated exposure to residential mortgages, business models and funding structures. With the increases, capital adequacy requirements in New Zealand would be broadly at the lower end of the range of requirements that, according to recent studies, would have been sufficient to absorb losses in the majority of past banking crisis without undue costs to economic activity. The RBNZ estimated that, overall, the expected capital increases would amount to 20-60 percent of current CET1 capital (an additional NZ$13.7 billion), equivalent to 70 percent of bank profits over the proposed 5-year transition period.

32. There is scope for some flexibility in the final settings for key parameters in the new bank capital framework. In staff's view, there is a strong case to double the new buffer for domestic systemically important banks (D-SIB buffer) to 2 percent (with a corresponding decrease in the capital conservation buffer for all banks) since much of the structural systemic financial risks identified in the FSAP arise from the D-SIBs. There would also be scope for a somewhat smaller increase of the general conservation buffer, given that other regulatory changes since the global financial crisis likely also lowered the probability of bank failure (e.g., higher liquidity requirements). Alternatively, the RBNZ could also evaluate whether a mix of Tier 1 and Tier 2 capital could provide for a similar strengthening of the loss absorbency provided by banks' capital buffer. Finally, the phase-in period could be set flexibly to ease the transition. In the discussions, staff also noted that a stronger bank supervision regime would still be needed, to complement the higher capital requirements.

33. The ongoing Phase Two of the Review of the RBNZ Act is expected to advance key areas of reform identified in the IMF's 2017 Financial Sector Assessment Program (FSAP). Staff welcomes the in-principle decision to adopt a deposit insurance framework, a move recommended by the 2017 FSAP (Annex VIII), and also emphasizes the importance of continued operational independence and additional resources to strengthen the supervisory and regulatory functions of the RBNZ.[7]

Authorities' Views

34. The authorities noted that, while household debt remains high, macrofinancial risks have moderated. House prices have moderately declined in Auckland while increases have slowed elsewhere in the country. Banks have steadily strengthened their lending standards since 2016. Further easing in LVRs by the RBNZ is possible if macrofinancial risks decline further, which would require continuing slow growth in credit and house prices, close to or below income growth, and banks maintaining prudent lending standards.

35. The RBNZ noted that the goal of the proposed gradual increase in the bank capital conservation buffer was to make the banking system safer. The proposal was based on evidence that the costs of systemic banking crises are higher than previously understood. The cost from higher capital requirements in terms of lending and economic growth were often overstated, while the benefits were understated. Increasing the amount and quality of capital ensures that banks can survive all but the most exceptional shocks. Officials also noted that the RBNZ is reviewing public submissions in the consultation process, in particular feedback on the risk appetite framework, the related calibration of capital requirements, instruments, and the implementation timeline.

36. Phase Two of the Review of the RBNZ will take into consideration the key reform recommendations of the 2017 FSAP. The in-principle decision to adopt a deposit insurance framework was consistent with the FSAP's recommendation on the need to have deposit protection to complete the financial safety net. The proposed insurance limit range, albeit comparatively low, would cover about 90 percent of depositors. The deposit insurance would complement the existing

[7] See also the accompanying Selected Issues Paper, Wong, 2019, "Interaction between Monetary Policy and Financial Stability in New Zealand."

options for the orderly resolution of an insolvent bank. The broader crisis management and resolution framework was still under review.

C. Policies to Improve Housing Affordability

Context

37. The government is refocusing elements of its multi-pronged approach to improve housing affordability.

- On the demand side, the policy measures so far have included an increase in the accommodation supplement—a cash subsidy linked to low-income recipients' actual rents or home ownership costs; the extension from two to five years of the period during which capital gains on residential investment property are taxed ("bright line test"); a change in the tax treatment of residential rental losses, which can only be deducted from future taxable income from rental properties rather than taxable income in general; and a ban on the purchase of residential property by nonresidents under the *Overseas Investment Amendment Act*.[8]

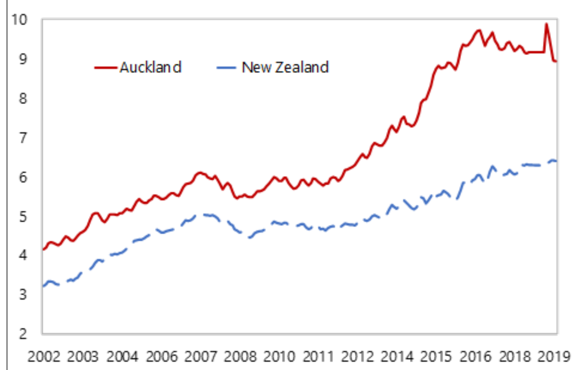
- On the supply side, the implementation of the *KiwiBuild* program—where the government plans to build 100,000 affordable homes for first-time home buyers over ten years from 2018—is lagging. The government is currently considering a reset of the program, which is likely to be smaller in scale and more regional needs-based, while at the same time prioritizing social housing, and rent support for low-income households. The Urban Growth Agenda is the umbrella for other measures on the supply side, including related to planning, zoning, and the provision of housing-related infrastructure.

- On the institutional side, the government established the Ministry of Housing and Urban Development, consolidating responsibilities for the housing agenda. The government agency *Kāinga Ora—Homes and Communities* was established as the lead developer for affordable homes and social housing.

[8] As noted in the 2018 Article IV Staff Report, the residency-based foreign ownership restrictions under the then-draft Amendment Bill were deemed a capital flow management measure (CFM) under the Institutional View (IV) on capital flows. Under the legislated *Overseas Investment Amendment Act,* in effect since October 2018, all residential land was reclassified as sensitive land and foreign ownership requires approval, except for Australians, Singaporeans, and resident visa holders. The legislated Act also provides for exemptions to sell a fraction of new apartment developments to nonresidents off the plan. The use of the CFM was not assessed to be appropriate under the IV because purchases by nonresidents did not seem to be of a scale to be considered the equivalent of a capital inflow surge. Property transfer and tax residency data suggest a relatively small drop in the share of foreign buyers since the ban was enacted. Nationwide, overseas buyers who were not "New Zealand Citizens or resident visa holders" acquired 0.5 percent of homes transferred in 2019Q2, down from 2.8 percent in 2018Q2 before the ban. In Auckland, the same share decreased to 1.1 percent from 6.5 percent in the same period of 2018. These data do not control for potential nonresident purchases through foreign-owned companies.

Staff's Views

38. Improving housing affordability would lower macrofinancial risks and contribute to more sustainable growth. Housing affordability has barely improved, notwithstanding the housing market cooling. House prices are expected to continue rising under the baseline economic outlook. Demand for housing is likely to remain strong, given population growth and low interest rates, while the supply response is constrained by land use and other restrictions. Construction costs are high. Improving housing affordability would reduce inequality and contribute to lower macrofinancial risks, and, in the longer term, make growth more sustainable, including by supporting productivity through agglomeration externalities. Supply-side reforms are central for broad improvements in affordability, although additional direct support might be required for some lower-income households.



Sources: REINZ; Statistics New Zealand; and Interest.co.nz.

39. The government's continued focus on advancing its comprehensive housing policy agenda is welcome. The consolidation for housing-related policies in one Ministry should help in policy implementation. Steps taken to support local governments' infrastructure funding and financing to facilitate timely infrastructure provision are welcome developments.

40. Nonetheless, the housing policy agenda could benefit from some further measures. The objectives of the *KiwiBuild* program could, at lower risk to the budget, be achieved through other means, including, for example, temporary tax credits for the construction sector to adopt new technology, rather than the government taking on the role of a developer. Staff welcomes the government's intention to consider adding elements of tax reform, such as a tax on all vacant land, to the agenda. A broad land tax, for example, would support more efficient land use. Since the comprehensive agenda should foster housing affordability on a non-discriminatory basis, the ban on purchases of residential property by nonresidents should be removed, given its use is not in line with the IMF's Institutional View (IV) on capital flows. At the local level, there should be reforms to simplify and standardize zoning and permit local councils to actively plan for and enable housing supply growth and planning reforms.

Authorities' Views

41. The implementation of the government's multi-pronged approach to improve housing affordability is advancing. A more comprehensive housing policy agenda is taking shape, including increased focus on making housing for lower income households more affordable through a better accommodation supplement. The authorities highlighted that, in addition to the housing related measures already put in place, the new Ministry of Housing and Urban Development has reinforced institutional capacity to deliver the full breadth of the housing plan, including on the legislative changes needed to ensure more affordable houses and the related infrastructure development. The ministry will be supported by a new government entity for affordable housing development, *Kāinga Ora—Homes and Communities*, to strengthen delivery.

42. The authorities do not consider the restrictions on purchases of residential property by nonresidents to be a CFM measure. The restrictions do not aim to affect capital flows or resolve a balance of payments issue. They are a demand-side measure to ban overseas speculators against the backdrop of the government's comprehensive housing agenda. The goal is to create a housing market with prices shaped by New Zealanders, and to make homes more affordable. They also pointed out that the Phase I review of the Overseas Investment Act (OIA) not only brought residential land into the category of sensitive land but also simplified the rules for investment in forestry by overseas persons.

D. Supporting Wellbeing and More Inclusive Growth

Context

43. Addressing low productivity growth will be central from a wellbeing perspective. New Zealand risks missing out on new technologies embodied in capital, as capital deepening has stalled in the current expansion, while total factor productivity growth has been relatively low in comparison with peers (Figure 9). While structural features seem to explain much of New Zealand's low productivity growth—a remote location, a small domestic market, and lack of interconnectedness, domestically and internationally—there is scope for policies to mitigate some of the implications, including for example, gaps in technology diffusion.

44. Within the greater focus on wellbeing under the *Living Standards Framework*, the government has a roster of policies to foster productivity growth. While major budget initiatives have a large social capital component – for example, child poverty and mental health – the authorities are also incorporating measures to lift productivity as identified in recent assessments of New Zealand's structural settings by the Productivity Commission and international organizations. The measures have included:

- Introducing an ***R&D tax credit regime***, now at an advanced stage, with a broad definition of R&D, including new digital technologies. It focuses on younger firms and follows many suggested best practices.
- Continuing to increase ***education spending***. This includes reform of the vocational education training (VET) sector to ensure more efficient delivery and reduce the scope of duplication among the different VET institutions in the country, in addition to improving and building schools at all levels.

- Creating a ***New Zealand Infrastructure Commission, Te Waihanga (NZIC)***, to be established in October 2019.[9] The NZIC aims to enhance procurement and delivery and set up an infrastructure pipeline.
- Using ***wage increases*** to further more inclusive growth, by establishing a *Fair Pay Agreement Working Group*, which recently recommended reintroducing sector-wide collective bargaining. This is in addition to the planned minimum wage increases outlined in 2018.
- Fostering regional development through the ***Provincial Growth Fund (PGF)*** and greater focus on ***regional immigration*** to align immigration of skilled labor with employers' needs in the regions.

Other elements of the structural reform agenda are still being prepared, with many of them (e.g., climate change policies) still at an early stage.

Staff's Views

45. The thrust of the structural reform program underway is adequate. General economic productivity should benefit from the R&D tax credit regime. VET reform is key to strengthening human capital. The new NZIC should ensure better targeting and implementation of publicly-provided physical capital, particularly with the identification of a pipeline of projects which should reduce uncertainty on how government policies (especially on transport) interact with private investment plans.

46. Overreach of binding sectoral wage agreements should be avoided. The government has not yet responded to the recommendations of the working group, but the expectation is that it will support binding, sector-wide wage agreements for a small number of low-pay, low-skill occupations. It will be important to consider the trade-offs involved. While such agreements can help in reducing inequality, they may also impede economic and labor market adjustment after large shocks and, depending on reach and design, they could also lower demand for low-skilled labor.

47. The authorities' continued pursuit of an open, multilateral trade regime is commendable. New Zealand remains a central player in the Regional Comprehensive Economic Partnership (RCEP) negotiation process and has implemented the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP). Given that foreign direct investment complements the productivity benefits of international trade, the current work on reducing the administrative burdens associated with the OIA is welcome.

Authorities' Views

48. The government is continuing its multi-pronged approach to boosting productivity as part of its broader focus on wellbeing. It is completing previously-announced initiatives,

[9] Its precursor, the Infrastructure Transactions Unit, was set up in November 2018, covering much of the procurement function of the NZIC.

including: an R&D tax credit to foster innovation by young firms and increase R&D spending to 2 percent of GDP; the provision by NZIC of market information on a pipeline of infrastructure projects and considering the introduction of new reserve powers to ensure that investment is in New Zealand's national interest; further reforming the OIA by streamlining processes for foreign direct investment; and reforming the VET sector to strengthen human capital. The government remains committed to deeper economic integration through international trade, with continued involvement in the negotiations for the RCEP, an upgraded free trade agreement (FTA) with China and a new FTA with the European Union.

STAFF APPRAISAL

49. New Zealand's economic expansion is still solid. Despite the loss of momentum in economic activity and a cooling in housing markets, output has remained close to potential, and the unemployment rate has continued to decline. Broader price and wage pressures have not yet emerged even though the economy has operated close to capacity for some time. The external position was weaker than implied by medium-term fundamentals and policy settings.

50. Economic growth is expected to remain close to that of potential output, but risks to the growth outlook are tilted to the downside. After increasing in early 2019, growth is expected to strengthen further in 2019-20 on the back of monetary and fiscal policy support, eventually leading to a small positive output gap and a gradual acceleration of inflation towards the 2 percent midpoint of the RBNZ's target range. Downside risks to the economic outlook in New Zealand have increased, however, reflecting higher downside risks to the global economic outlook.

51. The recent monetary policy easing fits the subdued inflation conditions and near-term risks to the outlook. Economic growth is only expected to remain close to potential on the back of a timely increase in macroeconomic policy support. Such support remains critical until underlying domestic demand and inflation have strengthened more durably. With downside risks to growth, employment, and inflation, insufficient monetary accommodation still is a bigger concern than the upside risk to inflation if the monetary policy stance were to turn out to be too expansionary.

52. Fiscal policy strikes an adequate balance between near-term demand support and maintaining prudent debt levels. The FY2019/20 budget supports new wellbeing initiatives and should provide modest near-term stimulus to aggregate demand. While New Zealand has substantial fiscal space, the continued emphasis on meeting the medium-term debt objectives highlights the government's commitment to maintaining the fiscal buffers needed to respond to potential large economic downturns and other contingencies such as natural disasters. The planned move from time-bound point targets for net public debt to a target range of 15 to 25 percent of GDP as a medium-term debt anchor provides for a welcome increase in flexibility.

53. The New Zealand authorities should prepare contingent policy responses in the event of a severe economic downturn. With the policy rate approaching its effective lower bound, the RBNZ will likely have to resort to an unconventional monetary policy response. On the fiscal side, readiness for a timely, effective response, given long implementation lags, especially in capital spending, will be essential.

54. The scope for easing macroprudential restrictions is limited, given still-high macrofinancial vulnerabilities. The combined impact of the LVR settings and tighter bank lending standards has led to a decline in riskier mortgages in bank assets. While house price inflation and credit growth have moderated, any further easing of LVR restrictions should consider the possible impact on banks' prudential lending standards, as well as the risks to financial stability from high household debt.

55. The proposed higher capital conservation buffers would provide for a welcome increase in banking system resilience. The new requirements would increase bank capital to levels that are commensurate with the systemic financial risks emanating from the banking system. Starting from a relatively strong position, there is scope for some flexibility when setting some parameters in the revised capital framework, including the length of the phase-in period and types of capital within the buffers. The new framework should also differentiate more between large and small banks. A stronger bank supervision regime would still be needed, to complement the higher capital requirements.

56. The main reforms envisaged in the ongoing Phase Two of the Review of the RBNZ Act should increase financial system resilience. The upgrades to the regulatory and supervisory framework would advance key areas of reform identified in the IMF's 2017 *Financial Sector Assessment Program*, including enhancing the RBNZ's resources and operational independence for its supervisory and regulatory functions, broadening the macroprudential toolkit, and introducing a deposit insurance framework.

57. Mitigating supply constraints is critical for housing affordability and requires further progress in the government's comprehensive housing policy agenda. The reform of the institutional structure, including the establishment of the Ministry of Housing and Urban Development, should help in implementing housing policies. Further work is needed to complete the agenda, including enabling local councils to actively plan for and increase housing supply growth. Tax reform, such as a tax on all vacant land, should also be considered.

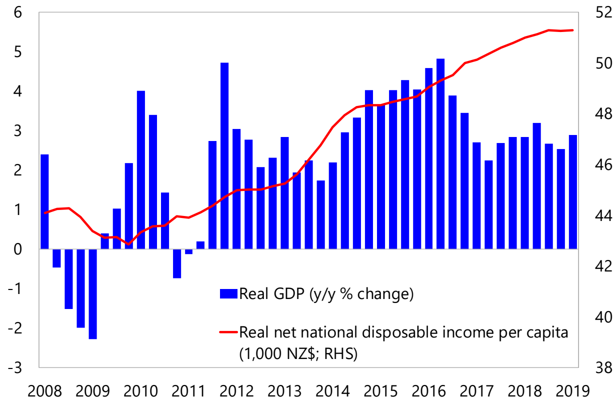
58. Addressing long-standing low productivity growth continues to be a central concern. In this respect, some important first steps have been taken, including the introduction of a new R&D tax credit regime; the creation of the New Zealand Infrastructure Commission to help in closing infrastructure gaps; and the reform of the vocational education and training sector.

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

Figure 1. Growth is Slowing

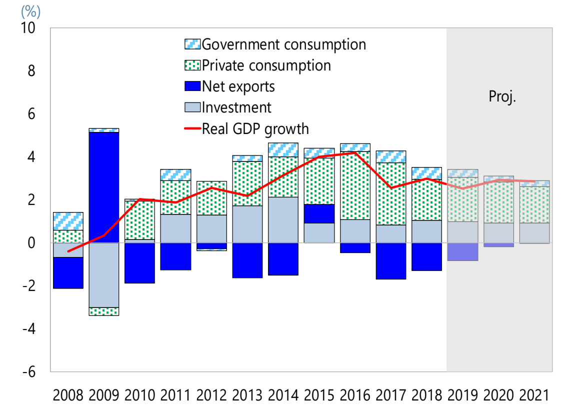
Economic growth has slowed...

Growth Performance



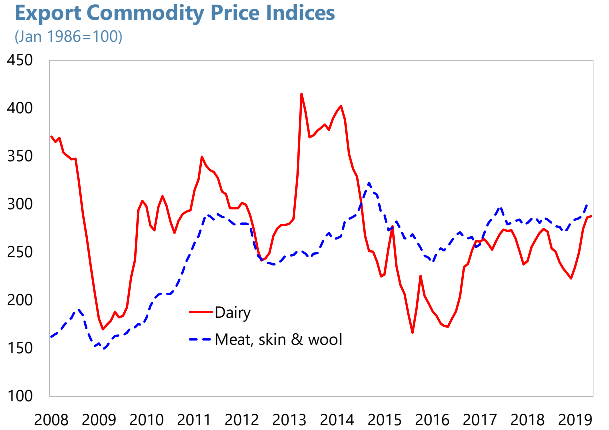
...with lower growth in domestic and external demand...

Contribution to Growth



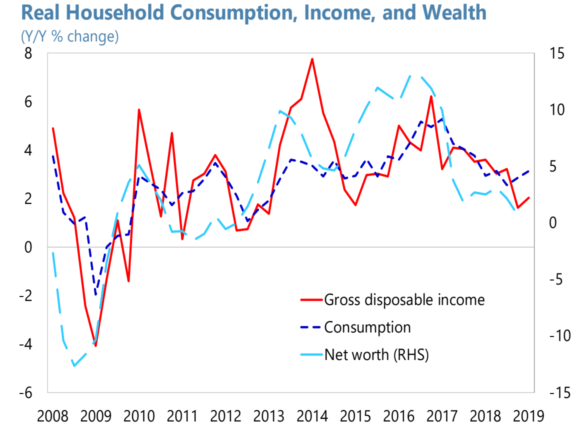
...and relatively weak agricultural commodity prices in 2018.

