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NEW ZEALAND

June 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE

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 2014 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- 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 March 31, 2014, with the officials of New Zealand on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 19, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release**.

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

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NEW ZEALAND

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

May 19, 2014

KEY ISSUES

Outlook and risks The economic expansion is becoming increasingly embedded and broad-based, driven by supportive financial conditions, historically high commodity prices, resurgent construction activity related to the Canterbury post-earthquake rebuild and general housing shortages, and a substantial increase in net immigration. The main external threat to the outlook continues to be a sharp slowdown in China. Domestically, rapid house price inflation remains a concern.

Medium- and long-term challenges. New Zealand's net external liability position, although relatively stable, is high by international standards, making it desirable to raise national savings. The government's ongoing fiscal deficit reduction contributes to this aim. As global liquidity could remain ample for some time and keep the exchange rate elevated, New Zealand's non-agricultural tradable sector will need to continue to adapt by further increasing efficiency to remain competitive. The banks, although well-capitalized, face longstanding structural issues that will remain sources of financial sector risk over the medium term.

Policy assessment. Macroeconomic policies are moving in the right direction. With excess capacity largely exhausted the RBNZ has begun tightening monetary policy. The government's plan to return the budget to surplus is on track. With public debt low and interest rates above the zero bound, the authorities have monetary and fiscal policy space to respond to shocks, and the free-floating New Zealand dollar provides an additional cushion against terms of trade and other external shocks. The well targeted macro-prudential policy framework should allow the RBNZ to take additional measures if needed to guard against the financial sector risks that would arise from an unsustainable acceleration in house price inflation.

Approved By
Jerry Schiff and Vikram Haksar

Discussions took place in Auckland and Wellington during March 21-31, 2014. The staff team comprised Messrs. Aitken (head), Ding, Jauregui, and Saker (all APD). Ms. Plater (OED) participated in the discussions.

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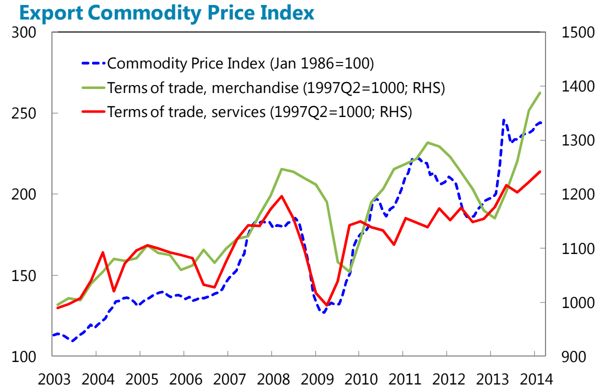
ANNEXES

RECENT DEVELOPMENTS

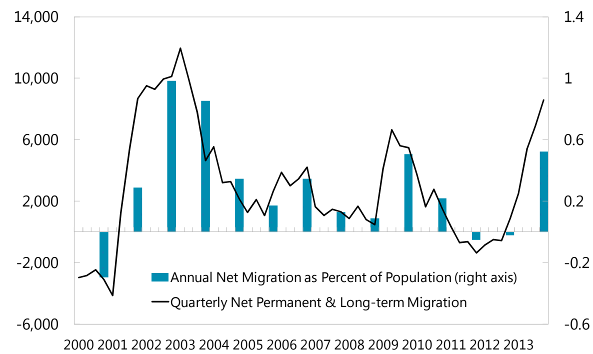
1. Economic developments. The economic expansion is becoming increasingly embedded and broad-based, with growth exceeding 3 percent in the second half of 2013, somewhat stronger than expected. The drivers include supportive financial conditions, record high export commodity prices, resurgent construction activity related to the Canterbury post-earthquake rebuild and general housing shortages, and a substantial increase in net immigration (text figures). Business and consumer confidence indicators have risen to the highest levels since the global financial crisis. The labor market continues to strengthen with the unemployment rate falling to 6 percent (Figure 1). Strong terms of trade have narrowed the 2013 current account deficit to 3¼ percent of GDP and have contributed to the elevated New Zealand dollar, which continues to hold back growth in the non-agricultural tradeable goods sector. With the high exchange rate damping tradable price inflation, headline inflation has remained below the mid-point of the target band (Figure 2). Nominal wage inflation has so far remained subdued.

Export Commodity Price Index



Sources: ANZ and Haver Analytics.

Net Permanent and Long-Term Migration



Source: SNZ.