Export Commodity Price Indices



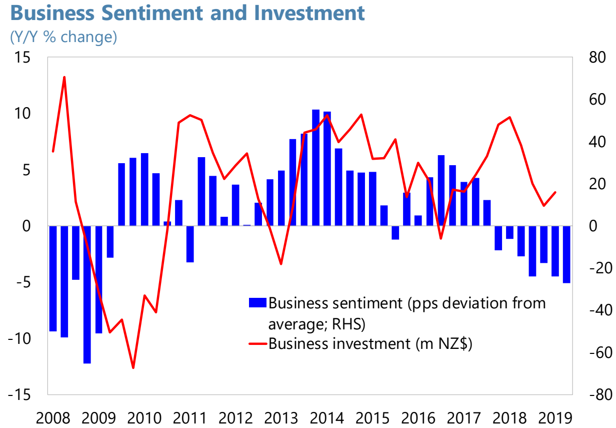
Consumption growth has slowed with income wealth...

Real Household Consumption, Income, and Wealth



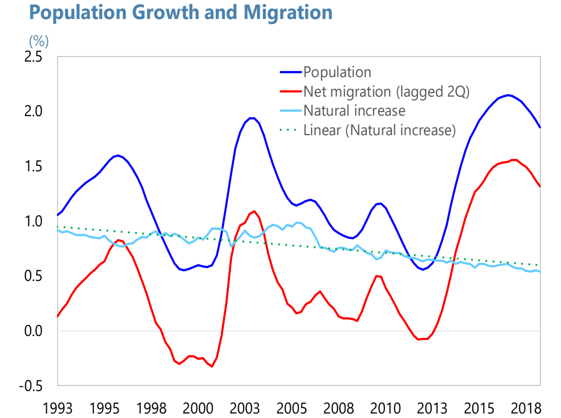
...and low business confidence is weighing on investment...

Business Sentiment and Investment



...despite still high net immigration.

Population Growth and Migration



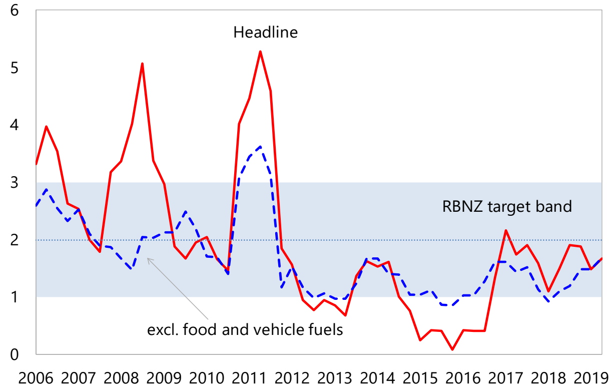
Sources: Haver Analytics; Statistics New Zealand; and IMF staff calculations.

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

Core inflation is stuck in the lower half of the target band…

CPI Inflation

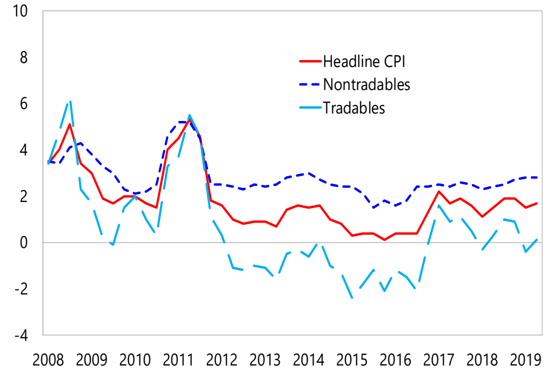
(Y/Y % change)



…primarily because of weak tradables inflation.

CPI Inflation

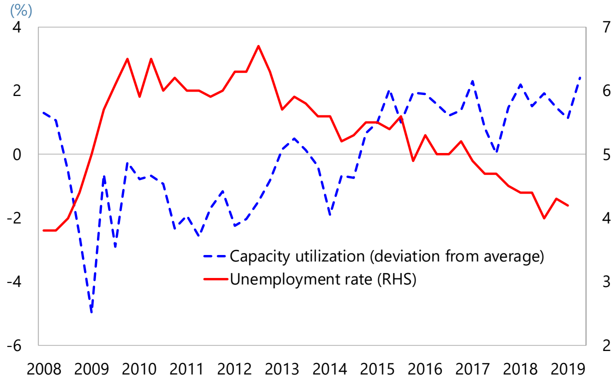
(Y/Y % change)



Unemployment is low and capacity utilization in manufacturing and construction is high.

Indicators of Resource Pressure

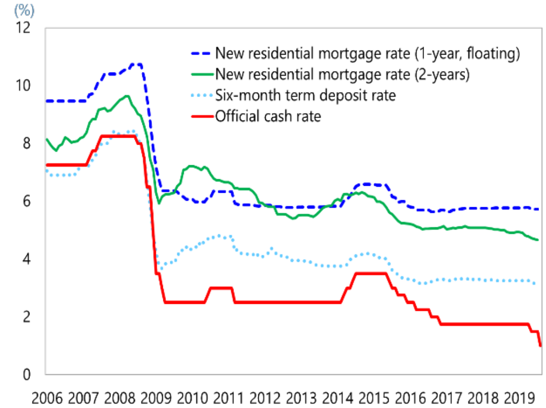
(%)



The policy rate is at a record low and banks have lowered mortgage rates.

Interest Rates

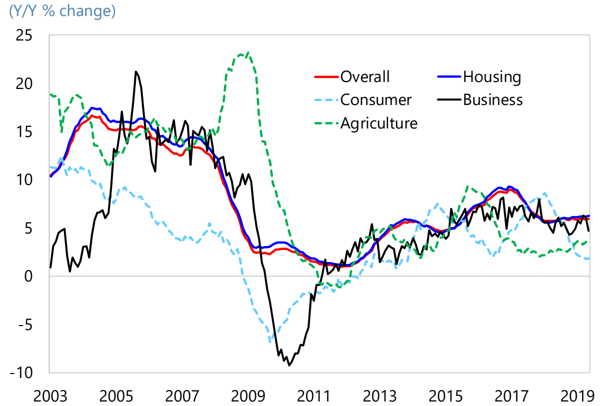
(%)



Credit growth is moderating led by softening housing credit …

Credit

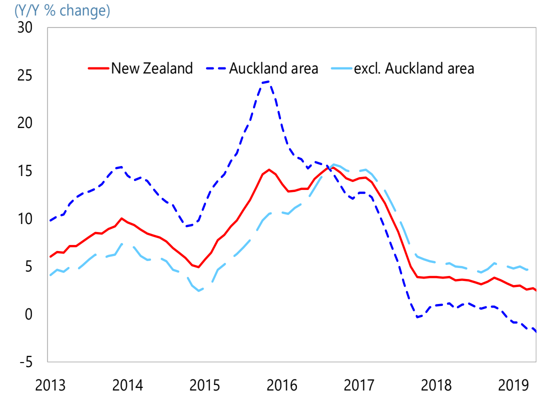
(Y/Y % change)



… and contributing to easing house price inflation.

House Prices

(Y/Y % change)

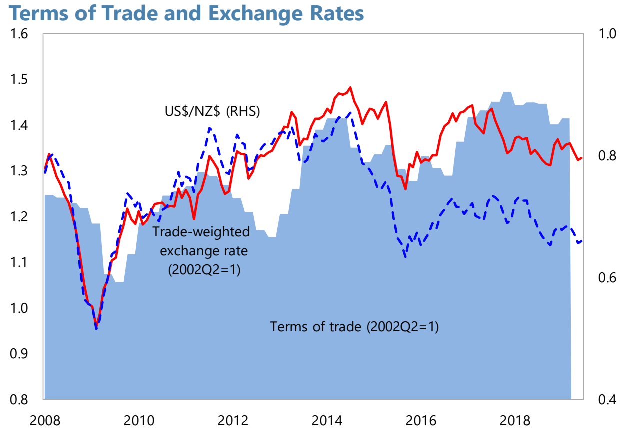


Sources: Reserve Bank of New Zealand; Haver Analytics; CoreLogic; and IMF staff calculations.

Figure 3. External Sector Remains Stable

The real exchange rate has risen while the terms of trade have declined ...

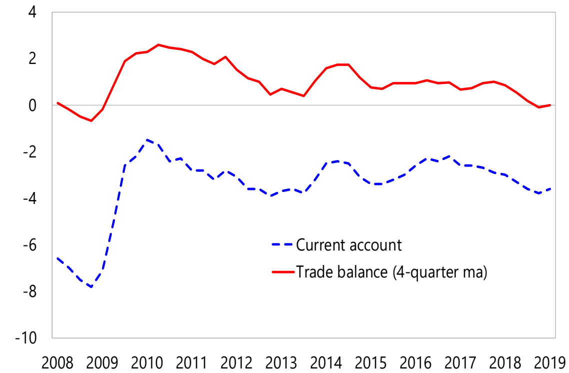
Terms of Trade and Exchange Rates



...and the current account deficit has widened.

Current Account

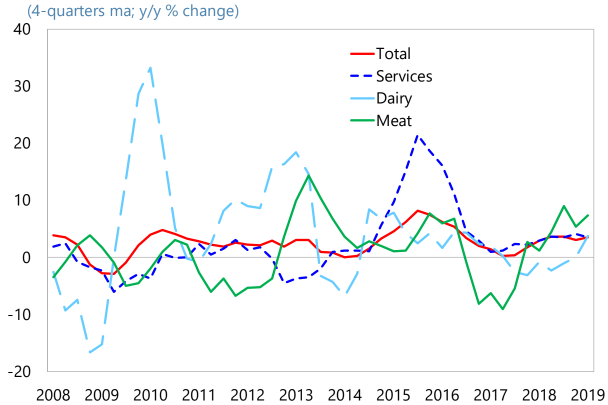
(% GDP)



Growth in export volumes has remained stable overall...

Export Volume

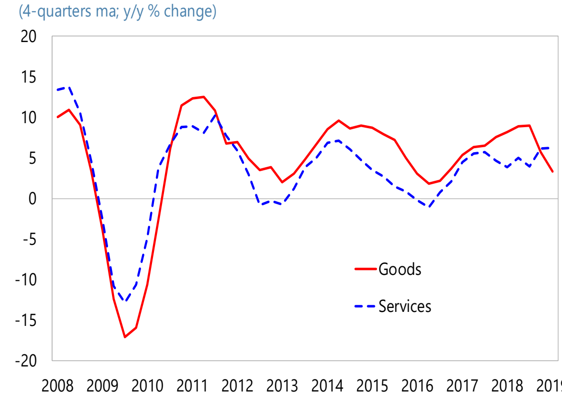
(4-quarters ma; y/y % change)



...while import growth has strengthened gradually.

Import Volume

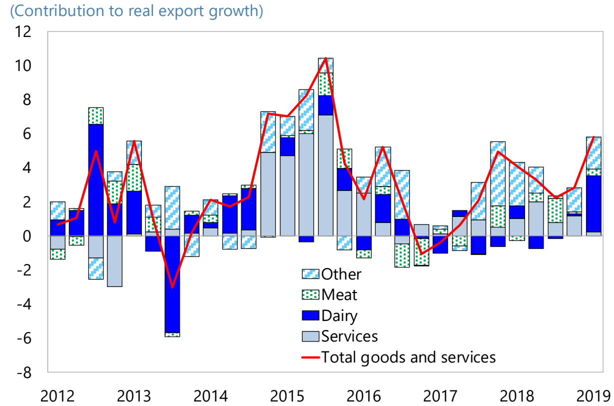
(4-quarters ma; y/y % change)



Services' contribution to export growth remains important ...

Export Composition

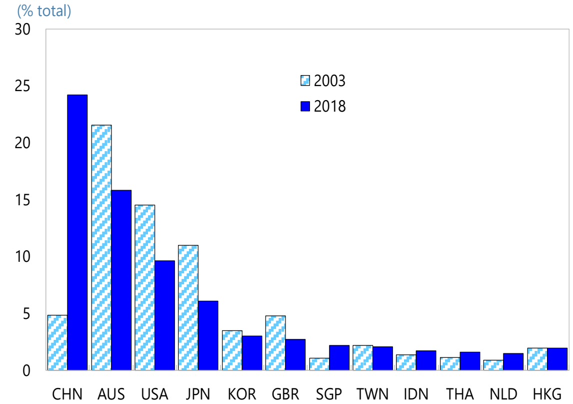
(Contribution to real export growth)



...and China has become the largest export destination

Exports by Destination

(% total)

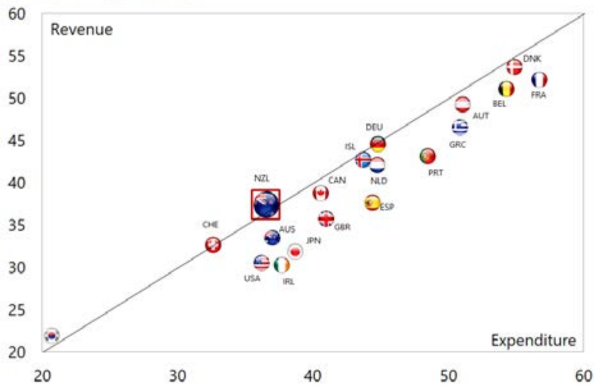


Sources: Reserve Bank of New Zealand; Haver Analytics; and IMF staff calculations.

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

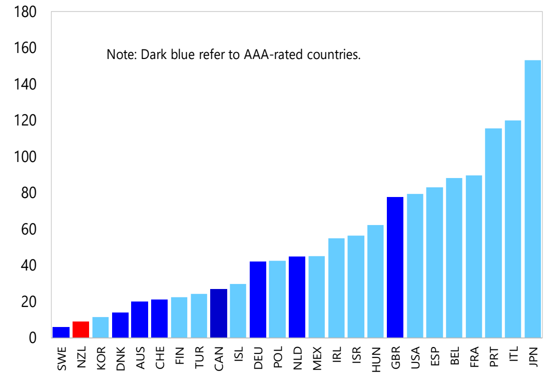
New Zealand has a relatively small government…

Revenue and Expenditure
(% GDP; average 2010-18)



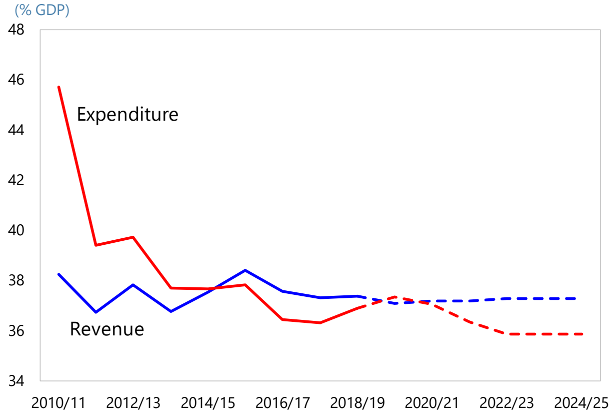
…and a low level of public debt.

Net Public Debt
(% GDP; 2018)



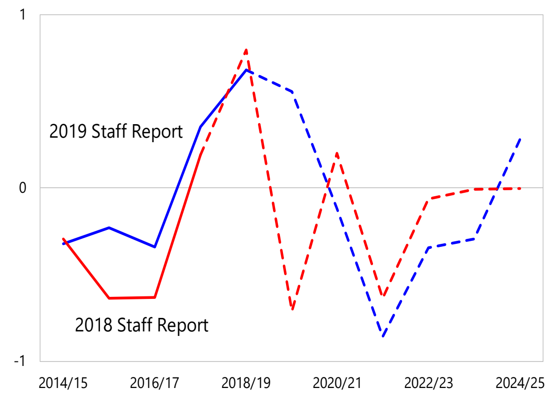
Expenditure has increased recently …

General Government Revenue and Expenditure
(% GDP)



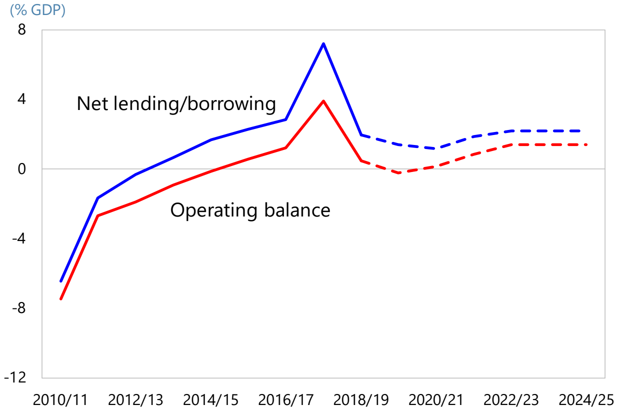
…underpinning a short-lived positive fiscal impulse…

Fiscal Impulse
(% nominal potential GDP)



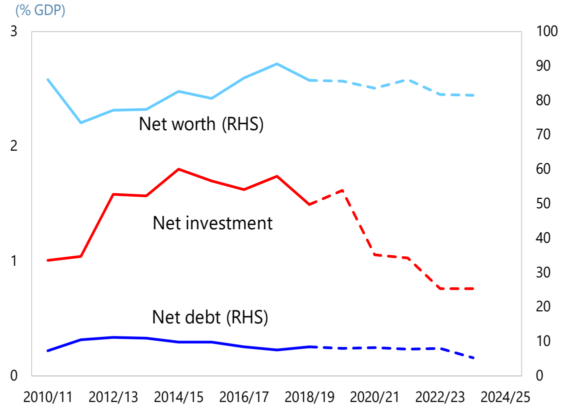
…but moderate fiscal consolidation going forward…

Overall and Operating Balance
(% GDP)



…should lower net debt but maintain net worth.

General Government Investment and Balance Sheet
(% GDP)



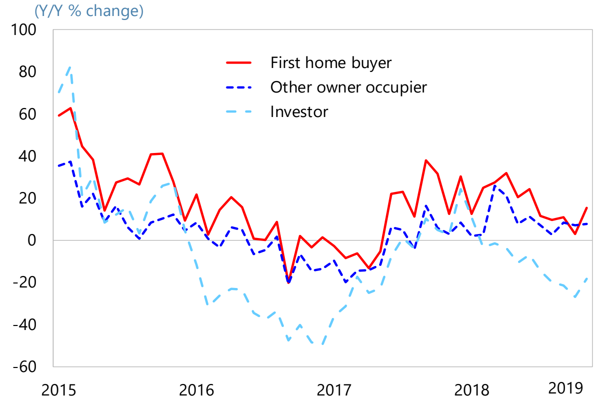
Sources: Treasury, *Budget 2018* and *2017 Half-Year Economic and Fiscal Update*; and IMF staff calculations.

Figure 5. The Housing Market Has Cooled

Growth in new housing loans has slowed.

New Residential Mortgage Lending

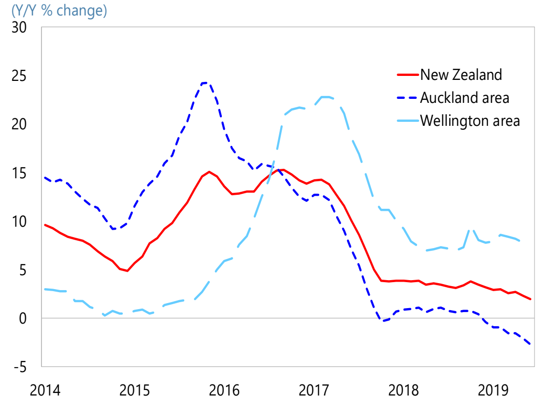
(Y/Y % change)



House price inflation is lower, with regional differences.

Residential House Prices: Regional Differences

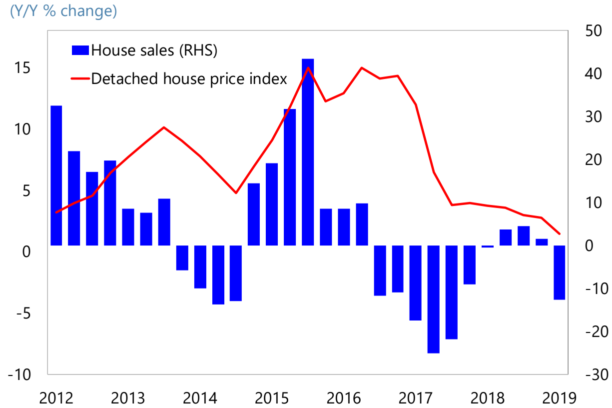
(Y/Y % change)



Sales have remained subdued …

House Prices and Sales

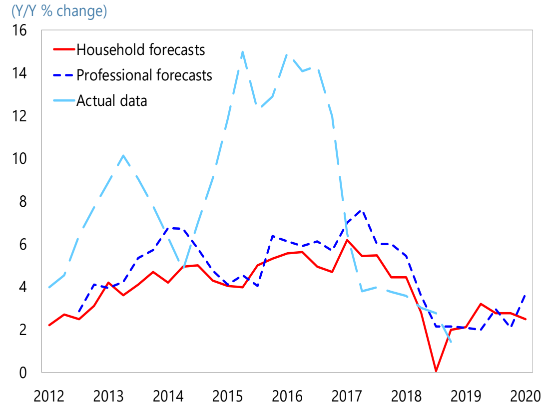
(Y/Y % change)



…amid stabilization in expected house price increases.

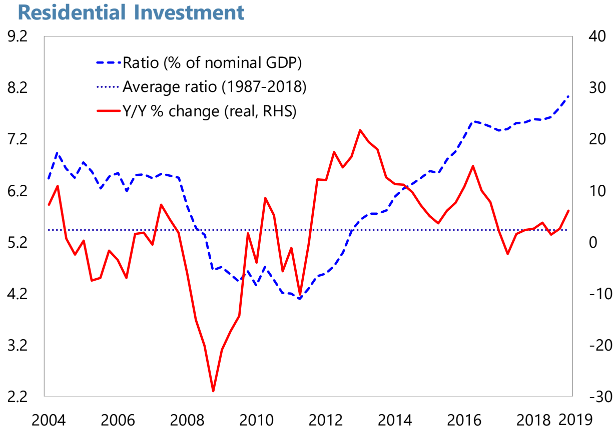
House Price Expectations

(Y/Y % change)



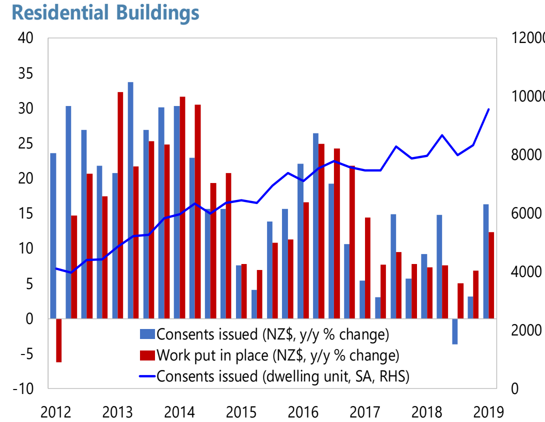
Residential investment has picked up gradually…

Residential Investment



…amid a pickup in building consents issued.

Residential Buildings

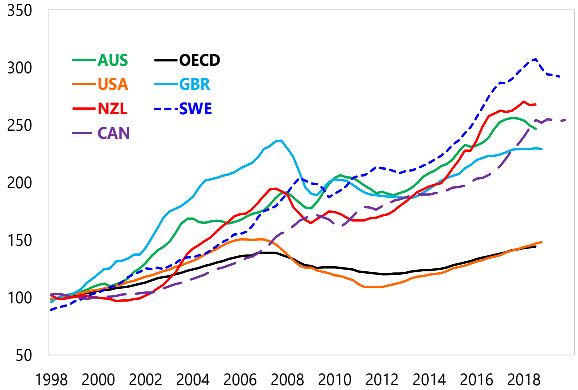


Sources: Reserve Bank of New Zealand; OECD; QV via Corelogic; Haver Analytics; and IMF staff calculations.

Figure 6. Household Debt and Housing Remain a Concern, But with Signs of Improvement

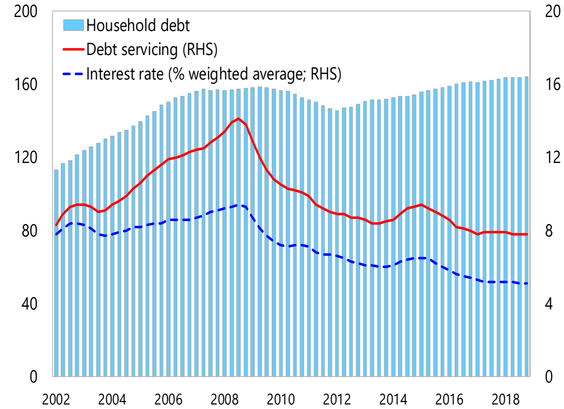
House price increases are still well above the OECD average…

Real House Prices vs OECD
(1998=100)



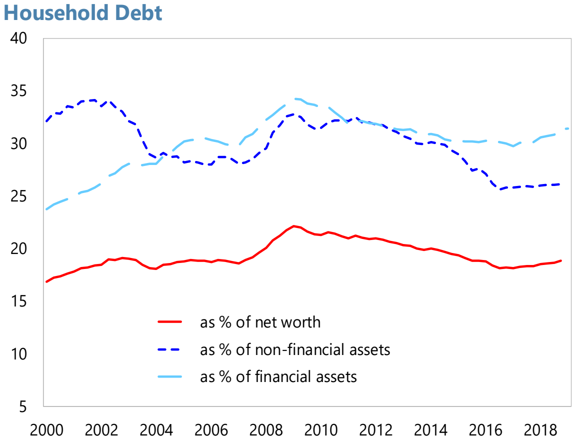
…and the household debt remains elevated despite reduction in debt servicing ratio.

Household Debt
(% nominal disposable income)



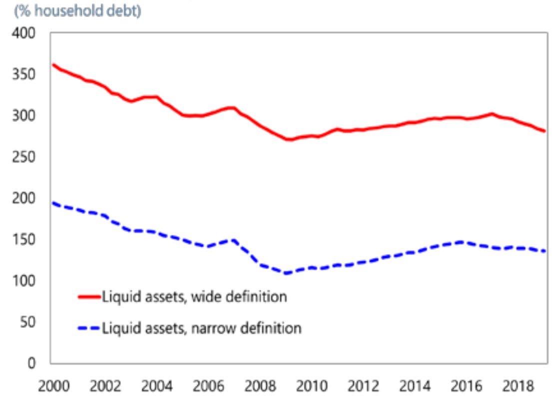
Household leverage has risen…

Household Debt



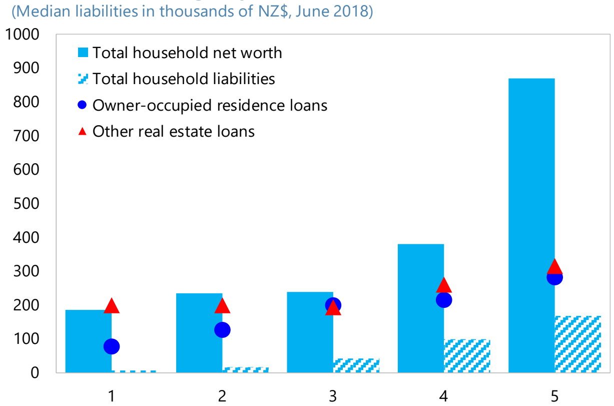
…but balance sheet liquidity is high.

Household Liquidity
(% household debt)



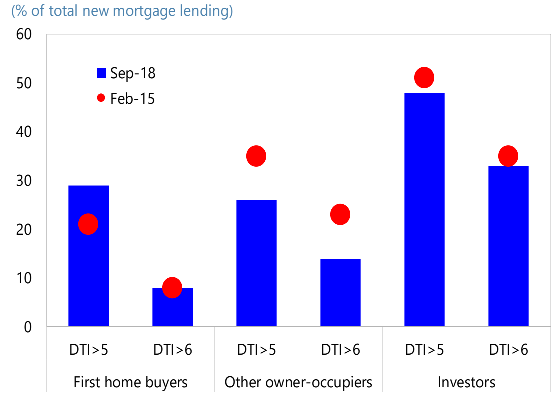
Richer households have higher other real estate loans …

Household Leverage by Income Quintile
(Median liabilities in thousands of NZ$, June 2018)



…while debt-to-income ratios of first-home buyers are still rising.

Share of High DTI Loans
(% of total new mortgage lending)

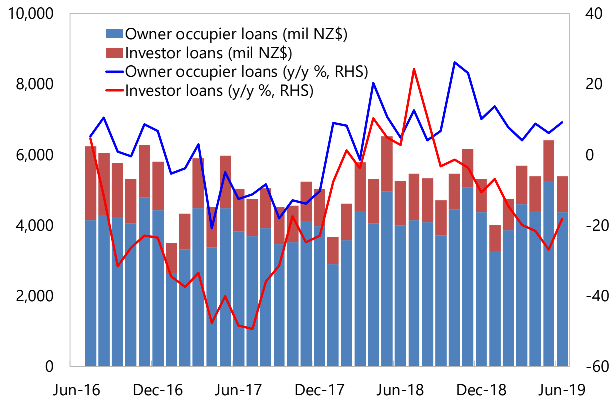


Sources: Reserve Bank of New Zealand; Statistics New Zealand; and Haver Analytics.

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

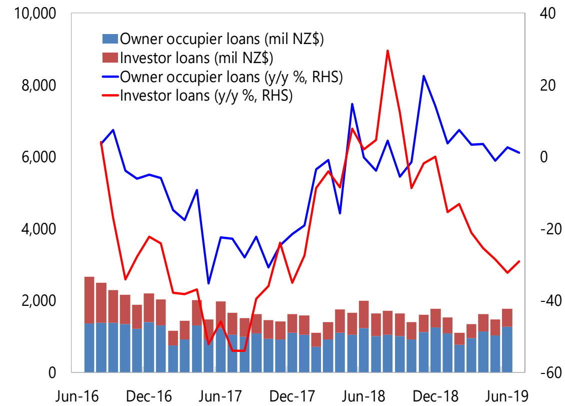
New principal and interest loans to investors…

New Residential Mortgage



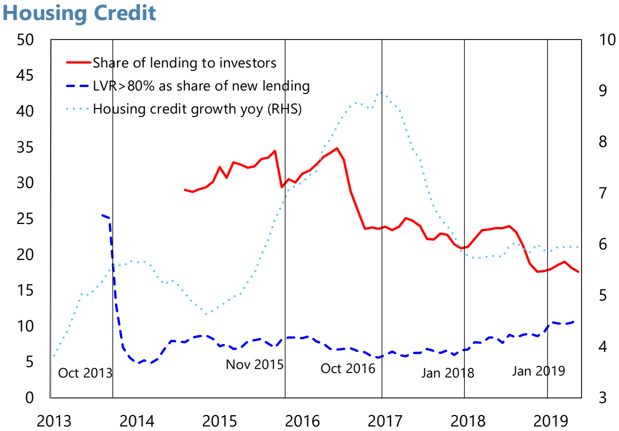
…and interest-only loans to investors continued to decline.

New Residential Mortgage - Interest Only Loans



Share of high LVR new lending has picked up after the relaxation of macro-prudential measures in 2018 and 2019…

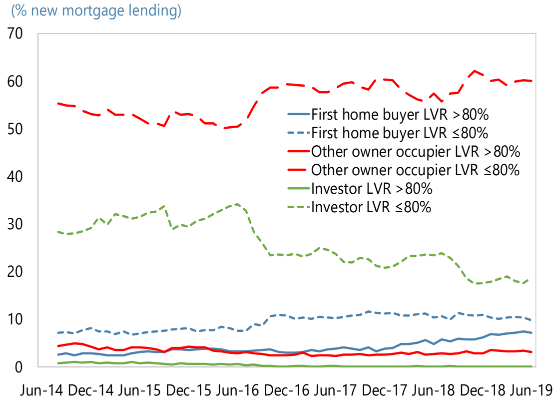
Housing Credit



…while the share of other more risky new lending has stabilized.

New Residential Mortgage by Borrower Type and LVR

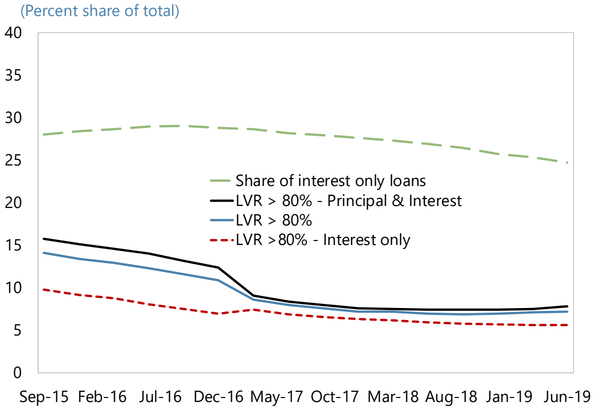
(% new mortgage lending)



Outstanding interest-only…

Existing Residential Mortgage Lending

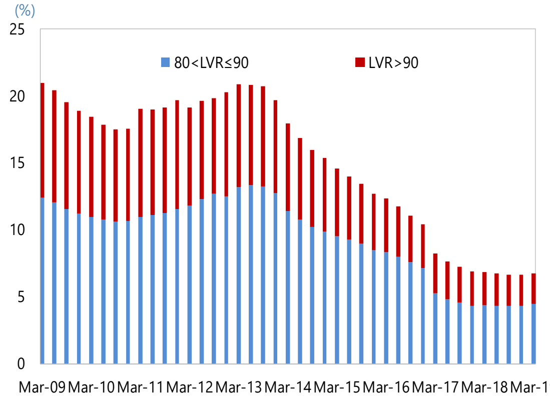
(Percent share of total)



…and high loan-to-value mortgages have stabilized.

Stock of High LVR Morgage Lending

(%)



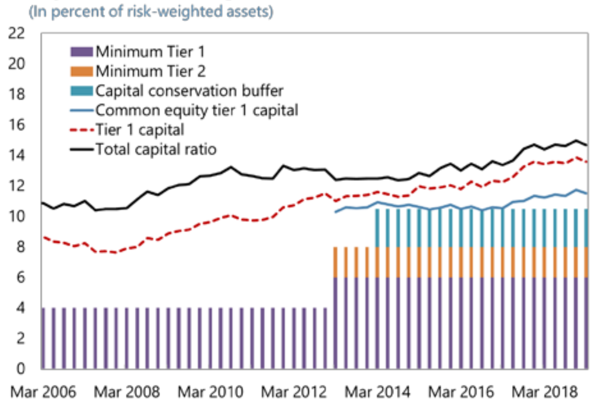
Sources: Reserve Bank of New Zealand; Statistics New Zealand; Haver Analytics; and IMF staff calculations.

Figure 8. The Banking Sector Is Strong

Banks are well capitalized…

Capital Ratios of Registered Banks

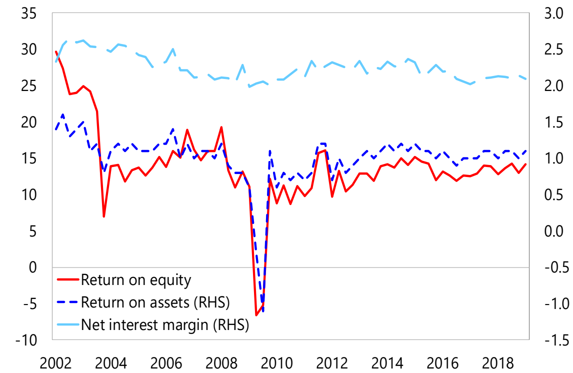
(In percent of risk-weighted assets)



…and remained highly profitable.

Profitability

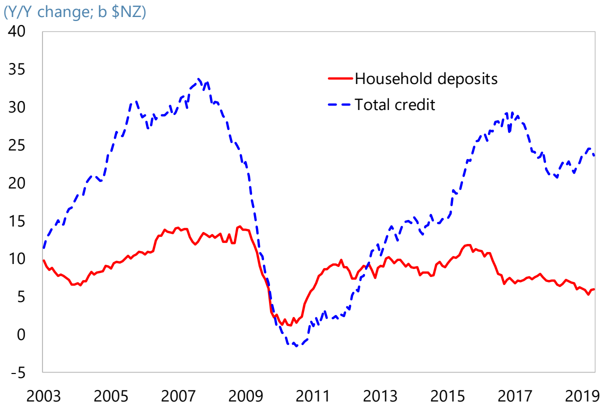
(%)



Credit growth has slowed from its peak and deposit growth trending down.

Credit and Household Deposits

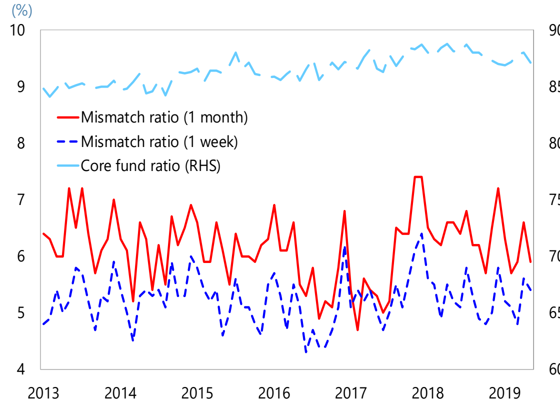
(Y/Y change; b $NZ)



…the funding maturity mismatch has improved, and core funding ratio is well above the regulatory minimum.

Liquidity and Core Funding

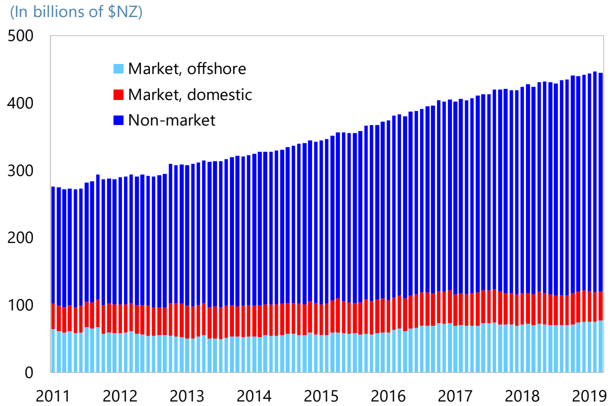
(%)



Growth in funding needs has slowed, with lower reliance on offshore market funding.

Total Funding

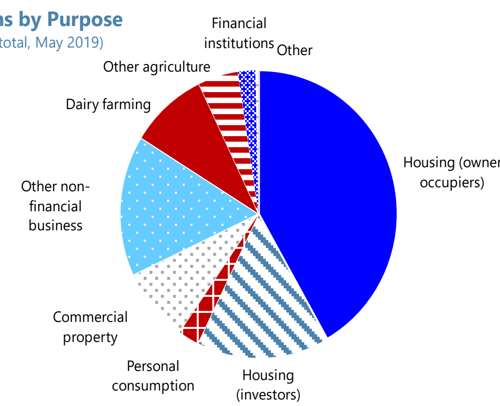
(In billions of $NZ)



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

Loans by Purpose

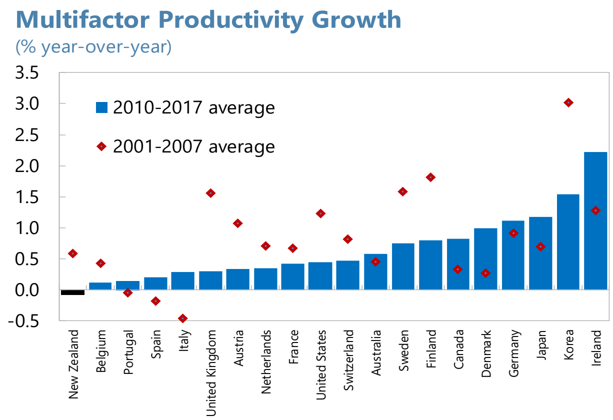
(% of total, May 2019)



Source: Reserve Bank of New Zealand.