2. Monetary policy. After keeping the policy rate at 2½ percent for almost three years, the Reserve Bank of New Zealand (RBNZ) began tightening monetary policy in March 2014 and has raised the policy rate to 3 percent. This makes New Zealand one of the first advanced economies to hike interest rates. The Reserve Bank also indicates that it expects to increase the policy rate steadily over the next two years.

3. Fiscal developments. Supported by healthy output growth the government's aim of reducing the budget deficit is going according to plan. The deficit is currently projected to decline almost ½ percent of GDOP to less than ½ percent of GDP this year due to restraint in expenditure growth.[1] The plan would reduce public debt from its peak of 26 percent of GDP in 2013 to about

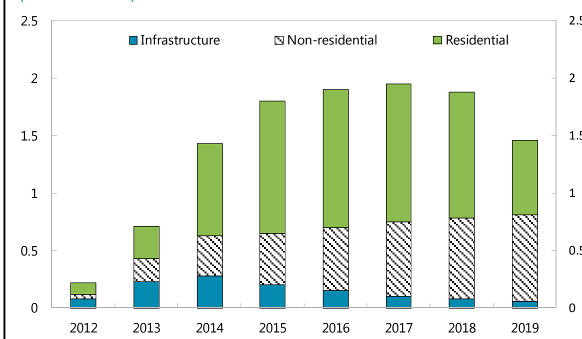
[1] After the fiscal stimulus in the aftermath of the financial crisis and two large earthquakes that increased net debt by 15 percent of GDP the government initiated a multiyear plan to improve the structural balance by 6 percent of GDP over the medium term.

20 percent by 2018. The government just concluded selling stakes in state-owned enterprises, which generated proceeds of about 2 percent of GDP.

OUTLOOK AND RISKS

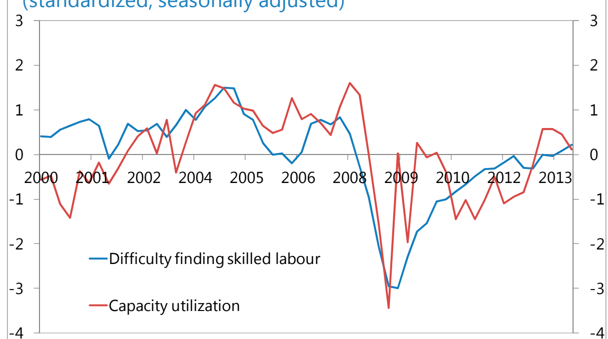
4. Near-term outlook. Growth is forecast to increase to about 3½ percent this year and moderate to a trend rate of 2½ percent over the medium term. Strong construction activity is expected to remain an important driver for near-term growth (text figure), although the speed of the Canterbury post-earthquake rebuild and its interaction with the wider economy are less certain. The terms of trade are projected to ease somewhat due to an assumed moderation in global dairy prices, but remain high relative to historical levels and continue to boost growth in national income. The current monetary policy stance remains well below neutral, and with leading indicators pointing to an economy that is set to grow above trend in the near-term, pressure on core inflation should follow, particularly from the construction sector (text figure).

Earthquake-related Investment and Reconstruction
(As share of GDP)



Source: RBNZ estimates.

Surveyed Capacity Measures
(standardized, seasonally adjusted)



Source: NZIER, RBNZ.

5. External risks. New Zealand's growth prospects remain exposed to external developments (Box 1). In particular:

- *A sharp growth slowdown in China.* About two thirds of New Zealand's exports of goods—mainly agricultural products—go to China, Australia, and other parts of Asia. A sharp slowdown in China could weaken growth prospects in the region and reduce New Zealand's terms of trade, which would also have an adverse impact on New Zealand's national income and overall economic activity. Past declines in commodity prices have usually been accompanied by a weakening of the exchange rate, partially buffering the impact on the economy.

- *Surges in global financial market volatility.* An orderly exit by other advanced economies from unconventional monetary policy could have the welcome effect of weakening New Zealand's exchange rate. However, a bumpy exit and bouts of financial market volatility could lead to widespread contagion and raise the cost of New Zealand banks' offshore borrowing which, for a given monetary policy stance, could raise household debt servicing costs and impact overall economic activity.