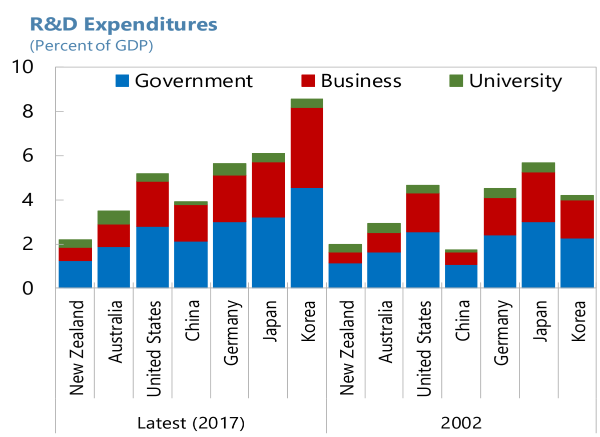
Figure 9. There Are Some Gaps in the Macro-Structural Position

New Zealand has had the lowest productivity growth post GFC…

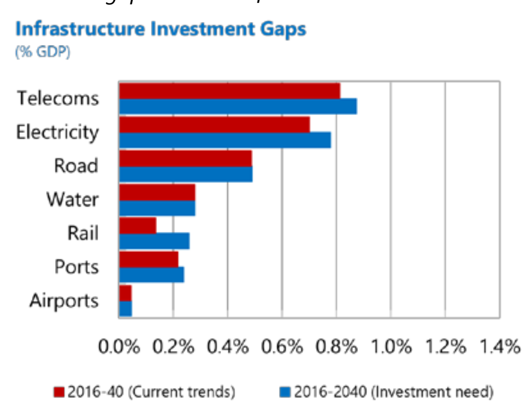


…notwithstanding a favorable regulatory environment.

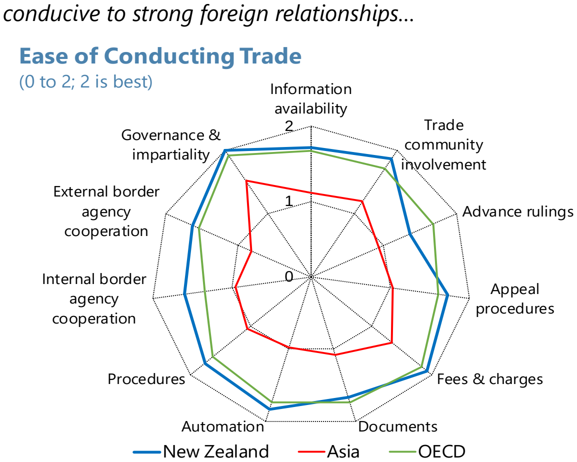
R&D spending remains low in comparison.



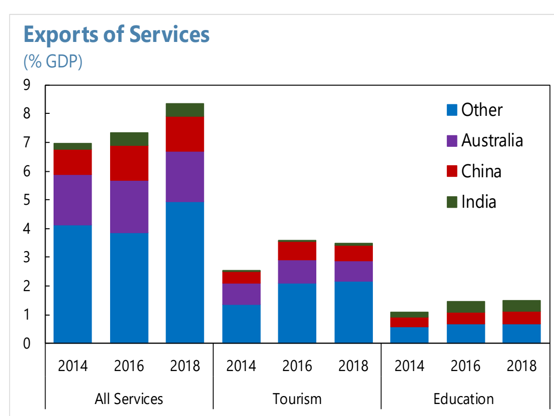
Productivity growth could be augmented by closing ivnestment gaps in basic infrastructure.



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



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



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

Table 1. New Zealand: Main Economic Indicators, 2014-2024
(Annual percent change, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
NATIONAL ACCOUNTS											
Real GDP (production)	3.6	3.5	3.9	3.1	2.9	2.2	2.7	2.6	2.6	2.5	2.5
Real GDP (expenditure)	3.1	4.0	4.2	2.6	2.8	2.5	2.7	2.6	2.6	2.5	2.5
Domestic demand	4.4	3.0	4.6	4.0	3.5	2.6	3.1	2.7	2.4	2.3	2.3
Private consumption	3.1	3.6	5.3	4.8	3.2	2.9	3.1	3.0	2.6	2.4	2.3
Public consumption	3.4	2.5	2.0	2.9	1.9	2.4	2.2	2.3	2.3	2.2	2.2
Investment	10.9	2.3	4.9	2.9	5.3	0.7	2.5	2.1	2.1	2.1	2.1
Public	6.5	4.6	-0.5	3.2	6.1	-1.7	3.4	1.3	1.2	1.2	1.2
Private	10.2	3.5	6.1	3.5	2.8	4.4	2.1	2.4	2.4	2.3	2.4
Private business	10.5	2.5	3.6	5.0	2.9	3.8	2.0	2.3	2.3	2.3	2.4
Dwelling	9.8	5.6	10.8	0.9	2.6	5.5	2.3	2.7	2.5	2.3	2.4
Inventories (contribution to growth, percent)	0.4	-0.3	0.1	-0.1	0.4	-0.7	0.1	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	-1.5	0.8	-0.5	-1.7	-1.1	0.2	-0.4	-0.2	0.0	0.0	0.1
Real gross domestic income	5.3	1.8	4.7	4.0	2.2	2.1	3.0	2.9	2.8	2.5	2.6
Investment (percent of GDP)	22.7	23.0	23.3	23.3	24.0	24.1	24.0	23.9	23.8	23.7	23.6
Public	5.7	5.9	5.6	5.6	5.8	5.6	5.6	5.6	5.5	5.4	5.3
Private	17.0	17.1	17.7	17.7	18.2	18.4	18.4	18.4	18.3	18.3	18.3
Savings (gross, percent of GDP)	19.6	20.0	21.1	20.4	20.2	19.9	19.7	19.7	19.6	19.5	19.3
Public	4.0	4.3	0.9	1.1	0.8	0.1	0.0	0.5	1.1	1.4	1.4
Private	15.5	16.0	20.3	19.3	19.4	19.8	19.8	19.2	18.5	18.0	17.9
Potential output	2.6	2.8	2.8	2.8	2.8	2.8	2.7	2.6	2.6	2.5	2.5
Output gap (percent of potential)	-1.4	-0.7	0.3	0.6	0.7	0.2	0.2	0.2	0.2	0.1	0.0
LABOR MARKET											
Employment	3.5	2.2	4.6	4.2	3.0	0.7	1.1	1.4	1.2	1.5	1.3
Unemployment (percent of labor force)	5.4	5.4	5.1	4.7	4.3	4.3	4.5	4.4	4.5	4.5	4.5
Wages (nominal percent change)	2.5	2.3	1.9	2.1	3.1	3.5	1.9	1.7	2.4	2.5	2.6
PRICES											
Terms of trade index (goods, % change)	5.6	-5.0	1.2	7.3	-1.7	-4.2	1.0	1.7	0.8	0.5	0.5
Consumer prices (avg, % change)	1.2	0.3	0.6	1.9	1.6	1.4	1.9	2.0	2.0	2.0	2.0
GDP deflator (avg, % change)	2.3	0.2	1.7	3.5	1.1	1.5	2.1	2.4	2.2	2.0	2.1
MACRO-FINANCIAL											
Official cash rate (policy rate, percent, avg)	3.1	3.2	2.2	1.8	1.8	1.5	1.3	1.3	1.7	2.3	2.7
Credit to the private sector (percent change)	4.0	7.5	7.0	4.9	5.4	5.2	4.6	4.5	4.8	5.0	5.0
House prices (percent change, avg)	6.5	12.1	14.1	6.4	3.3	1.5	3.0	3.0	3.0	3.0	3.0
Interest payments (percent of disposable income)	9.0	9.1	8.2	7.8	7.8	7.6	7.4	7.2	7.1	7.0	6.9
Household savings (percent of disposable income)	2.5	2.6	3.4	2.4	3.1	3.3	3.5	3.7	3.9	4.0	4.2
Household debt (percent of disposable income)	154	158	161	163	164	161	157	154	151	149	149
GENERAL GOVERNMENT (percent of GDP) 1/											
Revenue	37.2	37.6	37.5	37.3	37.5	37.4	37.3	37.3	37.4	37.5	37.5
Expenditure	37.7	37.4	36.7	36.2	36.7	37.3	37.3	36.8	36.3	36.1	36.1
Net lending/borrowing	-0.5	0.2	0.9	1.1	0.8	0.1	0.0	0.5	1.1	1.4	1.4
Operating balance	1.2	2.0	2.5	2.8	2.4	1.7	1.3	1.5	2.0	2.2	2.2
Cyclically adjusted balance	0.8	1.1	1.5	1.5	1.1	0.6	0.5	1.0	1.6	1.9	1.9
Gross debt	34.2	34.4	33.5	31.6	29.8	29.6	30.2	30.6	31.9	31.3	28.5
Net debt	10.4	9.8	9.1	8.0	8.0	8.2	8.1	7.9	7.8	6.5	3.8
Net worth	80.2	81.8	83.5	88.3	88.5	86.0	84.9	85.2	84.2	82.0	81.6
BALANCE OF PAYMENTS											
Current account (percent of GDP)	-3.1	-3.0	-2.2	-2.9	-3.8	-4.1	-4.3	-4.2	-4.2	-4.3	-4.3
Export volume	3.3	7.4	2.1	1.8	3.1	3.8	3.3	3.7	4.3	4.0	4.4
Import volume	7.9	4.0	3.3	6.9	5.8	2.7	4.0	3.7	3.5	3.3	3.5
Net international investment position (percent of GDP)	-65.0	-60.8	-59.5	-55.4	-57.4	-58.3	-59.9	-61.2	-62.6	-64.1	-65.6
Gross official reserves (bn US$)	15.8	14.3	18.2	20.3	17.6	…	…	…	…	…	…
MEMORANDUM ITEMS											
Nominal GDP (bn NZ$)	240	250	266	282	293	305	320	336	352	368	385
Percent change	5.5	4.2	6.0	6.2	3.9	4.0	4.9	5.0	4.8	4.6	4.6
Nominal GDP per capita (US$)	43,858	37,743	38,983	41,382	41,205	40,634	42,084	43,901	45,801	47,615	49,547
Real gross national disposable income per capita (NZ$)	47,900	48,141	49,689	50,212	50,530	50,604	50,981	51,456	51,857	52,244	52,572
Percent change	3.1	0.5	3.2	1.1	0.6	0.1	0.7	0.9	0.8	0.7	0.6
Population (million)	4.5	4.6	4.6	4.7	4.8	4.9	5.0	5.1	5.2	5.3	5.4
US$/NZ$ (average level)	0.831	0.700	0.697	0.711	0.693	…	…	…	…	…	…
Nominal effective exchange rate	115.4	108.1	109.6	111.1	106.8	…	…	…	…	…	…
Real effective exchange rate	112.9	105.0	105.8	107.4	102.9	…	…	…	…	…	…

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

1/ Calendar year.

Table 2. New Zealand: Fiscal Accounts, 2013/14-2023/24
(In percent of GDP, unless otherwise indicated)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
						Est.		Projedtions			
GENERAL GOVERNMENT 2/											
Revenue	**36.8**	**37.5**	**37.6**	**37.6**	**37.3**	**37.4**	**37.1**	**37.2**	**37.2**	**37.3**	**37.3**
Tax revenue	29.6	30.7	30.9	31.2	31.2	31.7	31.9	31.9	32.0	32.2	32.2
Direct taxes	18.9	19.7	19.9	20.2	20.2	20.4	20.6	20.6	20.8	21.0	21.0
Individual and withholding	12.0	12.5	12.5	12.5	12.5	12.5	13.0	13.0	13.1	13.3	13.3
Corporate	4.9	5.2	5.3	5.6	5.7	5.9	5.6	5.6	5.7	5.8	5.8
Property	2.0	2.0	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Indirect taxes	10.7	11.0	11.1	11.0	11.1	11.2	11.3	11.3	11.2	11.2	11.2
Of which: GST	7.2	7.4	7.5	7.5	7.6	7.7	7.9	7.8	7.9	7.9	7.9
Non-tax revenue	7.2	6.8	6.6	6.4	6.1	5.7	5.2	5.3	5.2	5.1	5.1
Expenditure	**37.7**	**37.7**	**37.0**	**36.4**	**36.2**	**36.9**	**37.3**	**37.0**	**36.4**	**35.9**	**35.9**
Expense	36.1	35.9	35.3	34.8	34.5	35.4	35.7	36.0	35.3	35.1	35.1
Employee expenses	8.8	8.9	8.7	8.5	8.4	8.5	8.3	8.6	8.6	8.5	8.5
Other operating expenses (excl. depreciation)	5.5	5.4	5.4	5.4	5.2	5.5	5.7	6.0	5.6	5.6	5.6
Social benefits	14.4	14.3	14.1	13.8	13.6	14.2	14.2	14.2	14.2	14.1	14.1
Other transfers	3.4	3.1	3.2	3.3	3.6	3.5	3.8	3.5	3.4	3.3	3.3
Interest	1.7	1.8	1.6	1.6	1.5	1.4	1.3	1.3	1.2	1.2	1.2
Other	2.4	2.4	2.4	2.3	2.3	2.3	2.4	2.4	2.4	2.3	2.3
Net acquisition of nonfinancial assets	1.6	1.8	1.7	1.6	1.7	1.5	1.6	1.1	1.0	0.8	0.8
Of which: Gross fixed capital formation	3.7	4.1	3.9	3.7	3.7	3.8	3.7	3.5	3.3	2.9	2.9
Operating balance	0.6	1.7	2.2	2.8	2.8	2.0	1.4	1.2	1.8	2.2	2.2
Primary balance	0.8	1.6	2.2	2.8	2.6	1.9	1.0	1.4	2.0	2.6	2.6
Net lending (+)/borrowing (-)	**-0.9**	**-0.1**	**0.6**	**1.2**	**1.1**	**0.5**	**-0.2**	**0.1**	**0.8**	**1.4**	**1.4**
GENERAL GOVERNMENT BALANCE SHEET 2/											
Liabilities	**62.3**	**62.2**	**63.7**	**61.2**	**58.6**	**57.5**	**57.8**	**56.5**	**55.5**	**57.3**	**53.6**
Gross debt	34.2	34.2	34.4	32.8	30.6	28.9	30.2	30.2	31.0	32.7	30.0
Other liabilities 3/	28.1	27.9	29.4	28.3	28.0	28.6	27.6	26.4	24.5	24.6	23.6
Assets	**139.7**	**144.8**	**144.3**	**147.6**	**149.3**	**143.4**	**143.6**	**140.5**	**141.9**	**139.3**	**135.6**
Financial assets	58.8	62.9	62.4	65.0	65.0	60.5	62.4	62.4	66.2	66.6	64.9
Debt relevant	23.3	24.4	24.5	24.4	23.1	20.6	22.2	22.0	23.3	24.8	24.8
Other	35.5	38.5	37.9	40.6	41.9	40.0	40.2	40.4	42.9	41.7	40.1
Nonfinancial assets	80.9	82.0	81.9	82.7	84.3	82.9	81.2	78.1	75.7	72.7	70.7
Net financial worth	**-3.5**	**0.7**	**-1.4**	**3.8**	**6.3**	**3.0**	**4.6**	**5.9**	**10.7**	**9.3**	**11.2**
Net debt 4/	**10.9**	**9.8**	**9.8**	**8.4**	**7.6**	**8.3**	**8.0**	**8.1**	**7.7**	**7.9**	**5.3**
Central government	7.8	6.5	6.2	4.8	4.2	4.8	4.3	4.3	3.7	3.8	1.0
Local government	3.0	3.3	3.6	3.6	3.4	3.6	3.7	3.8	4.0	4.1	4.3
Net worth	**77.4**	**82.6**	**80.6**	**86.5**	**90.7**	**85.9**	**85.8**	**84.0**	**86.4**	**82.0**	**81.9**
Central government	32.2	37.5	36.1	42.5	47.8	44.2	45.5	45.4	49.3	46.4	47.4
Local government	45.2	45.1	44.5	43.9	42.9	41.7	40.3	38.5	37.1	35.6	34.5
MEMORANDUM ITEMS											
Cyclically adjusted balance (percent of potential GDP)	0.0	0.3	0.6	1.0	0.7	0.2	-0.2	0.0	0.9	1.2	1.5
Fiscal impulse (change in CAB; in percent of potential GDP)	-0.8	-0.3	-0.3	-0.4	0.3	0.5	0.5	-0.2	-0.9	-0.4	-0.3
Change in real revenue (percent)	3.5	5.0	4.8	4.8	3.3	2.0	1.7	3.6	2.5	3.4	2.0
Change in real primary expenditure (percent)	1.5	2.7	3.2	3.1	3.8	4.1	4.0	2.6	0.7	1.6	2.0
New Zealand Superannuation Fund											
Budget transfers (+ = receipts)	0.0	0.0	0.0	0.0	0.2	0.3	0.5	0.6	0.7	0.7	0.7
Net assets	10.9	12.1	11.5	12.6	13.5	14.0	14.8	15.6	16.7	17.7	18.1
Contributed capital	6.3	6.1	5.8	5.4	5.3	5.5	5.7	6.1	6.5	6.9	7.3
Central government											
Revenue	33.5	34.2	34.2	34.2	34.0	34.3	34.0	34.1	34.1	34.2	34.2
Expenditure	34.0	34.0	33.5	32.8	32.6	33.5	33.9	33.6	32.9	32.5	32.5
Net lending (+)/borrowing (-)	-0.5	0.2	0.7	1.4	1.3	0.8	0.1	0.4	1.1	1.7	1.7
Local government											
Revenue	3.9	4.0	4.0	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Expenditure	4.2	4.3	4.1	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Net lending (+)/borrowing (-)	-0.3	-0.3	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
GDP (in billion NZ$)	237	245	257	273	289	299	311	328	343	361	376

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

1/ The fiscal year runs from July to June.

2/ Accrual basis; GFS. Comprises Core Crown (excludes RBNZ), Crown entities, and local governments. Includes New Zealand Superannuation Fund.

3/ "Other liabilities" include government pension liabilities, and the Accident Compensation Corporation (ACC) liabilities (roughly 85 percent funded by assets, and projected to be fully funded by 2019/2020).

4/ "Net debt" is gross debt less debt-relevant financial assets - cash and equivalents, marketable securities, etc. (often held to cover pension liabilities).