Box 1. New Zealand: Risk Assessment Matrix [1/]

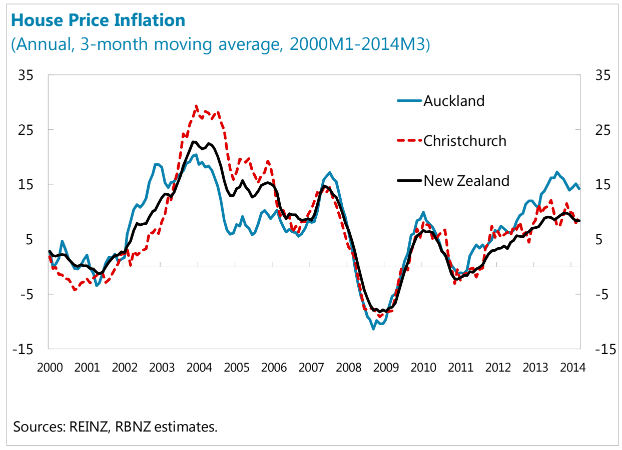
Main Sources of Risks	Overall Level of Concern	
	Likelihood / Direction	**Expected Impact on Economy**
Potential external risks		
➢ **A sharp growth slowdown in China**	**Low/Medium** ↓	**Medium** China and Australia are the top two destinations for New Zealand exports, leaving growth prospects vulnerable to their economic outlook. A sharp slowdown in China would affect New Zealand directly through the terms of trade and indirectly through its impact on Australia as China accounts for a large share of demand of Australia's exports. The flexible exchange rate serves as an important buffer against the terms of trade shocks.
➢ **Surges in global financial market volatilities**	**High** ↓	**Medium** Orderly tapering would likely be beneficial for the economy and may help bring about an exchange rate depreciation. However, a bumpy exit from unconventional monetary policies and bouts of market volatility would likely raise the cost of New Zealand banks' offshore wholesale borrowing.
➢ **Sustained decline in commodity prices**	**Medium** ↓	**High** As commodity exports form a substantial part of New Zealand's total exports, a sustained decline in global commodity prices would have an adverse effect on national income and overall economic activity. The floating exchange rate would help buffer the impact.
Potential domestic risks		
➢ **A sharp fall in house prices**	**Medium** ↓	**Medium to High** There are underlying supply and demand factors that contributed to the high and rising house prices in New Zealand, but the risk of house price overshooting remains. A deterioration in households' ability to service mortgage debt, possibly due to a sharp rise in unemployment, falling incomes, or very high domestic interest rates, could cause a sudden price correction, reducing consumer confidence as a large share of wealth is in housing, worsening banks' balance sheets, and impacting overall economic activity. It is too early to gauge the full effect of the macro-prudential policies introduced last October.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

6. **Housing sector risks.** By historical and international comparisons and some measures of affordability New Zealand's house prices appear elevated (text figure). This in part reflects a limited housing stock from low housing investment in recent years and geographical constraints preventing a rapid housing supply response.[2] With house price inflation running high, there remains the risk that expectations-driven, self-reinforcing demand dynamics and price overshooting could take hold. The government's steps to help alleviate supply bottlenecks, measures to tighten standards for mortgage lending (paragraph 11), and an increase in mortgage rates should help ease price pressures. But a sudden price correction—possibly triggered by a shock to household incomes or

[2] See Annex 2 of the Staff Report for the 2013 Article IV Consultation, "The Housing Market in New Zealand."

borrowing costs—could reduce consumer confidence, impact overall economic activity, and hurt banks' balance sheets.



7. Tail risks and downside scenarios. Many of the above risks are closely linked—for example a sharp slowdown in China could weaken growth prospects in Australia, triggering a broad-based fall in demand for New Zealand's exports, and lead to a sudden decline in house, farm and commercial real estate prices. This in turn could weaken consumer demand and negatively affect banks' balance sheets and their willingness to lend. The downside macroeconomic impact in a scenario where shocks compound each other, while difficult to model, could be large.

8. Policy space to manage risks. The authorities have monetary and fiscal policy space to respond to shocks. The RBNZ has scope to adapt monetary conditions to help buffer against a downside scenario, and the free-floating New Zealand dollar provides an additional cushion against terms of trade and other external shocks. New Zealand's modest public debt gives the authorities scope to delay their planned deficit reduction path in the event of a sharp deterioration in the economic outlook. The new macro -prudential policy framework improves the RBNZ's ability to safeguard financial stability, and the bank stands ready to take additional measures if needed to guard against the risks that would arise from an unsustainable acceleration in house price inflation. As a longer term measure, policies to address housing supply constraints will continue to play an important role in containing price pressures and increasing affordability.

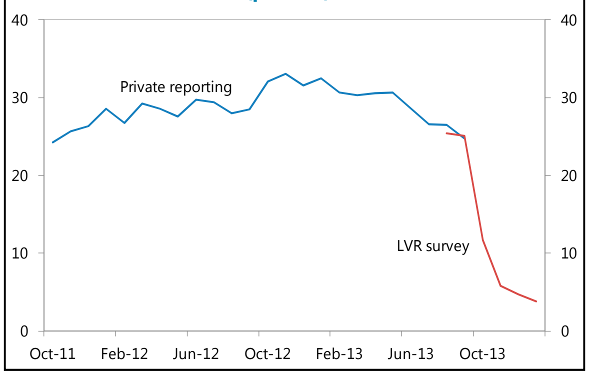
9. Authorities' views. The authorities shared staff's assessment of the economic outlook and risks. They noted some early signs that recent policy measures to help slow house price inflation are gaining traction, and emphasized that addressing housing supply constraints is key to containing house price pressures and increasing affordability over the longer run. Nevertheless they remain keenly aware of the risks the housing market cycle poses to the financial sector and the economy in the near term. They continue to regard a sharp growth slowdown in China and a related decline in commodity prices as the main external risk to the New Zealand economy, and emphasized the role of the floating exchange rate in providing a cushion against such shocks.

NEAR-TERM MACROECONOMIC MANAGEMENT

10. Monetary policy stance. Growth is set to exceed trend and other indicators point to a strengthening of the labor market. With inflationary pressures starting to emerge the RBNZ has moved toward a policy of withdrawing monetary stimulus, with the clear signal that it expects to increase rates steadily by nearly 200 basis points by end-2015. This could also help to cool house price inflation. Going forward an effective monetary policy transmission would allow for a nimble policy response should growth circumstances change. More broadly, the integrity and credibility of the RBNZ's monetary policy framework and the free floating exchange rate will continue to play a key role in delivering macroeconomic stability and enhancing the resilience of the New Zealand economy.

11. Macro-prudential measures. In response to house price inflation and to boost financial sector resilience the RBNZ last year took a number of prudential measures including requirements for banks to hold higher levels of capital against their high loan-to-value (LVR) housing exposure and tight limits on lending above 80 percent LVR threshold (Box 2). The result has been a sharp reduction in high LVR lending (text figure). The RBNZ has made it clear that the LVR restrictions are not intended to be permanent and could be eased or removed once housing market pressures have moderated.[3] More generally, the available tools under the new macro-prudential policy framework should be viewed as a complement to macroeconomic and micro-prudential tools, used sparingly and with caution, and primarily with the objective of limiting the buildup of system-wide financial risk.

Share of New Residential Mortgages at LVRs Greater than 80 Percent (percent)



12. Fiscal policy. New Zealand's fiscal position compares well to its advanced economy peers, but the government considers it a priority to return to budget surplus to preserve its favorable standing with external creditors against the background of relatively high net foreign liabilities, and to build buffers and create fiscal space to cope with future economic shocks and deal with aging and health care cost pressures that are expected to increase over the long term. The government's deficit reduction plan includes better targeting of social spending where it has identified sizeable inefficiencies and potential for cost savings. The cuts in spending are broad based with a ¾ percent of GDP reduction in health, ¾ percent in social security, ½ percent in education, and nearly ¾ percent in other functions from 2012 to 2016.[4] With solid economic growth, revenue is forecast to increase by ¾ percent of GDP in the same period. Deficit reduction would also play a role in supporting monetary policy through the current cycle by making room for increases in private sector and earthquake-related reconstruction spending and thereby allowing for lower interest rates than would otherwise be the case and reducing pressure on the exchange rate. To this end, any revenue over-performance while demand pressure remains strong should be used to pay down government debt rather than being used for higher spending.

13. Authorities' views. The authorities agreed with staff on the policy actions required—a tightening of monetary conditions, continued deficit reduction to support this, and maintaining

[3] The RBNZ, acknowledging the uncertainties, has said that the measures have reduced inflation pressures by an amount similar to a 25-50 basis point increase in the policy interest rate, and that without the measures house price inflation would be in the range of 2½ percent higher than at present.

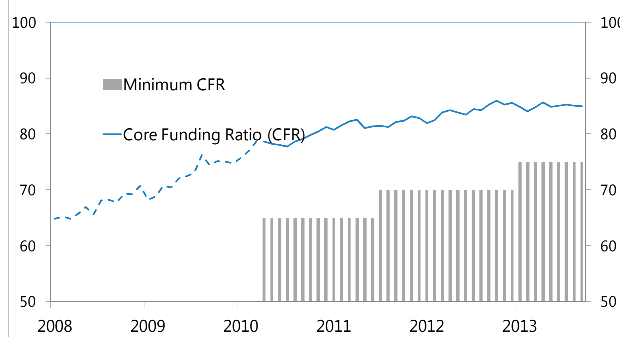
[4] The actual functional distribution of cuts will depend on the future allocation of the budget's operating allowances.