Table 3. New Zealand: Balance of Payments, 2014-2024
(In percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
BALANCE OF PAYMENTS											
(% GDP)											
Current account	-3.1	-3.0	-2.2	-2.9	-3.8	-4.1	-4.3	-4.2	-4.2	-4.3	-4.3
Balance on goods and services	1.2	0.8	1.0	1.0	-0.2	-0.7	-0.8	-0.5	-0.3	-0.1	0.2
Exports of goods and services	28.3	28.1	26.6	27.4	28.1	27.8	27.6	27.7	27.9	28.0	28.3
Exports of goods	21.0	19.6	18.2	19.1	19.6	19.4	19.1	19.3	19.7	20.1	20.5
Exports of services	7.3	8.5	8.4	8.3	8.5	8.5	8.5	8.4	8.2	7.9	7.8
Imports of goods and services	27.2	27.3	25.7	26.4	28.3	28.6	28.4	28.2	28.1	28.1	28.2
Imports of goods	20.6	20.5	19.2	19.8	21.4	21.4	21.3	21.2	21.1	21.1	21.1
Imports of services	6.6	6.7	6.5	6.5	6.9	7.1	7.1	7.1	7.0	7.1	7.1
Primary income, net	-4.0	-3.6	-2.9	-3.6	-3.5	-3.0	-3.0	-3.0	-3.0	-3.0	-3.1
Inflows	3.0	3.1	3.1	3.0	3.0	3.3	3.3	3.3	3.3	3.3	3.3
Outflows	7.0	6.6	6.0	6.7	6.5	6.3	6.3	6.3	6.3	6.3	6.3
Secondary income, net	-0.2	-0.1	-0.1	-0.2	-0.1	-0.3	-0.5	-0.7	-0.9	-1.1	-1.4
Inflows	0.7	0.8	0.8	0.8	0.9	0.7	0.6	0.6	0.6	0.6	0.6
Outflows	0.9	0.9	0.9	0.9	1.0	1.0	1.1	1.3	1.5	1.7	1.9
Capital and financial account											
Capital account, net	0.0	0.1	0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account, net	-1.8	0.6	-3.7	-1.9	-0.3	-4.6	-4.3	-4.2	-4.2	-4.3	-4.3
Direct investment	-1.0	0.1	-1.7	-1.4	-0.5	-1.7	-1.9	-1.9	-1.8	-1.8	-1.8
Equity	-1.8	-1.2	-1.0	-2.1	-1.0	-0.9	-1.3	-1.3	-1.3	-1.3	-1.3
Debt	0.8	1.4	-0.7	0.3	0.5	-0.8	-0.5	-0.5	-0.5	-0.5	-0.5
Portfolio investment	-0.2	-1.3	-2.9	0.4	0.6	-2.0	-1.8	-1.8	-1.7	-1.8	-1.8
Equity	0.5	-0.7	1.2	0.5	0.0	0.7	0.6	0.6	0.6	0.5	0.5
Debt	-0.7	-0.6	-4.1	-0.1	0.7	-2.7	-2.4	-2.3	-2.3	-2.3	-2.3
Financial derivatives	0.4	0.9	-0.1	0.4	1.0	-0.7	-0.1	-0.1	-0.1	-0.1	-0.1
Other investment	-0.9	1.4	-0.8	-2.3	-0.2	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Reserve assets	-0.2	-0.6	1.7	0.9	…	…	…	…	…	…	…
Net errors and omissions	1.3	3.4	-2.1	0.9	3.5	-0.5	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET											
Net international investment position	-65.0	-60.8	-59.5	-55.4	-57.4	-58.3	-59.9	-61.2	-62.6	-64.1	-65.6
Equity, net	-5.2	-4.8	-4.1	-2.4	-5.2	-5.7	-6.2	-6.6	-7.0	-7.5	-8.0
Assets	32.7	34.6	36.4	39.8	39.1	41.8	41.8	41.8	41.8	41.8	41.8
Liabilities	37.8	39.4	40.5	42.2	44.3	47.4	47.9	48.4	48.8	49.3	49.8
Debt, net	-68.2	-64.6	-65.0	-63.4	-61.2	-62.0	-63.1	-64.0	-64.9	-66.0	-66.9
Assets	41.1	46.8	45.0	39.1	40.4	39.7	39.7	39.7	39.7	39.7	39.7
Liabilities	109.3	111.4	110.1	102.4	101.6	101.7	102.8	103.7	104.7	105.7	106.7
External assets (gross)	82.2	90.0	91.0	89.2	88.4	90.9	90.9	90.9	90.9	90.9	90.9
Equity	32.7	34.6	36.4	39.8	39.1	41.8	41.8	41.8	41.8	41.8	41.8
Debt	41.1	46.8	45.0	39.1	40.4	39.7	39.7	39.7	39.7	39.7	39.7
External liabilities (gross)	147.2	150.8	150.5	144.6	145.9	149.1	150.7	152.1	153.5	155.0	156.5
Equity	37.8	39.4	40.5	42.2	44.3	47.4	47.9	48.4	48.8	49.3	49.8
Debt	109.3	111.4	110.1	102.4	101.6	101.7	102.8	103.7	104.7	105.7	106.7
Of which: NZ$ denominated	60.7	64.0	66.2	57.8	53.8	52.7	53.0	56.3	56.8	57.4	57.9
FX denominated	43.5	45.1	45.1	45.0	44.9	44.3	44.6	47.4	47.8	48.3	48.8
Short-term	35.7	34.9	35.6	30.0	34.5	30.7	31.1	31.4	31.6	32.0	32.2
MEMORANDUM ITEMS											
Gross official reserves (bn NZ$)	15.8	14.3	18.2	20.3	17.6	…	…	…	…	…	…
In months of prospective imports	3.6	3.8	4.1	4.2	3.6	…	…	…	…	…	…
In percent of short-term external debt	23.6	24.6	27.0	34.5	26.0	…	…	…	…	…	…

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

Table 4. New Zealand: Monetary and Financial Sector, 2014-2024
(In billions of NZ$, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
CENTRAL BANK											
Net foreign assets	16.3	18.6	21.7	24.4	22.4	22.3	23.4	24.5	25.7	26.9	28.1
Net domestic assets	-2.7	-4.6	-7.7	-9.3	-7.7	-8.3	-8.7	-9.2	-9.6	-10.0	-10.5
Net domestic claims	1.2	-0.4	-1.4	-1.4	-4.4	-4.5	-4.7	-4.9	-5.2	-5.4	-5.7
Claims on Central government (net)	1.0	-0.7	-1.5	-1.5	-4.5	-4.5	-4.8	-5.0	-5.3	-5.5	-5.7
Claims on Other Depository Corporatic	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other items net	-3.9	-4.2	-6.2	-7.9	-3.3	-3.8	-4.0	-4.2	-4.4	-4.6	-4.8
Monetary base	13.6	13.9	14.0	15.1	14.6	14.0	14.6	15.4	16.1	16.9	17.6
DEPOSITORY CORPORATIONS											
Net foreign assets	-79	-73	-80	-76	-80	-80	-84	-88	-92	-97	-101
Net domestic assets	309	326	352	369	391	467	486	511	535	560	586
Net domestic claims	365	388	415	436	459	467	486	511	535	560	586
Claims on Central government (net)	10	6	7	7	7	3	4	4	4	4	4
Claims on State and Local Government	4	3	6	6	7	7	8	8	9	9	9
Claims on Public Nonfinancial Corpora	0	0	1	1	1	1	1	1	1	1	1
Claims on Private Sector	342	367	392	412	434	445	463	486	510	533	557
Claims on Other Financial Corporations	10	11	9	9	9	10	11	11	12	13	13
Other items net	-56	-62	-63	-67	-67	0	0	0	0	0	0
Broad money	231	253	273	293	311	387	402	423	443	463	485
MEMORANDUM ITEMS											
Private sector credit 2/	355	382	409	429	452	476	497	520	545	572	601
Housing loans 1/	195	210	229	242	256	270	285	300	316	334	352
Business loans 1/	85	90	97	103	108	114	117	121	126	132	137
Household deposits	131	145	156	167	177	184	193	203	213	222	233
					In percent of GDP						
Private sector credit 2/	148	152	154	152	154	156	156	155	155	155	156
Housing loans 1/	81	84	86	86	87	89	89	89	90	91	91
Business loans 1/	35	36	37	37	37	37	37	36	36	36	36
Household deposits	54	58	59	59	60	60	60	60	60	60	60
					Percentage change						
Private sector credit 2/	4.0	7.5	7.0	4.9	5.4	5.2	4.6	4.5	4.8	5.0	5.0
Housing loans 1/	4.7	7.6	9.2	5.5	5.9	5.5	5.4	5.4	5.4	5.5	5.5
Business loans 1/	4.5	6.7	7.8	6.1	5.0	4.9	3.4	3.2	4.0	4.3	4.3
Household deposits	8.9	11.1	7.1	7.1	6.2	4.0	4.9	5.0	4.8	4.6	4.6

Sources: RBNZ and IMF staff calculations.

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

2/ Depository corporations.

Table 5. New Zealand : Financial Sector Indicators, 2012-18

	2012	2013	2014	2015	2016	2017	2018
Interest rates (percent end-year)							
90-day bank bill rate	2.7	2.7	3.4	3.2	2.3	2.0	1.9
90-day bank bill rate, real	1.6	1.5	2.2	2.9	1.7	0.1	0.3
Stock market index (percent change, end-year]	24.2	16.5	17.5	13.6	8.8	22.0	4.9
Capital adequacy (in percent)							
Regulatory capital to risk-weighted assets	13.1	12.5	12.4	13.5	13.7	14.7	15.0
Tier I capital to risk-weighted assets	11.5	11.4	11.4	12.1	12.4	13.6	13.9
Common equity tier 1 to risk-weighted assets	...	10.6	10.8	10.8	10.7	11.4	11.7
Capital to assets	7.1	7.3	7.4	7.3	7.2	7.7	7.7
Asset quality (in percent)							
Non-performing loans to total loans	1.4	1.0	0.8	0.5	0.5	0.5	0.5
Non-performing loans net of provisions to capit	9.8	6.9	5.4	3.9	n.a.	n.a.	0.7
Non-performing loans (in millions of NZ$)	4,278	3,372	2,773	1,988	2,183	2,296	3,686
Liquidity and funding (in percent)							
Liquid assets to total assets	16.2	16.2	15.7	15.0	13.1	13.3	13.3
Liquid assets to short-term liabilities	23.8	23.1	22.5	21.7	20.0	20.0	19.8
1-month maturity mismatch	7.9	7.0	6.9	6.3	6.8	7.4	7.2
Core funding ratio	85.6	85.5	86.3	85.8	87.2	88.7	87.0
Asset composition (percentage share of total)							
Agricultural	15.2	14.9	14.9	15.1	14.6	14.1	13.9
Business	25.8	25.4	25.3	25.1	25.0	25.1	25.0
Households	59.1	59.7	59.8	59.8	60.4	60.7	61.1
Of which: Housing	55.1	55.8	55.8	55.9	56.7	56.9	57.3
Profit Ratios (in percent)							
Return on assets	0.9	1.1	1.1	1.0	1.0	1.1	1.0
Return on equity	11.4	13.9	14.1	12.0	12.6	13.9	13.0
Net interest margin	2.2	2.2	2.4	2.3	2.1	2.1	2.1

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

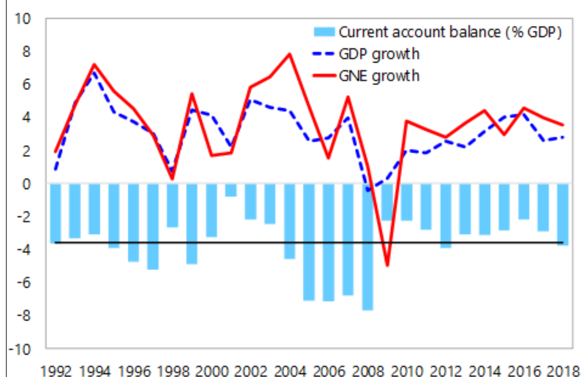
Annex I. External Sector Assessment

With the real effective exchange rate (REER) still above its long-term average and considering the External Balance Assessment (EBA) estimates, the external position in 2018 was assessed to be weaker than implied by fundamentals and desired policy settings, while the New Zealand dollar is moderately overvalued.

1. New Zealand has historically run a current account deficit, averaging close to 4 percent of GDP over the past few decades. These deficits reflect a long-standing structural savings-investment imbalance. They have resulted in a sizeable negative net international investment position (NIIP). New Zealand's NIIP amounted to minus 57 percent of GDP at the end of 2018.

2. The current account (CA) deficit has generally remained below the long-term average in the current expansion. While the latter has been mostly driven by domestic demand and, to some extent, the income (quantity) effects of increases in the terms of trade, the related deterioration in the real trade balance was broadly offset by the price effects of the terms of trade and a lower primary income deficit, with the latter reflecting the decline in interest rates globally.

Current Account Balance and Growth



Sources: Haver Analytics; and IMF staff calculations.

3. Nevertheless, several indicators suggest that New Zealand's external imbalance was excessive.

- **New Zealand's REER was some 10 percent above its long-term average, consistent with the strong terms of trade and relatively strong domestic demand.** The latter factors have underpinned the strength of the New Zealand dollar during the expansion more broadly, consistent with the currency's status as a commodity currency. Nevertheless, in the first half of 2018, the terms of trade declined by 3 percent (compared to the 2017 average), and the REER depreciated by 4 percent. In late 2018, however, the REER rebounded by 2 percent, consistent with a shift in expectation for a relatively more dovish monetary policy stance in major advanced economies and a small rebound in the terms of trade.

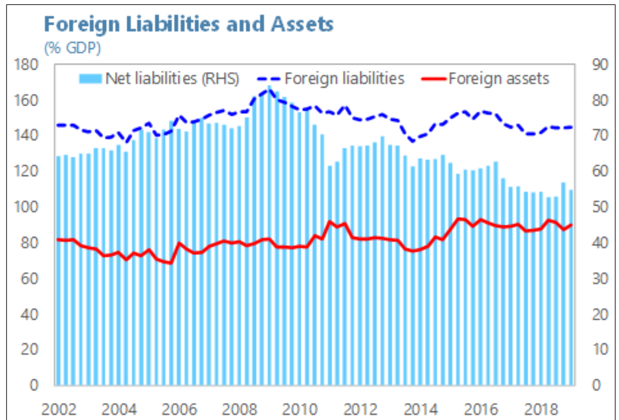
- **The EBA REER index and level regressions suggests that the New Zealand dollar was overvalued in real effective terms in 2018.** The models imply that, in real effective terms, the dollar was overvalued by 11 percent and 3 percent respectively (see Table).

EBA Exchange Rate Assessments

	2016	2017	2018
REER index regression	7%	15%	11%
REER level regression	2%	10%	3%
Current account regression	3%	4%	9%
External sustainability	5%	1%	2%

Source: IMF EBA estimates.

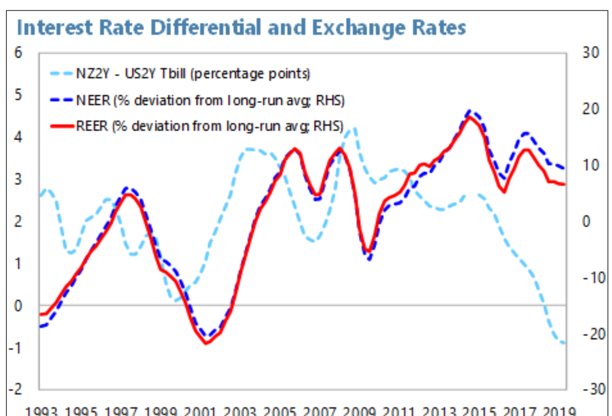
- **The EBA current account regression suggests that the current account deficit in 2018 was weaker than implied by fundamentals and desired policy settings.** The estimated cyclically-adjusted CA norm for 2018 was -0.8 percent of GDP, compared to an actual, cyclically-adjusted CA balance of -3.6 percent. However, in staff's view, the CA norm is closer to -1.6 percent of GDP, reflecting, as in the case of Australia, traditionally large investment needs due to New Zealand's size, low population density, and initial conditions. With this adjustment, the estimated CA gap is in the range of -1.6 to -3.2 percent of GDP. Applying the EBA-estimated elasticity of the current-account-to-GDP ratio with respect to the REER of -0.25 to the mid-point of this range translates the gap into a currency overvaluation of around 9 percent. Policy gaps in New Zealand currently contribute to lowering the CA gap, everything else equal, and, therefore, currency overvaluation. In the longer term, the government's planned gradual fiscal consolidation should help to narrow the current account deficit by boosting national savings.



Sources: Haver Analytics; and IMF staff calculations.

- **The NIIP level and trajectory are close to being sustainable**. The External Stability (ES) approach suggests that the NIIP would be stabilized at current levels with a CA deficit of 2.8 percent of GDP, while the adjusted medium-term CA deficit is projected at 3.2 percent. This implies that the currency is overvalued by around 2 percent. The structure of New Zealand's external balance sheet reduces the vulnerability associated with its large negative NIIP. Since external NIIP liabilities are mainly in New Zealand dollars and there is a net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector has a net foreign currency liability position, but it is fully hedged.

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



Sources: Haver Analytics; and IMF staff calculations.

Annex II. Risk Assessment Matrix[1]

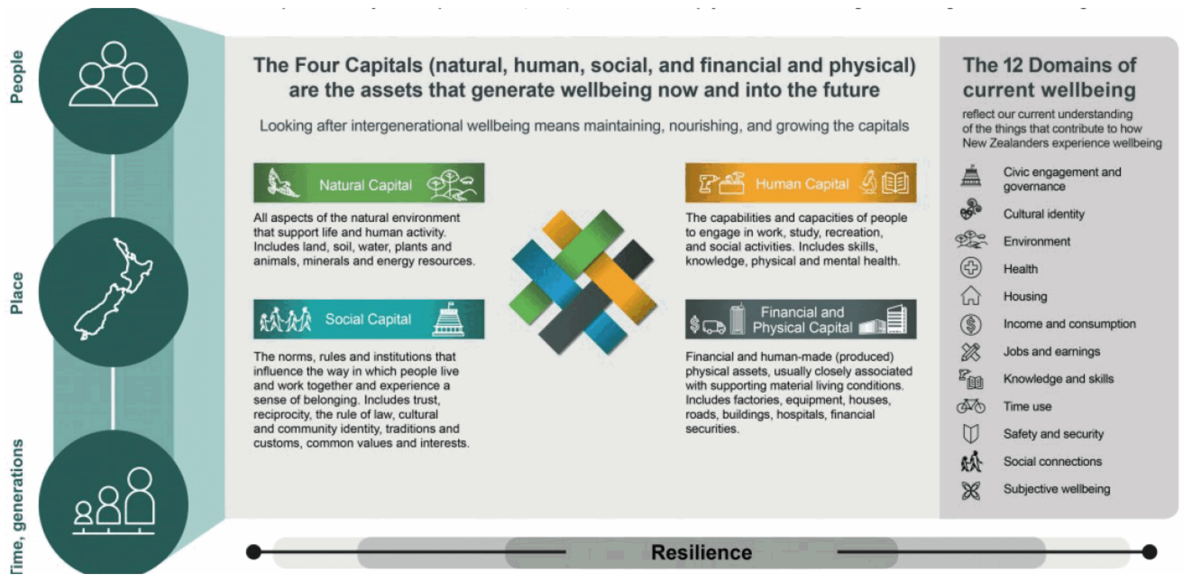
	Source of risks	Likelihood	Time horizon	Impact	Policies to reduce impact
	Domestic Risks				
↑	Stronger growth because of higher dairy prices	**L**	Short to medium term	**L** This could boost the agricultural sector (especially rural areas) and accelerate deleveraging in the sector.	Automatic adjustment through commodity currency mechanism.
↑	Stronger growth because of increase in net migration	**L/M**	Short to medium term	**M** In the short term, this could ease labor shortages, upward pressure on inflation, and increase housing demand. In the medium term, potential output growth will be higher.	Monetary policy tightening to dampen short-term positive aggregate demand effects.
↓	Housing market downturn	**M**	Short to medium term	**H** A sharper-than-expected housing market correction would lower residential investment and private consumption, given high household debt. Financial accelerator effect would amplify the downturn.	Monetary and selective macroprudential policy easing; fiscal policy stimulus; measures to facilitate mortgage debt restructuring.
	External Risks				
↓	Large swings in energy prices	**M**	Short to medium term	**L** Elevated price volatility or large and persistent price swings would complicate economic management. Higher energy prices would worsen the terms of trade and increase inflation pressures.	Monetary policy tightening if higher inflation expectations are becoming embedded in core inflation.
↓	Weaker-than expected global growth o China o U.S. and Europe	**M** **M/H**	Short to medium term Short to medium term	**H** A slowdown which is not fully offset by policy easing in the short term, and in the medium term, insufficient progress in deleveraging and rebalancing increase the probability of larger disruptive adjustment. This would reduce external demand, lower exports, and lead to large commodity price declines potentially including dairy prices, which could cause an economic downturn in New Zealand. **M** Lower growth in these economies could result in lower exports and inhibit medium-term growth performance.	Combined monetary, fiscal policy easing as economy could reach the effective lower bound for monetary policy quickly; and selective macroprudential easing if the housing market correction is severe. Structural reforms to raise productivity.
↓	Sharp tightening of global financial conditions o Market expectation of tighter U.S. monetary policy o Sustained rise in risk premia	**L/M**	Short term	**M** Depending on investor sentiment towards New Zealand, deteriorating external funding conditions for banks, and spillovers from the broader effects on global growth and commodity prices.	Combined monetary, fiscal policy easing as economy could reach the effective lower bound for monetary policy quickly; and selective macroprudential easing if housing market correction is severe.
↓	Rising protectionism and retreat from multilateralism	**H**	Short to medium term	**M** The negative consequences for global trade and capital flows, and global growth would lower New Zealand's external demand, with negative direct and indirect aggregate demand effects.	Combined monetary, fiscal policy easing as economy could reach the effective lower bound for monetary policy quickly; and selective macroprudential easing if housing market correction is severe.