Box 2. New Zealand's Experience with Macro-Prudential Policies

The banking system performed relatively well during the global financial crisis despite its strong links with volatile international capital markets. It remains sound and well positioned for the on-going recovery with overall credit picking up. Despite this positive outcome, the authorities have moved to tackle existing vulnerabilities that remain from both domestic and external sources. The micro-prudential framework has been incrementally strengthened in line with Basel III standards and a new resolution framework has been added but the RBNZ has also added more innovative macro-prudential policies to its toolkit to strengthen the resilience of the overall financial system to possible shocks.

The macro-prudential policies are aimed at tackling a number of vulnerabilities. On the external side, to reduce the risk from banks' long standing reliance on potentially volatile foreign funding, the core funding ratio has been progressively raised and specific liquidity ratios have been introduced (text figure). These have had a noticeable impact as shown by the only limited effects of recent volatility in global financial markets on the local banks. A major domestic risk to financial stability has been bank lending to the housing market. The risks are two-fold; (i) that such lending could lead to a price overshooting which if abruptly reversed could damage banks' balance sheets; and (ii) that in such a situation, banks would need to shore up capital by cutting lending to the real economy and the ensuing credit crunch would have macroeconomic effects that raise non-performing loans.

Banking System Core Funding
(percent of loans and advances)



Source: RBNZ

The RBNZ has recently introduced requirements for banks to hold a higher level of capital against high loan-to-value ratio (LVR) mortgage lending and tight limits on lending above the 80 percent LVR threshold. There are emerging signs that these policies may be starting to cool the housing market. High LVR lending has fallen from around 25 percent of all mortgage lending in September 2013 to 5.6 percent at the end of March 2014. National house sales dropped 11 percent between October 2013 and March 2014, with the drop in sales volumes evenly spread across regions. The RBNZ also estimates that, in the absence of LVR restrictions, annual house price inflation could have been around 2.5 percentage points higher in the year to March 2014.

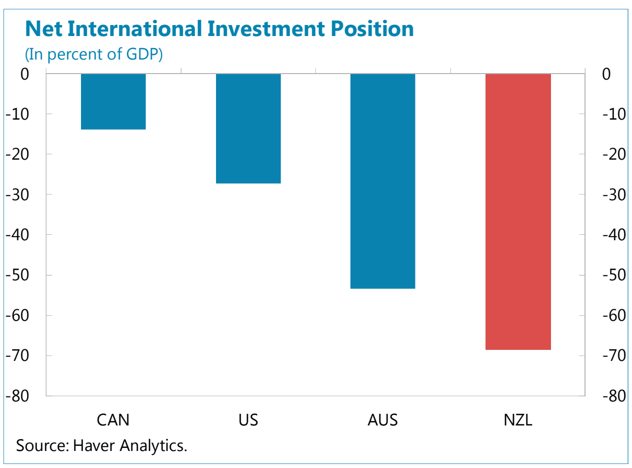
New Zealand's macro-prudential policy framework has several important features:

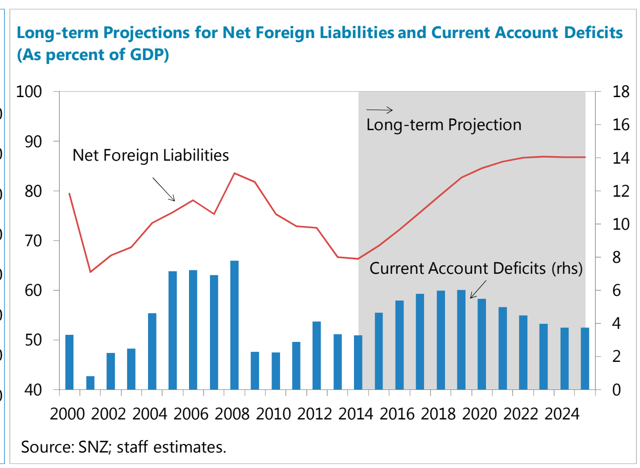
- The introduction of macro-prudential policy measures has been on a gradual and incremental basis with full industry consultation. They have also been well targeted and aimed at avoiding distortions. Unlike their use in many Asian economies, they have not been fine tuned in terms of geography or the profile of the purchaser.
- The measures have been announced as being temporary to be eased when the housing market cools down. This has reduced the incentive for evasion and there are no signs of regulatory arbitrage or increased activity by the non-bank financial sector that could reduce the effectiveness of these measures.
- These measures reinforce rather than substitute for the existing monetary and exchange rate framework. Monetary policy continues to be the primary tool in managing aggregate demand, while the macro-prudential measures focus on protecting financial stability. The measures do not aim to influence capital inflows or the level of the exchange rate.