[1] Based on the Spring 2019 Global Risk Assessment Matrix (G-RAM).

Annex III. The Framework Behind the Wellbeing Budget

1. New Zealand's *Budget 2019* uses a new format, the "Wellbeing Budget." At this stage, the goal is to expand the analytical underpinnings of how new spending is considered and justified. It also allows for a new way to present the budget to the public, outside of the narrow consideration of the fiscal strategy and standard economic indicators.

Figure III.1. The Treasury's Living Standards Framework (LSF)



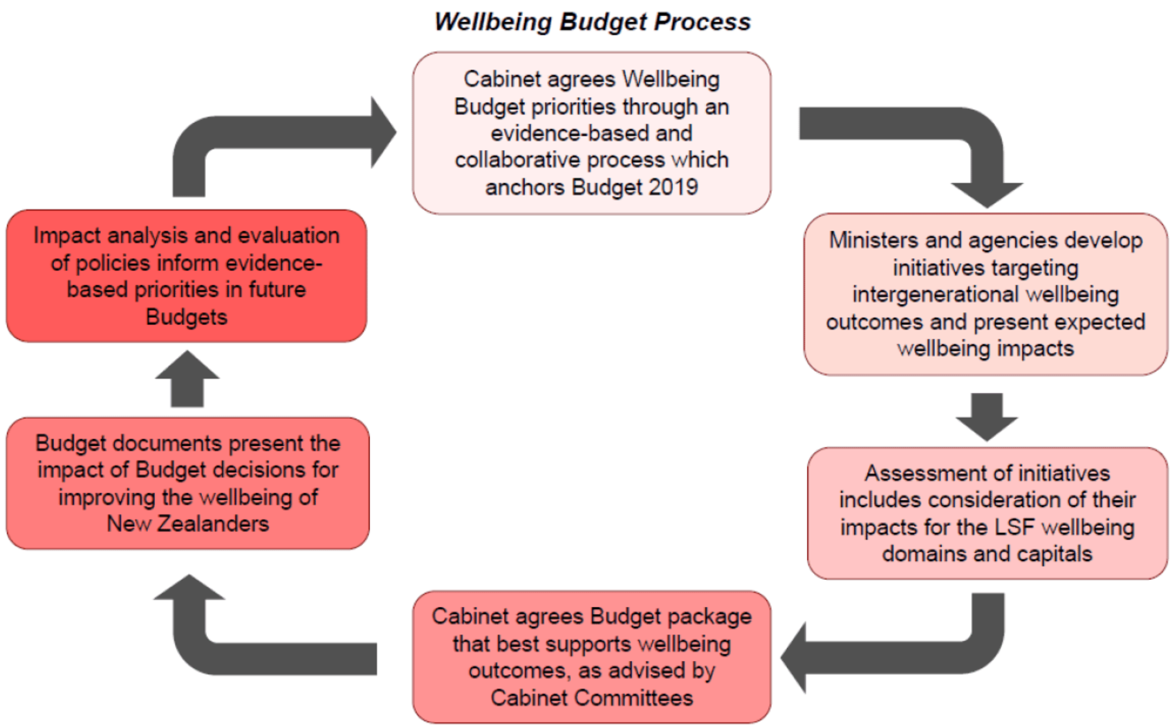
Source: New Zealand Treasury, 2019.

2. The Wellbeing Budget is underpinned by the new Living Standards Framework (LSF). It has three components (Figure V.1):

1) The ***12 Domains*** comprising over 100 indicators (presented in an online dashboard) that provide a view of current wellbeing ("our people" and "our country") for the economic, financial, natural, and social realms in New Zealand, to help identify policies to maintain and create assets for:
2) The ***Four Capitals*** – ***Human***, ***Natural***, ***Social***, and ***Physical/Financial*** – ("our future") which are themselves a view on future wellbeing and are used to justify and identify government spending, based on considerations of:
3) ***Risk and Resilience***, where the resilience of the four capitals are examined in face of shocks and changing priorities.

How to properly identify that new spending, given the government's budget constraint, will be anchored by ***Priorities***, of which there are currently five: create opportunities for productive firms and regions to transition to a sustainable, low-emissions economy; support innovation, social and economic opportunities for the digital age; lift Maori and Pasifika community incomes, skills and opportunities; reduce child poverty and improve child wellbeing; support everyone's mental wellbeing.

Figure III.2. The Wellbeing Budget Process



Source: New Zealand Treasury (2018), *Budget 2019: Budget Policy Statement.*

3. The LSF is the outcome of research on wellbeing in New Zealand that builds on OECD work and is integrated into the formulation of the budget policy statement and document (Figure V.2)**.** During the process to construct the budget document, government departments rely on the LSF and the relationships of their departments to the four capitals to help define and prioritize new spending. The priorities, having been identified at the *Budget Policy Statement* phase, help the government make decisions on which new spending to introduce. The "five priorities" are the initial priorities for *Budget 2019*, that will carry forward to future budgets, but more can be added, and they can be redefined or removed, based on the progress indicated by the LSF dashboard.

4. The LSF will be integral to the construction of the budget and influence future budgets, even if it initially appears limited in its scope. While formally the "Wellbeing Budget" will only influence a small portion of the budget – new spending – in practice it will serve as an overarching framework to justify current spending and create longer-term plans for the various budget allocations. It will provide a systematic approach to discussing the costs and benefits of spending, as it should highlight the relationships of various projects to the four capitals, and to understand how it contributes to the different wellbeing indicators.

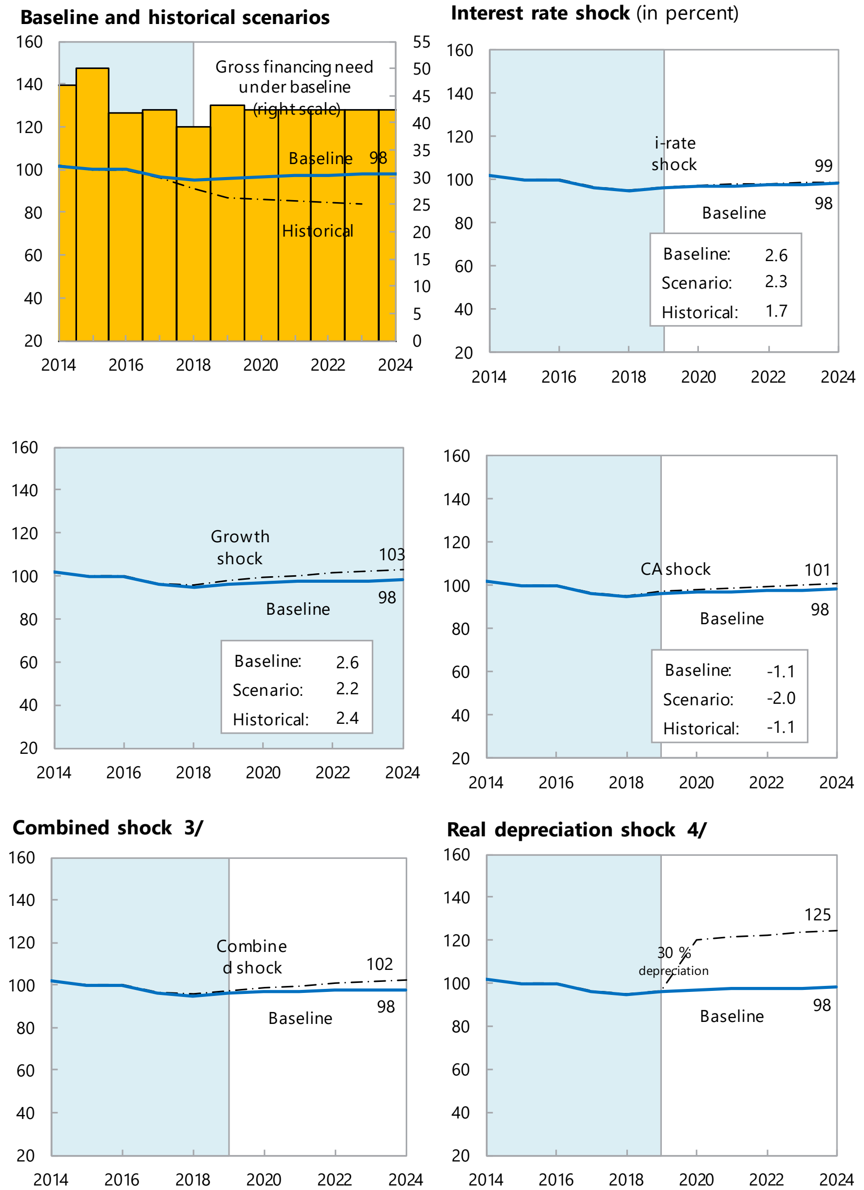
5. There are issues which are not covered by the LSF. The LSF does not examine the performance of Government. It does not prioritize government spending on wellbeing outcomes; that is goal of fiscal policy which can use the LSF as an input to the government's processes.

6. The LSF is still under development. While there is a well-articulated framework for use in budgeting, there is still further work to improve and add indicators. How budgetary outcomes will be evaluated and considered for use of the LSF in future budgets is also a work in progress, since there is no data yet available from this sort of approach to justify a specific method of evaluation. How to evaluate and use the framework is an issue that the mission will further explore. However, the government will seriously consider three measures to integrate the LSF and wellbeing into the fiscal framework: (i) embed a focus in the *Public Finance Act 1989* which defines the budget process and associated public accountability; (ii) integrate the LSF's domains into the Treasury's cost-benefit analysis framework; (iii) apply the LSF in creating business cases, the first example being for a NZ$1.5 billion regional development project in Porirua.

Annex IV. External and Fiscal Debt Sustainability Analysis

Figure IV.1. New Zealand: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020.

Table 1. New Zealand: External Debt Sustainability Framework, 2011-2024

(In percent of GDP, unless otherwise indicated)

	Actual 2011	2012	2013	2014	2015	2016	2017	2018	Historical Average 10-Year	Standard Deviation 10-Year	2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	**113.0**	**112.1**	**102.7**	**101.6**	**99.8**	**99.5**	**96.4**	**94.9**			**96.1**	**96.8**	**97.2**	**97.6**	**97.8**	**98.0**	**-3.3**
Change in external debt	-4.9	-0.9	-9.4	-1.1	-1.8	-0.3	-3.1	-1.4			1.3	0.7	0.4	0.4	0.3	0.1	
Identified external debt-creating flows (4+8+9)	-7.8	0.5	-4.6	-6.0	5.7	-0.9	-6.7	-1.5			1.6	1.1	0.5	0.5	0.3	0.1	
Current account deficit, excluding interest payments	0.5	2.0	1.3	1.4	1.3	0.8	1.6	2.4			1.6	1.5	1.2	1.0	0.9	0.7	
Deficit in balance of goods and services	-2.1	-0.5	-1.0	-1.2	-0.8	-1.0	-1.0	0.1			0.5	0.1	-0.4	-0.7	-1.0	-1.5	
Exports	30.8	29.0	28.4	28.3	28.1	26.6	27.4	28.1			27.8	27.4	27.4	27.5	27.6	27.9	
Imports	28.7	28.6	27.5	27.2	27.3	25.7	26.4	28.2			28.3	27.5	27.1	26.8	26.6	26.4	
Net non-debt creating capital inflows (negative)	-0.7	0.1	-1.4	-2.9	-0.8	2.1	-2.8	-2.5			0.0	-0.5	-0.7	-0.6	-0.6	-0.7	
Automatic debt dynamics 1/	-7.7	-1.6	-4.6	-4.5	5.2	-3.8	-5.5	-1.4			0.1	0.1	0.0	0.1	0.0	0.1	
Contribution from nominal interest rate	2.3	2.0	1.8	1.8	1.6	1.4	1.3	1.3			2.5	2.5	2.4	2.4	2.4	2.4	
Contribution from real GDP growth	-1.9	-2.7	-2.3	-3.5	-4.1	-3.7	-2.9	-2.7			-2.4	-2.4	-2.4	-2.3	-2.3	-2.3	
Contribution from price and exchange rate changes 2/	-8.1	-0.9	-4.0	-2.8	7.7	-1.5	-4.0	-0.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.9	-1.4	-4.8	4.9	-7.5	0.6	3.6	0.0			-0.3	-0.4	-0.2	-0.1	0.0	0.1	
External debt-to-exports ratio (in percent)	366.9	386.4	361.0	358.6	355.7	373.6	352.3	337.6			345.9	353.0	354.1	354.9	354.0	350.9	
Gross external financing need (in billions of US dollars) 4/	87.6	99.3	100.9	93.8	87.8	77.0	85.0	80.1			90.3	94.5	100.4	106.9	113.6	120.0	
in percent of GDP	52.4	56.7	54.0	46.9	50.1	41.6	42.4	39.4			43.2	42.3	42.3	42.3	42.4	42.3	
Scenario with key variables at their historical averages 5/											**86.6**	**86.0**	**85.4**	**84.9**	**84.2**	**83.7**	**-4.4**
Key Macroeconomic Assumptions Underlying Baseline																	
Nominal GDP (US dollars)	167.1	175.1	187.0	199.7	175.4	185.0	200.5	203.2			208.8	223.1	237.5	252.7	267.6	283.5	
Real GDP growth (in percent)	1.8	2.5	2.2	3.6	3.5	3.9	3.1	2.8	2.4	1.5	2.6	2.7	2.6	2.5	2.5	2.5	
Exchange rate appreciation (US dollar value of local currency, change in percent)	9.7	2.5	1.2	1.3	-15.7	-0.5	2.0	-2.5	0.0	8.7	-1.2	1.5	1.1	1.3	1.0	1.0	
GDP deflator (change in domestic currency)	2.9	-0.3	3.2	2.3	0.2	1.7	3.5	1.1	1.8	1.3	1.3	2.5	2.6	2.4	2.3	2.3	
GDP deflator in US dollars (change in percent)	12.9	2.2	4.5	3.6	-15.6	1.3	5.6	-1.4	2.0	9.7	0.0	4.1	3.7	3.8	3.3	3.4	
Nominal external interest rate (in percent)	2.2	1.8	1.7	1.8	1.4	1.4	1.5	1.4	1.7	0.3	2.7	2.8	2.7	2.6	2.6	2.6	
Growth of exports (US dollar terms, in percent)	18.9	-1.3	4.7	6.4	-13.0	0.1	11.3	4.2	3.5	12.2	1.5	5.5	6.5	6.6	6.5	7.0	
Growth of imports (US dollar terms, in percent)	20.3	4.2	2.8	5.7	-11.9	-0.7	11.3	8.5	3.6	14.0	3.0	4.0	4.7	5.3	5.2	5.1	
Current account balance, excluding interest payments	-0.5	-2.0	-1.3	-1.4	-1.3	-0.8	-1.6	-2.4	-1.1	0.8	-1.6	-1.5	-1.2	-1.0	-0.9	-0.7	
Net non-debt creating capital inflows	0.7	-0.1	1.4	2.9	0.8	-2.1	2.8	2.5	0.6	1.9	0.0	0.5	0.7	0.6	0.6	0.7	

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

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

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

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

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

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

Figure IV.2. New Zealand Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

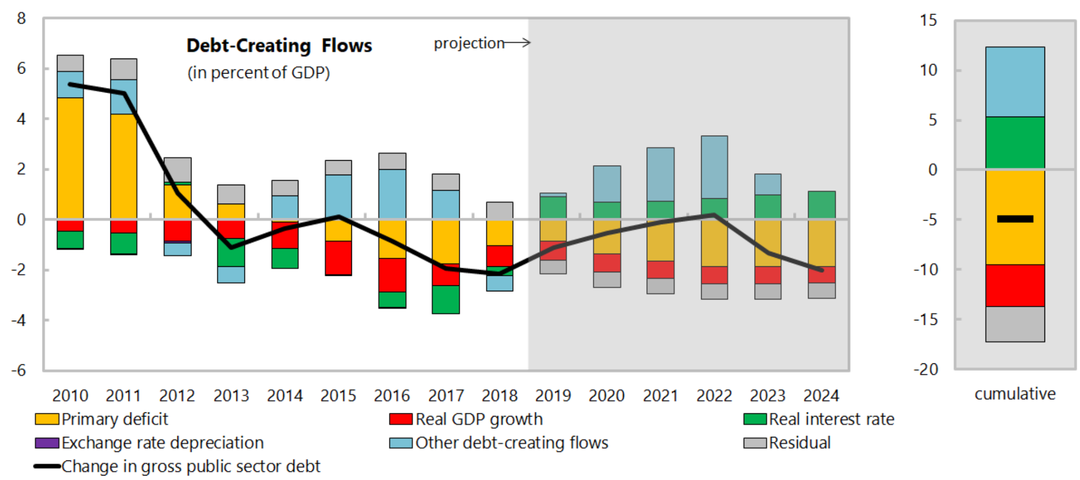
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of May 15, 2019		
	2010-2016 [2]	2017	2018	2019	2020	2021	2022	2023	2024	Sovereign Spreads		
Nominal gross public debt	33.8	31.6	29.4	28.3	27.8	27.7	27.8	26.5	24.5	EMBIG (bp) 3/	-64	
Public gross financing needs	2.1	-1.0	-0.3	4.1	3.4	3.9	3.7	4.0	4.5	5Y CDS (bp)	19	
Net public debt	9.2	8.0	8.8	10.4	10.7	10.4	9.8	8.4	6.5			
Real GDP growth (in percent)	2.8	2.7	2.8	2.7	2.7	2.6	2.6	2.5	2.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.9	3.5	1.1	1.5	2.5	2.6	2.4	2.3	2.3	Moody's	Aaa	Aaa
Nominal GDP growth (in percent)	4.7	6.2	3.9	4.0	5.3	5.3	5.0	4.9	4.9	S&Ps	AA	AA+
Effective interest rate (in percent) [4]	5.8	4.8	4.7	4.8	5.2	5.4	5.6	6.1	6.8	Fitch	AA	AA+

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	1.3	-2.0	-2.2	-1.1	-0.6	-0.1	0.2	-1.3	-2.0	-4.9	
Identified debt-creating flows	0.6	-2.6	-2.8	-0.6	0.1	0.5	0.8	-0.7	-1.4	-1.3	
Primary deficit	1.2	-1.8	-1.0	-0.9	-1.4	-1.7	-1.9	-1.9	-1.9	-9.5	0.5
Primary (noninterest) revenue and gr	36.4	36.4	36.5	36.6	36.6	36.5	36.4	36.4	36.4	218.9	
Primary (noninterest) expenditure	37.6	34.7	35.5	35.7	35.3	34.9	34.5	34.5	34.5	209.4	
Automatic debt dynamics [5]	-1.5	-2.0	-1.2	0.1	0.0	0.0	0.2	0.3	0.5	1.1	
Interest rate/growth differential [6]	-1.5	-2.0	-1.2	0.1	0.0	0.0	0.2	0.3	0.5	1.1	
Of which: real interest rate	-0.6	-1.1	-0.4	0.9	0.7	0.7	0.8	1.0	1.1	5.3	
Of which: real GDP growth	-0.9	-0.8	-0.8	-0.8	-0.7	-0.7	-0.7	-0.7	-0.6	-4.1	
Exchange rate depreciation [7]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.8	1.2	-0.6	0.2	1.4	2.1	2.5	0.8	0.0	7.0	
Please specify (1) (e.g., drawdown o	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Stock-flow adjustment, incl. asset ch	0.8	1.2	-0.6	0.2	1.4	2.1	2.5	0.8	0.0	7.0	
Residual, including asset changes [8]	0.7	0.6	0.7	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-3.6	



Sources: National authorities and IMF staff calculations.

1/ Public sector is defined as general government.

2/ Based on available data.

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

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

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

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

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

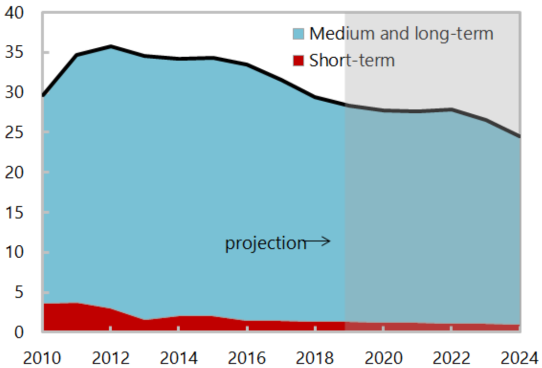
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

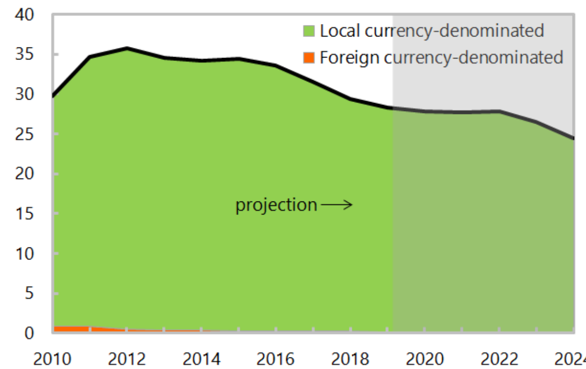
Figure IV.3 New Zealand Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



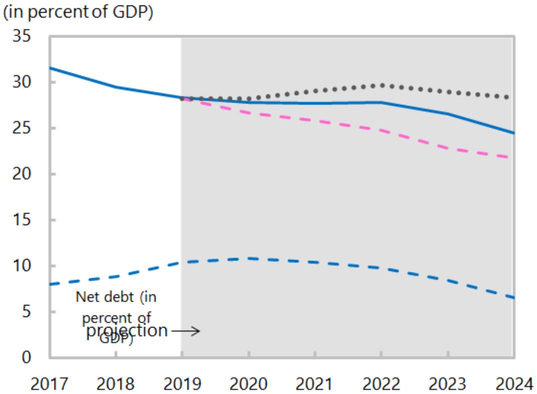
By Currency
(in percent of GDP)



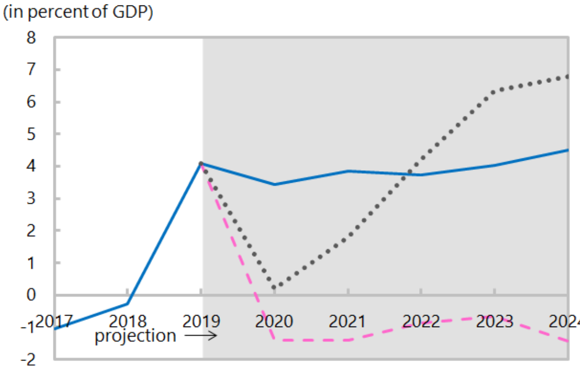
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.7	2.7	2.6	2.6	2.5	2.5
Inflation	1.5	2.5	2.6	2.4	2.3	2.3
Primary Balance	0.9	1.4	1.7	1.9	1.9	1.9
Effective interest rate	4.8	5.2	5.4	5.6	6.1	6.8
Constant Primary Balance Scenario						
Real GDP growth	2.7	2.7	2.6	2.6	2.5	2.5
Inflation	1.5	2.5	2.6	2.4	2.3	2.3
Primary Balance	0.9	0.9	0.9	0.9	0.9	0.9
Effective interest rate	4.8	0.1	0.1	0.1	0.2	0.1

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.7	2.6	2.6	2.6	2.6	2.6
Inflation	1.5	2.5	2.6	2.4	2.3	2.3
Primary Balance	0.9	-0.7	-0.7	-0.7	-0.7	-0.7
Effective interest rate	4.8	0.1	0.6	1.3	1.9	2.1

Sources: National authorities and IMF staff calculations.

Annex V. Fiscal Policy and Downside Risks[1]

1. A need for a fiscal policy response to an economic downturn in New Zealand is becoming more likely than it has been in the past. The global risk profile is increasingly tilted to the downside, at a time when the RBNZ's policy rate is already at a low of 1 percent. If a major risk realized, the effective lower bound (ELB) on nominal interest rates might be more likely to become a constraint on monetary policy in current circumstances. This annex considers the effects of a fiscal policy response to a slowdown in China in line with the risk assessment matrix in Annex II and with the policy rate at the ELB.[1] The effects on New Zealand would be relatively small if the RBNZ could cut the policy rate but much larger if it could not (Figure V.1, blue versus red lines).

2. The effectiveness of a fiscal policy response would depend on the instruments used. Depending on the instruments, the multipliers of the discretionary fiscal policy response would be different. The annex considers two options at the opposite end of the spectrum of the multipliers (Figure V.1, solid and dashed green lines):[2]

- ***Lower Multipliers, Quicker to Deploy:*** Government consumption spending and a GST rate cut.
- ***Higher Multipliers, Slower to Deploy:*** Government infrastructure investment and GST rebates targeted to lower-income households.

3. Both fiscal options would succeed in mitigating the impact of the shock. The high-multiplier option would provide more insurance against risks of the downturn being larger than expected.

- ***In the case of lower-multiplier stimulus, there would be a multiplier for real GDP of 0.7 on impact.*** Government spending would increase aggregate demand, providing stimulus for the rest of the economy. The temporary cut in the GST rate would raise disposable incomes, which would primarily support consumption for lower-income, credit-constrained households.
- ***In the case of higher-multiplier stimulus, there would be a multiplier for real GDP of 1.1 on impact.*** Public infrastructure investment would not only lift aggregate demand in the near term, but also productivity, which would encourage more private investment. A larger share of the targeted GST rebate would likely be spent compared to a general GST rate cut, as it would affect only households that would benefit strongly from such a rebate.

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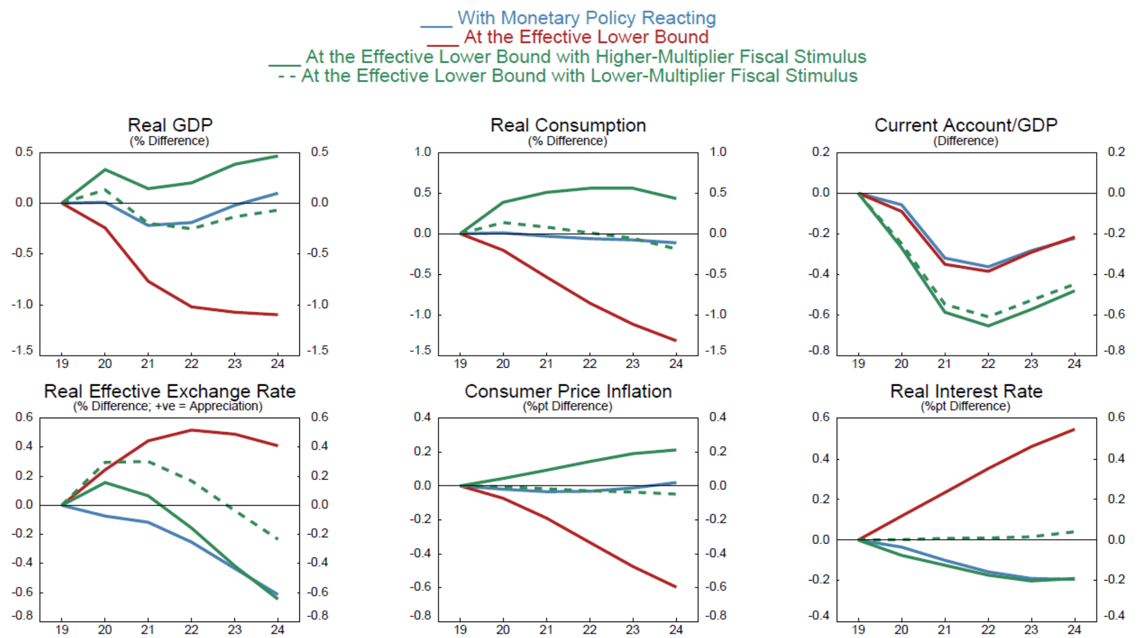
[1] For more detail on the model used, and the risk scenario centered on a slowdown in China, see the accompanying Selected Issues Paper, Muir, 2019, "Trade, Net Migration and Agriculture: Interactions between External Risks and the New Zealand Economy."

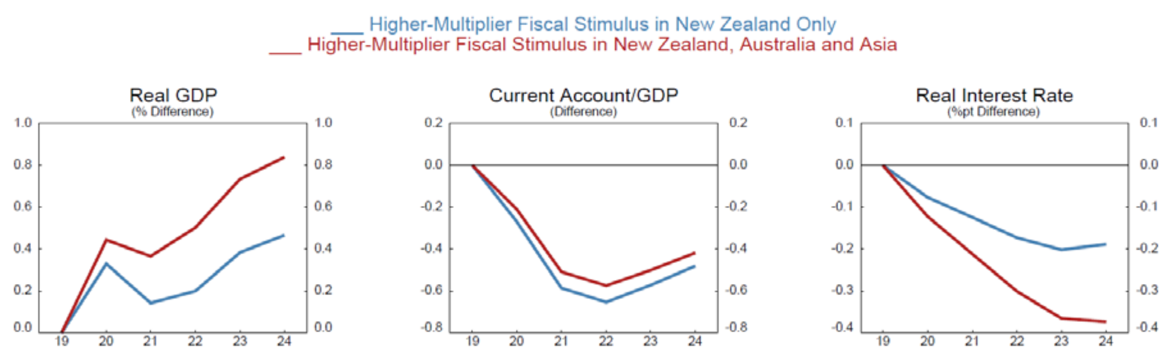
[2] In the simulations, each pair of fiscal instruments is changed by 0.5 percent of GDP relative to their baseline paths for five years. For more details on the fiscal multipliers used, please see the accompanying Selected Issues Paper, Muir, 2019, "Trade, Net Migration and Agriculture: Interactions between External Risks and the New Zealand Economy," in particular, Annex II.

Figure V.1. Slowdown in China with Various New Zealand Policy Options



Source: IMF staff calculations.

Figure V.2. Slowdown in China with Fiscal Stimulus in Different Economies



Source: IMF staff calculations.

4. **In both cases, there is some leakage abroad from the fiscal stimulus.** Given that New Zealand is a relatively open economy, many of the goods purchased to use the fiscal stimulus funds would be imported. That said, given the leakage, the REER would eventually depreciate with a fiscal policy response and stimulate exports. Still, the effects of a fiscal stimulus in New Zealand would be reinforced if other countries would also use fiscal stimulus to counter the impact of the growth slowdown in China (Figure V.2).

5. **The simulations underscore the benefits of policy preparation for an economic downturn**. The implementation of a high-multiplier fiscal policy package is likely to take longer, especially in the absence of a pipeline of infrastructure project and nimble administrative capacity. Contingency planning could, however, ensure that such a package is implemented quickly.

Annex VI. New Zealand's Review of the Capital Adequacy Framework for Banks

1. The RBNZ has proposed higher minimum capital requirements for banks after a review of the bank capital framework. The review also covered the types of instruments that qualify as capital and the framework for risk weights. Under the proposal, the minimum regulatory capital requirements of locally incorporated banks would comprise an unchanged 6 percent minimum Tier 1 capital requirement and a higher prudential capital buffer of 9 or 10 percent, both in terms of risk-weighted assets (RWA). The prudential capital buffer under the proposed framework would consist of a general conservation buffer of 7.5 percent (from 2.5 percent currently), a countercyclical capital buffer (CCyB) of 1.5 percent (currently not activated), and, for domestic systemically important banks (D-SIBs), a new DSIB surcharge of 1 percent.[1] The increases in the capital buffer would have to be met with common equity Tier 1 capital (CET1). New Zealand banks are currently operating with an average of 15 percent of regulatory capital (of which about 12 percent of CET1 capital), compared to a minimum requirement of 10.5 percent of total capital.[2]

2. The new capital requirements aim to reflect the social risk appetite. Higher capital requirements reduce the probability of a severe banking crisis, reflecting that crises are economically and socially very costly. And with well-capitalized banks, the risks of adverse feedback loops between reduced lending and falling asset prices would also be lower in a banking crisis or a recession. The RBNZ calibrated the risk appetite framework by targeting a probability of a banking crisis of 1 in 200 years. It also aims to reduce the advantage larger banks using the Internal Ratings (IR) approach have compared to (typically smaller) banks applying the standardized approach (SR). To this end, it proposes applying a floor to the risk weights computed under the IR approach of 85 percent of the equivalent risk weights calculated under the SR.[3]

3. The higher capital requirements would be at the lower end of the range of recent estimates of desirable levels of bank capital. Dagher and others (2016)[4] suggested that capital in the range of 15-23 percent of RWA would have been sufficient to absorb losses in the majority of past banking crisis, a range consistent with other recent studies (BIS, 2019).[5] The benefits from reducing the risks and inefficiencies from too-high bank leverage exceed the potential costs in terms

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[1] The RBNZ has also undertaken a consultation on a framework for identifying D-SIBs (Apr 8-May 31, 2019). APRA determined that the big four Australian banks are D-SIBs in Australia. In New Zealand, the big four (in percent terms ANZ-32, BNZ-20, ASB-19, Westpac-18) accounted for 89 percent of total assets in 15 locally incorporated banks, with a significant step down in size with other banks ranging from less than 5 percent to 1.5 percent or smaller.

[2] The current Tier 2 minimum of 2 percent RWA is proposed to be retained but to be decided whether it should remain in the capital framework.

[3] The current Tier 2 minimum of 2 percent RWA is proposed to be retained but to be decided whether it should remain in the capital framework.

[4] Jihad D, G. Dell'Ariccia, L. Laeven, L. Ratnovski, and H. Tong, 2016, "Benefits and Costs of Bank Capital," IMF Staff Discussion Note 2016/04.

[5] BIS, 2019, "The Costs and Benefits of Bank Capital – A Review of the Literature," BIS Working Paper 37.

of reducing bank credit and increasing cost of credit. Earlier studies likely understated net benefits of higher capital requirements (BIS, 2019), including, for example, by assuming no reduction in funding costs despite the lower overall riskiness of a bank. At the same time, though, post-GFC reforms such as stronger liquidity regulation and improved bank resolution frameworks could have reduced the probability and costs of banking crises, a factor that was not considered in the estimates of desirable bank capital.

Annex VII. Phase Two Review of the RBNZ Act: Key Issues, Options, and In-principle Decisions[1]

Phase 2A

	Financial stability objectives
Issue	*What should the RBNZ's high-level objectives be?*
Context	Whether the RBNZ's existing objective to 'promote the maintenance of a sound and efficient financial system' was still appropriate, whether other terms should be used instead (such as financial stability'), and whether other objectives (such as promoting competition, protecting consumers or enhancing public confidence) should be added.
In-principle Decision	To replace the existing 'soundness and efficiency' financial policy objectives with a single high-level objective to 'protect and enhance financial stability.'
Assessment	Financial stability is a reasonable high-level objective.
	Institutional governance and decision making
Issue	*How should the RBNZ be governed?*
Context	o Should the RBNZ's governance arrangements move from a single-decision-maker model (the status quo) to a more typical board structure? o Should the RBNZ have a statutory Financial Policy Committee (FPC) with responsibility for prudential policy? o Who should monitor the RBNZ's performance?
In-principle Decision	o A new governance board will be established with statutory responsibility for all the RBNZ's decisions (except those reserved for the Monetary Policy Committee). o No statutory FPC will be established; the new governance board will be responsible for all prudential policy decisions. o The Treasury will be responsible for assessing the RBNZ's performance, replacing the existing Reserve Bank Board as monitoring agent.
Assessment	The new governance board would help to bring diverse perspectives and experiences to key decisions. The board governance model is already used by all New Zealand Crown entities (including the Financial Markets Authority (FMA)). While a specialist FPC would have been preferable, it is little used for prudential policy, with the Bank of England being a notable exception.
	Prudential regulation- separation and regulatory perimeter
Issue	a) *Should prudential regulation remain with the RBNZ – for and against structural separation*
Context	*For*: Potential conflict between monetary policy and prudential policy roles, and between prudential function and lender-of-last resort function; and combined functions concentrate too much power in one organization. *Against:* Complementarity between price stability and financial stability; synergies and better coordination between functions; and higher costs of transition.
In-principle Decision	To keep the responsibility for prudential regulation with the RBNZ. This will maximize synergies between the RBNZ's prudential regulation function and other functions. This is a cost-effective regulatory model given New Zealand's size.
Assessment	Staff supports this pragmatic solution. There is no reason to incur a high transition cost for limited gains. New Zealand also has limited scale or capacity to support two separate agencies. Nonetheless, the regulatory function needs to be supported with greater resourcing and adequate operational independence.
Issue	(b) *How should the regulatory perimeter be set?*
Context	New Zealand has two parallel regimes: A 'names-based' banking regime – firms that undertake financial services once registered, banks are both regulated and supervised by the RBNZ; and a NBDT regime–NBDTs are regulated by the RBNZ, but are supervised by private sector entities known as financial markets supervisors (FMS). Given that the two regimes largely seek to address the same risks, it is likely that regulating both banks and NBDTs under a single framework would improve the regime's efficiency and coherence.
In-principle Decision	To unite the currently separate regulatory regimes for banks and non-bank deposit takers (NBDTs) (such as finance companies and building societies) into a single 'licensed deposit taker' framework.

[1] The first consultation (November 2018-January 2019) covered the five main issues laid out in Phase 2A. The second consultation (commenced on July 24, 2019) reported on in-principle decisions on Phase 2A issues and laid out policy options for a second group of topics under Phase 2B. A third consultation (expected later in 2019) will seek feedback on any residual issues. Final policy decisions on Phase 2 issues by the Cabinet are expected in early 2020.