macro-prudential measures to cool the housing market. They noted that as spare capacity has largely been exhausted it is important that inflation expectations remain anchored, and the RBNZ's monetary policy tightening is aimed at keeping future average inflation near the 2 percent target mid-point and ensuring that the economic expansion can be sustained. They agreed that positive budget revenue surprises associated with strong economic growth should be used to pay down debt. They emphasized that while monetary policy and macro-prudential policies are complements, it is essential that each be focused on its primary objective—price stability and financial stability respectively.

EXTERNAL STABILITY

14. Current account. New Zealand's persistent current account deficits and relatively high net external liabilities reflect longstanding structural saving-investment imbalances, with low household savings playing a key role (text figure). The reasons for low household savings cannot be fully explained by New Zealand's observed fundamentals, but might be partly related to less quantifiable factors such as New Zealand's tax, social security, and welfare systems.[5] The deficit narrowed last year as a result of the strong terms of trade, but is expected to widen as growth in private consumption and investment remains strong. Investment related to ongoing earthquake reconstruction will also continue to add to the deficit through the forecast horizon. Reducing pressure on the exchange rate and limiting the current account deficit in a lasting way will require structural measures to address the savings-investment gap, rather than being the task of short-term macroeconomic management. Over the longer term, as reconstruction tapers off and if the





exchange rate overvaluation recedes, current account deficit could decline to below 4 percent of GDP, stabilizing the net foreign liability position at below 90 percent of GDP (text figure).[6]

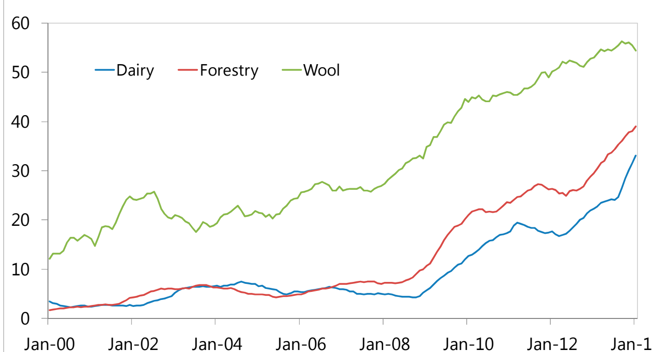
[5] See Annex 3 of the Staff Report for the 2013 Article IV Consultation, "Household Savings and the Current Account in New Zealand." Household savings are structurally low. In this Annex we use a quantitative approach to why this might be the case, but much of the low savings rate is left unexplained by observable factors.

[6] The recorded decline in net foreign liabilities in recent years reflects one-off post-earthquake reinsurance payments from offshore to New Zealand. This effect is expected to unwind as these are payments are used for reconstruction spending over the forecast horizon.

15. Exchange rate assessment. At 86 cents to the U.S. dollar, our estimates suggest that the exchange rate is 5-15 percent stronger than would be consistent with stabilizing net foreign liabilities over the longer term (Box 3). There are several factors contributing to the current level of the exchange rate including the high terms of trade, the gap between domestic and foreign interest rates, New Zealand's favorable growth outlook, and an appetite for relatively safe New Zealand assets. If any of these factors were to ease, in part through a faster-than-expected tightening of monetary conditions in other advanced economies, the exchange rate would likely depreciate. The government's ongoing deficit reduction plan should also ease pressure on the exchange rate by boosting national saving. However, global liquidity could remain ample for some time, and New Zealand's non-agricultural tradable sector will need to continue to adapt by further increasing efficiency to remain competitive.

16. Coping with terms of trade shocks. The historically high terms of trade has been one of the key drivers of economic growth recently. Some moderation of the terms of trade is built into the baseline scenarios. Although the share of primary exports to China of New Zealand's total exports has increased markedly since 2008 (text figure), partly related to New Zealand's reputation for high quality dairy products relative to Chinese producers, New Zealand is still well integrated into global markets for these products which would buffer shocks that arises from weaker demand in China. The floating exchange rate will also help by depreciating when the terms of trade fall, making other tradable goods and services more competitive. The impact of a faster-than-anticipated decline in the terms of trade on nominal output would affect budget revenue more broadly.