	A single regime will more clearly align regulatory activities with the RBNZ's financial stability objective, and also support good regulatory outcomes through greater regulatory efficiency (minimizing duplication across regimes) and neutrality (treating similar activities in the same way).
Assessment	Staff welcomes the shift to a single licensed deposit-taking framework which would improve the regulatory regime's efficiency and coherence, and help aligning with the design of the deposit protection scheme.
	Deposit Protection
Issue	*Should there be depositor protection in New Zealand?*
Context	*For*: Mitigate information asymmetries and the lack of financial capability, mitigate the risk of bank runs, and support public confidence. *Against*: Create moral hazard and favoring higher risk institutions.
In-principle Decision	To introduce a deposit insurance regime, with a proposed coverage limit in the range of $30,000-$50,000 per depositor. The upper limit would fully protect about 90 percent of individual deposit accounts and 40 percent of deposit funds.
Assessment	The 2017 FSAP recommended reconsidering the merits of introducing a deposit insurance framework as the first best element to complete the financial safety net. Next steps will have to address the design and calibration of mechanisms for protection that advance the public policy objectives.

Phase 2B

	Macroprudential policy
Issue	**What role should the Reserve Bank have in macroprudential policy?**
Context	Some macro-prudential tools can generate significant 'distributional' consequences that raise questions about whether the RBNZ should have sole authority to use them.
options	o Macroprudential tools – the RBNZ could be restricted to using only capital and liquidity related tools, keep the right to also use LVRs, or it could be granted new powers to use other tools (such as debt-to-income [DTI] restrictions) o Governance – the RBNZ could keep its sole authority to use macro-prudential tools or it could be required to consult or seek approval from the Minister or other agencies (such as the Treasury or the Financial Markets Authority) before making decisions.
	Prudential regulatory tools and powers
Issue	*What prudential regulatory tools and powers should the RBNZ have?*
Context	Prudential regulation in New Zealand occurs through both primary legislation (agreed by Parliament and set out in the Reserve Bank Act), and delegated rule-making powers. The scope of delegated rule-making powers could nonetheless be clarified.
Options	o Enhancing the clarity and safeguards included in the high-level legislative framework. o Reframing the core prudential rule-making instrument. Three broad models are possible: - *Enhanced status quo* – continue with the current legislative framework for conditions for registration (CoRs), while making improvements to the broader framework for rule-making as well as operational changes. - *Standards* – in addition to the changes envisioned in an enhanced status quo, this model would increase the legitimacy of rule-making by replacing CoRs with an instrument (standards) that was subject to parliamentary oversight, and potential disallowance. - *Regulations* – shifting from CoRs to a system of regulations would improve legitimacy by giving the government the power to approve significant regulatory rule changes.
	Supervision and enforcement of prudential regulation
Issue	*How should the RBNZ supervise and enforce prudential regulation?*
Context	The RBNZ's approach to supervision relies on public disclosure and director attestations to ensure that regulatory standards are being met. In contrast, regulators overseas have tended to shift towards a more intrusive, skeptical, and active model of supervision. In terms of enforcement, the RBNZ already has a number of supervisory and court-based enforcement tools. However, these tools may not be enough to allow the RBNZ to respond to non-compliance appropriately.
Options	o Supervision options: Enhanced status quo – the RBNZ maintains its existing supervisory approach but with more resource; spot-check inspections; regular on-site inspections; and continuous monitoring by locating supervisors permanently in banks. o Additional enforcement tools that could strengthen the RBNZ's enforcement role include: o Statutory public notices – public warnings supported by legislation o Enforceable undertakings – commitments from banks that are enforceable in court o Infringement notices – criminal offences that carry fines but do not result in criminal convictions o Civil penalties – non-criminal penalties that are applied under the civil standard of proof.

	Balance sheet functions
Issue	*How should the RBNZ's balance sheet function be formulated?*
Context	Since the GFC, many central banks have used their balance sheets to provide emergency lending to banks facing liquidity shortfalls (being 'lenders of last resort') and to conduct quantitative easing to stimulate economic growth (implementing monetary policy). These balance sheet tools are designed to support monetary and financial stability
Options	Whether the Reserve Bank Act provides a sufficiently clear and appropriate legislative basis for the RBNZ to use its balance sheet for these purposes (below), or whether its role needs to be clarified: o Lender of last resort – the RBNZ can already lend to banks and other financial institutions to provide emergency liquidity assistance. o Monetary policy implementation – the MPC formulates monetary policy, which the RBNZ implements. Normally it does this by managing the amount of liquidity in the financial system to keep actual interest rates consistent with the OCR. In a severe downturn the MPC may need to use unconventional monetary policy tools (such as purchasing government bonds) to stimulate demand in the economy.
	Funding
Issue	*How should the RBNZ be funded and resourced?*
Context	The RBNZ's funding is currently set out in a five-year agreement between the Minister of Finance and the RBNZ Governor. The agreement aims to achieve a balance between budgetary independence and value for money based on the incentives of the two parties, but it has been criticized for lacking transparency and delivering what is seen as insufficient funding for the Reserve Bank to achieve its statutory objectives.
Options	The pros and cons of options to reform the existing funding mechanism are: o Transparency requirements – the RBNZ could be required to release more details about how it spends its funding, and could be subject to checks by the Controller and Auditor-General. o The role of the Minister - this could change from the current 'agreement' model to either to 'consult' with the Minister, which would give the RBNZ more independence to determine its own funding level, or an 'approval' power that would give the Minister a greater role (as is the case for government departments). o The source of funding – the RBNZ currently receives its funding from a combination of self-generated revenue (through its balance sheet operations) and fees for providing certain services (such as registering banks). An alternative funding model could see some of the RBNZ's functions (such as prudential supervision) funded by a financial industry levy. While this would make the funding model more complex, it would mean that the financial firms that benefit from the RBNZ's supervisory service also pay for it.
	Crisis Management
Issue	*What features should New Zealand's bank crisis management regime have?*
Context	Since the GFC, countries have undertaken wide-ranging regulatory reforms to ensure that failing banks can be wound up in an orderly way without relying on taxpayer support. The Reserve Bank Act already has systems that are recognized internationally as important for effective resolution. However, as has been noted by the IMF and other stakeholders, New Zealand's crisis management regime falls short of best practice in some areas.
Options	A number of reforms could be used to enhance New Zealand's crisis management regime: o Specifying a clear set of resolution objectives to guide the Reserve Bank's decisions on how best to resolve a failing bank and ensure it can be held to account for its decisions. o Clarifying instances when the RBNZ needs to consult or seek approval from the Minister to use a resolution power, such as when public funds might be at risk. o Ensuring that the RBNZ has broad enough powers to resolve a failing bank without severe systemic disruption or exposing taxpayers to loss, such as a power to 'bail in' unsecured debt to recapitalize a bank. o Establishing clear protections for creditor property rights, which could include creditors receiving compensation if a resolution decision makes them worse off than they would have been in liquidation o Ensuring that funding options are available to facilitate resolution, so that resolution authorities do not have to rely on public ownership, bailouts, or government guarantees to resolve failed banks.
	Coordination
Issues	*How should the RBNZ coordinate with other agencies?*
Context	It has become increasingly important to coordinate policy to avoid regulatory overlaps and gaps as the RBNZ is one of the many agencies responsible for overseeing New Zealand's financial sector and broader economy. The Treasury, the Ministry of Business, Innovation and Employment (MBIE), the FMA, the Commerce Commission and various other government agencies have distinct roles that intersect with those of the RBNZ.
Options	Potential reforms could include: o Encouraging more coordination via a letter of expectations from the Minister or adding formal coordination objectives and requirements to the Reserve Bank Act. o Enabling RBNZ staff to share more information by harmonizing legislative provisions across financial sector legislation.

Annex VIII. Follow-Up on Key Recommendations of the 2017 FSAP

Recommendation	Time Frame	Update and Implementation
Financial Stability and Financial Sector Resilience		
Increase RBNZ resources for the supervision and regulation of banks, insurance companies, and FMIs.	ST	**In process**. RBNZ has been bringing on board additional staff. Phase 2 Review of the RBNZ Act examines options on funding.
Strengthen cooperation and collaboration arrangements with Australian authorities.	ST	**In process**. Ongoing interaction, completed a hypothetical bank crisis simulation exercise in September 2017, follow-up exercise on communications coordination being planned. Phase 2 Review of the RBNZ Act will also consider coordination arrangements.
Clarify responsibilities of the Treasury and RBNZ on financial sector issues to reinforce the role of RBNZ as prudential regulator and supervisor.	ST	**In process.** Governance and prudential regulation options are examined in Phase 2 Review of the RBNZ Act.
Issue enforceable standards on key risks, governance, risk management, and controls to make RBNZ's supervisory expectations more transparent and support supervisory preventive action.	ST	**In process.** Phase 2 Review of the RBNZ Act examines options on supervision and enforcement.
Review and extend the enforcement regime to promote preventive action and enhance sanctions powers, including by eliminating ministerial consent for directions, and making compliance with RBNZ policy documents evidence of prudent practice.	MT	**In process.** Phase 2 Review of the RBNZ Act examines options on supervision and enforcement.
Initiate on-site programs to test the foundation of the three-pillar approach and directors' attestations and increase supervisory engagement with institutions in order to require appropriate action.	ST	**In process**. A team has been formed to undertake cross-cutting review. Phase 2 Review of the RBNZ Act is considering empowering the Reserve Bank to undertake some form of on-site inspections.
Refine Financial Markets Authority (FMA) supervision by a) direct monitoring of aspects of asset management relevant to financial stability; b) ensuring quality of Financial Markets Supervisors; and	I	**In process**. The FMA has completed a valuation thematic and has planned redemption/liquidity stress testing for late 2019. **In process.** The FMA continue to have extensive ongoing engagement with the six licensed supervisors. The FMA conducted a thematic review of supervisory processes in 2018.

Recommendation	Time Frame	Update and Implementation
c) enhancing insurance intermediary and conduct regulation and supervision.		**In process**. A public consultation of New Zealand's insurance contract law review closed in end-June.
Expand the FMA's regulatory perimeter to include licensing and supervision of custodians and appropriate oversight of wholesale asset managers.	ST	**In process.** The FMA has received its outsourced thematic on custodial arrangements and is progressing work to consider whether there is a case for recommending the establishment of a regulatory regime for custodians.
Adopt and implement proposed Financial Market Infrastructures (FMI) legislation on regulation, oversight, and enforcement powers.	I	**In process**. In April 2017, the Government agreed to adopt an enhanced legislative framework for the regulation of FMIs. An exposure draft of the proposed legislation was published on August 1, 2019 and the legislation is due to be introduced into Parliament by the end of the year.
Adopt the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMI) through detailed requirements in secondary legislation; change the frequency of FMI self-assessments in the proposed regime from three to two years; and enhance compliance of the designated FMIs with PFMI requirements.	ST	**In process**. The proposed legislation will provide the ability for the PFMI to be implemented via standards prescribed in secondary legislation. The frequency of FMI self-assessments may be changed from three to two years once the new legislation is in force.
Ensure that designated nonfinancial businesses and professions are subject to AML/CFT requirements, particularly company service providers, lawyers, and accountants.	MT	**Done**. The *AML/CFT Amendment Act 2017,* which extends the coverage of the AML/CFT laws, has come fully into effect. The legislation now covers lawyers, conveyancers and businesses that provide trust and company services (from July 1, 2018); accountants (from October 1, 2018); and real estate agents (from January 1, 2019).
Expand data collection and modeling efforts to develop structural models for credit risk in commercial real estate (CRE) and corporate portfolios.	MT	**In process**. Current focus is on embedding stress testing within the prudential framework. Consideration of enhancements will follow.
Macroprudential Framework		
Strengthen arrangements for macroprudential policy by increasing communication efforts; by increasing the transparency of the process to adjust the framework; and by maintaining an accountability framework that does not jeopardize the integrity and independence of the macroprudential decision-making process.	C	**In process.** The RBNZ has published a review of experience with its loan-to-value ratio policy and provided more clarity on the purpose and strategy for using macroprudential tools. Phase 2 Review of the RBNZ Act examines the role the RBNZ should have in macro-prudential policy, including the tools available, and whether special governance arrangements should apply when using these tools.
Introduce DTI measures in the macroprudential toolkit.	I	**In process.** The RBNZ conducted a public consultation in June-August 2017 on the possible addition of serviceability restrictions

Recommendation	Time Frame	Update and Implementation
		to the macroprudential toolkit. The role of DTI measures is included in Phase 2 Review of the RBNZ Act (see above).
Implement DTI measures if the changes to the LVR do not reduce the risks in the housing sector.	I	The authorities do not need to pursue this recommendation at present as housing risks continue to moderate.
Increase capital buffer requirements to reflect the concentration of the financial sector in four banks.	I	**In process.** A public consultation on the RBNZ's proposed increase in capital adequacy requirement for locally incorporated registered banks is currently underway, decisions are expected by end-November 2019.
Crisis Readiness, Management, and Resolution		
Strengthen domestic crisis management arrangements by reaching ex ante agreement on roles, responsibilities, and processes; prepositioning, mobilization, logistics, and communications plans; and testing through simulation exercises.	MT	**In process.** Phase 2 Review of the RBNZ Act examines options to enhance the crisis management regime, most of which have been developed with reference to the 2017 FSAP recommendations.
Reconsider the merits of deposit insurance, or in the absence of policy support, introduce a limited depositor preference to provide legal certainty for the *de minimis* exemption in OBR.	MT	**Partially done.** In-principle decision to adopt a deposit insurance framework was announced in June 2019, as a part of the Phase 2 Review of the RBNZ Act.
Revise the RBNZ Act to provide greater clarity and certainty in resolution, by inserting objectives in resolution including protection of depositors and the public interest and requiring accountability reporting against these objectives; by clarifying that the RBNZ is the sole resolution authority and inserting an express requirement for ministerial consent for resolutions with fiscal or systemic implications only.	MT	**In process.** Phase 2 Review of the RBNZ Act examines options to enhance the crisis management regime, most of which have been developed with reference to the 2017 FSAP recommendations.
C = continuous; I (immediate) = within one year; ST (short-term) = 1–3 years; MT (medium-term) = 3–5 years.		
Sources: IMF (2017), *New Zealand, Financial Sector Assessment Program—Financial System Stability Assessment*; and New Zealand authorities.		

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

September 6, 2019

Prepared By

Asia and Pacific Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of July 31, 2019)

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

General Resources Account:	SDR Million	Percent Quota
Quota	1,252.10	100.00
Fund Holdings of Currency	1,015.78	81.13
Reserve position in Fund	236.55	18.89
Lending to the Fund	22.18	
New Arrangements to Borrow		

SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	853.76	100.00
Holdings	878.11	102.85

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to Fund [1/]

	Forthcoming				
	2019	2020	2021	2022	2023
Principal					
Charges/Interest		0.01	0.01	0.01	0.01
Total		**0.01**	**0.01**	**0.01**	**0.01**

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

Exchange Arrangement:

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

Article IV Consultation:

New Zealand is on the 12-month consultation cycle. The 2018 Article IV consultation was concluded by the Executive Board on June 25, 2018.

FSAP Participation and ROSCs:

New Zealand has participated in two FSAPs to date.

- The FSSA from the 2003 FSAP mission and the Detailed Assessments of Observance of IOSCO Objectives and Principles of Securities Regulation and FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism were published under Country Reports No. 04/126, No. 04/417, and No. 05/284, respectively.

- New Zealand participated again in 2016, with one FSAP mission in August 2016 and another FSAP mission in November 2017. The FSSA was discussed by the Executive Board at the time of the discussion of the Staff Report for the 2017 Article IV Consultation with New Zealand.

Technical Assistance:

- A monetary and financial statistics (MFS) technical assistance (TA) mission visited New Zealand during October 1-12, 2018. The *TA report* was published on June 14, 2019.

STATISTICAL ISSUES

(As of August 21, 2019)

I. Assessment of Data Adequacy for Surveillance
General. Data provision is adequate for surveillance. The authorities are continuing to enhance data quality and expand the range of data available, and are making progress towards subscribing to the IMF's Special Data Dissemination Standard (SDDS).
Real Sector. Annual estimates of GDP are compiled for production, expenditure and income, in nominal and chained volume terms. Estimates are fully reconciled via supply and use tables and make use of annual enterprise and household surveys to update benchmarks. The authorities compile quarterly estimates of GDP, also in nominal and chained volume terms, based on appropriate indicators. New Zealand only produces a quarterly rather than monthly consumer price index, which has national coverage and a contemporary weight reference period (2015/2016). Data collection methods are appropriate, and include web-scraping and the use of scanner data.
Fiscal Sector. Stats NZ provides annual data (operating statement, balance sheet, government expenses by function, taxation revenue and non-financial assets reconciliation) on the general government and its central and local government subsectors following the Government Finance Statistics Manual 2014 (GFSM 2014) recommendations for data beginning from 2009 on a fiscal year (July-June) basis. It is published roughly five months following the fiscal year end, preceded by data on a provisional basis at the time of the budget (usually in May). It replaced the publication of data only on the central and local government subsectors on December 5, 2016. The authorities also report detailed central government debt data to the IMF / World Bank Quarterly Public Sector Debt Database. The Treasury also provides data on a timely basis for the central government that complies with New Zealand equivalents of the GAAP Public Sector Public Benefit Entity (PBE) Standards from 2005 onwards. They are provided on a monthly basis (with a one-month lag), with an annual statement published within 4 months of the fiscal year end. The impact of moving from NZ IFRS International Financial Reporting Standards) to PBE Standards on July 1, 2014 was not significant, due to a strong degree of convergence between the two suites of standards. The provided data enable adequate assessment of the impact of fiscal policy measures on New Zealand's economic performance.
Monetary and Financial Sectors. The Reserve Bank of New Zealand (RBNZ) publishes monthly and quarterly data on a broad range of monetary and financial variables. Monetary statistics compiled by the RBNZ are consistent with the methodology of the *2016 Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG)*. New Zealand reports high quality monetary

statistics regularly to STA for publication in *International Financial Statistics*. There is room for improving the timeliness of the data for other financial corporations. RBNZ also reports some data and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
Financial Sector Surveillance: New Zealand currently does not report Financial Soundness Indicators (FSIs) for dissemination on the Fund website. The authorities should develop an action plan to submit the FSI data and metadata to the IMF for posting.
External Sector. Stats NZ provides timely information on the balance of payments and the international investment position (IIP) on a quarterly frequency since 2000. An expanded lending and debt statistic was introduced in 2012. The new series complements the existing IIP and international financial assets and liabilities measures of New Zealand's international balance sheet position, with a time series of external lending and debt in total and by sector, and the ownership relationship between the New Zealand-resident party and the non-resident counterparty of external lending and debt positions. This follows the IMF's external debt methodology in excluding values for financial derivative asset and liability positions. RBNZ provides monthly data on official international reserves. New Zealand's reporting of international reserves has been modified for March 2000 data onwards to conform to the standards required by the IMF for the purpose of subscription to the SDDS. Stats NZ also participates in the coordinated direct and portfolio investment surveys of the STA.

Table of Common Indicators Required for Surveillance
(As of August 27, 2019)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	8/27/19	8/27/19	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	7/19	8/14/19	M	M	M
Reserve/Base Money	7/19	8/14/19	M	M	M
Broad Money	6/19	8/16/19	M	M	M
Central Bank Balance Sheet	7/19	8/14/19	M	M	M
Consolidated Balance Sheet of the Banking System	6/19	8/16/19	M	M	M
Interest Rates[2]	7/30/19	7/30/19	D	D	D
Consumer Price Index	Q2 2019	7/16/19	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2017/18	5/30/19	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[4]	2017/18	5/20/19	A	A	A
External Current Account Balance	Q1 2019	6/19/19	Q	Q	Q
Exports and Imports of Goods and Services	Q1 2019	6/19/19	Q	Q	Q
GDP/GNP	Q1 2019	6/19/19	Q	Q	Q
Gross External Debt	Q1 2019	6/19/19	Q	Q	Q
International Investment Position[5]	Q1 2019	6/19/19	Q	Q	Q

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