Share of Primary Exports to China
(Annual total, %)

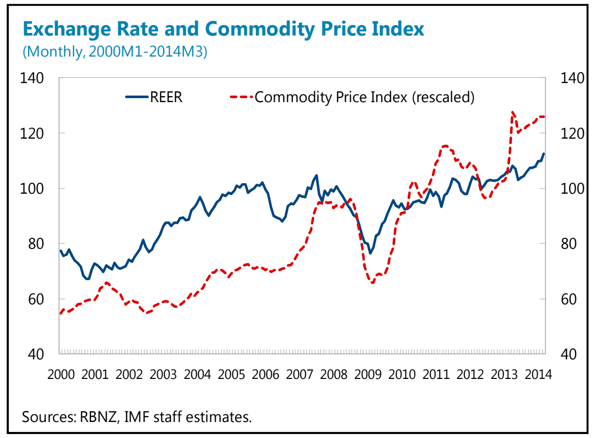


Source: RBNZ

17. Authorities' views. The authorities agreed that the persistent strength of the New Zealand dollar reflects a combination of structural savings-investment imbalances and the strength of the terms of trade, reinforced at present by the more advanced process of monetary policy normalisation in New Zealand compared to other countries. They recognize the long-standing vulnerability associated with the country's relatively large net external debt position, and view the planned increase in public savings as the most effective policy action to manage this risk. They emphasized the key role the integrity and credibility of the monetary and fiscal policy framework and the floating exchange rate have played in delivering macroeconomic stability and enhancing the resilience of the New Zealand economy. They agreed that the New Zealand dollar appears overvalued, viewing the current level of the exchange rate as unsustainable in the long run. They expect that the currency's current strength should dissipate if New Zealand's export commodity prices moderate and external monetary conditions begin tightening.

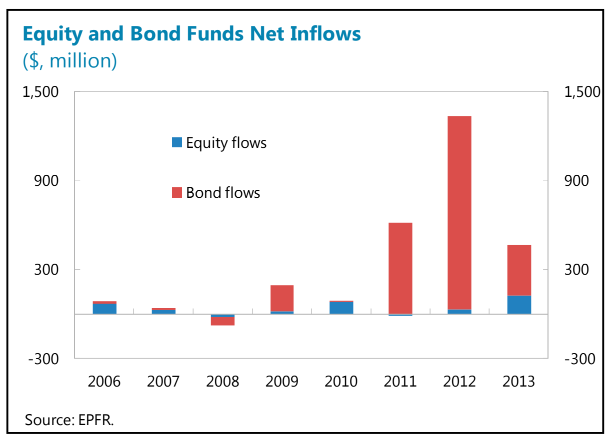
Box 3. Exchange Rate Assessment [1/]

New Zealand's real effective exchange rate remained elevated in 2013 driven by historically high prices for commodity exports. The relatively strong dollar continues to weigh on the competitiveness of export and import-competing industries. The current account deficits are projected to widen in the medium term, partly related to the post-earthquake reconstruction investment.



Aside from the structural savings-investment imbalance that contributes to the persistently strong exchange rate, there are a number of short-term factors associated with its current level, including the recovery in global risk appetite and increased portfolio and official flows into New Zealand.

Model-based approaches suggest that New Zealand's real exchange rate is 5-15 percent above the level that would be consistent with medium term fundamentals. The IMF's amended real effective exchange rate (REER) regression approach attempts to identify the policy-related (both domestic and international) drivers of the deviation of each country's real exchange rate from its fundamentals-based fitted value. Applied to New Zealand, this yields an estimate of 13 percent overvaluation for 2013. About 9 percent of the overvaluation is due to unexplained residuals, i.e., the exchange rate gap not explained by medium term fundamentals and policy drivers. A similar approach, the current account regression, suggests that New Zealand's current account deficits are larger than the level consistent with the medium term fundamentals by 1 percent of GDP. Given estimated trade elasticities, this would suggest an overvaluation of about 5 percent. These estimates are, however, subject to considerable uncertainty.



The IMF's external stability approach suggests that stabilizing net external liabilities in the medium term would require the current account deficit falling to about 3¾ percent of GDP. Given estimated trade elasticities, this would require the New Zealand dollar to be about 11 percent weaker than its current level.

1/ This box is based in part on preliminary results from the IMF's External Balance Assessment (See http://www.imf.org/external/np/res/eba/data.htm).

SAFEGUARDING FINANCIAL SECTOR STABILITY

18. Financial developments. New Zealand's financial system remains sound and analysis shows that New Zealand's banking sector would be resilient in the face of a severe economic shock.[7] The banks are well capitalized—all comfortably meet the new Basel III minimum capital requirement—and liquidity buffers are solid. Non-performing loan ratios are low and declining and recent stress tests indicate that, even under adverse assumptions, they do not pose risks to the healthy capital positions. Banks continue to shift toward more stable funding sources, and use of offshore borrowing has been reduced and is of longer maturity. Nevertheless the banks face longstanding structural issues that will remain sources of financial sector risk over the medium term. The four largest banks are systemically important with broadly similar business models, and their reliance on offshore funding, while declining, is still high by international standards and represents a risk. Residential mortgages and agricultural lending account for most of banks' assets, sectors vulnerable to price fluctuations and where leverage is still high. Although as subsidiaries the major banks are not dependent on borrowing from their Australian parents, they are still vulnerable should a parent get into trouble which could affect their access to offshore borrowing.

19. Micro and macro prudential measures. The micro-prudential supervisory and regulatory framework has been strengthened since the global financial crisis including through more stringent capital requirements, the introduction of a new bank resolution framework, and measures to promote a greater commitment to New Zealand depositors by foreign owned-banks through mandatory subsidarization. The RBNZ is undertaking another round of stress tests based on robust assumptions that will, for the first time, include the smaller banks. In addition, the RBNZ has enhanced its oversight of the non-bank financial sector that proved to be vulnerable during the previous downturn. The authorities also implemented macro-prudential measures as highlighted in Box 2. The RBNZ will be responsible for applying these measures after consultation with the Minister of Finance. The measures could help dampen credit cycles, strengthen macroeconomic management, and guard against an acceleration of house price inflation.

20. Authorities' views. The authorities emphasized their conservative approach to bank regulation and supervision. Given this and New Zealand banks' high quality capital, they did not see a need at present to raise the minimum capital requirements for the four systemically important banks above the Basel III norms. The authorities agreed with staff that the new set of macro-prudential tools should be viewed as a complement to and not substitute for macroeconomic and micro-prudential measures, and should be used sparingly and with caution with the primary objective of maintaining financial system stability.

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[7] See Annex 1 of the Staff Report for the 2013 Article IV Consultation, "The Resilience of New Zealand's Banking Sector." A recent stress test conducted jointly by the RBNZ and the Australians included a 40 percent fall in the world price of New Zealand commodity exports, a six month freeze on wholesale debt markets, a cumulative output loss of 4 percent, a rise in unemployment to 11½ percent, and a fall in house, farm and commercial property prices of 30 percent. The test indicated that the banks would still comply with the minimum Tier 1 capital ratio in place at the time of 4 percent.

STAFF APPRAISAL

21. Outlook and risks. The economic expansion is becoming increasingly embedded and broad-based. Headline inflation has remained subdued, but with the economy set to continue to grow above trend in the near term, pressures on core inflation should follow. The key external risk to the outlook remains a sharp slowdown in growth in China, which would affect New Zealand directly through the terms of trade and indirectly through its impact on Australia, a key trading partner. Bouts of financial market volatility could also lead to widespread contagion and raise the cost of New Zealand banks' offshore borrowing. Domestically, house price inflation remains high and there remains a risk of house price overshooting and accompanying vulnerabilities.

22. Monetary and fiscal policy. Staff welcomes the Reserve Bank's shift toward a policy of withdrawing monetary stimulus, with the clear signal that rates would be increased further over the next two years. In addition to the longer-term benefits, deficit reduction will play an important role in supporting monetary policy through the current cycle, allowing for lower interest rates than would otherwise be the case and reducing pressure on the exchange rate.

23. External vulnerabilities and the exchange rate. New Zealand's large net external liabilities, although relatively stable, are a longstanding source of risk and reflect historically low household savings rates. Given a structural savings-investment imbalance, reducing pressure on the exchange rate and limiting current account deficits in a lasting way will require addressing the reasons for low savings, rather than being the task of short-term macroeconomic management. Aside from these structural factors, there are a number of short-term factors contributing to the currently overvalued exchange rate, including historically high terms of trade and an appetite for relatively safe New Zealand assets. If global monetary conditions were to become less stimulatory, the exchange rate would likely depreciate over time, reducing the current account deficit over the medium term.

24. Managing risks. With public debt relatively low and interest rates above the zero bound, the authorities have monetary and fiscal policy space to respond to shocks, and the free-floating New Zealand dollar provides an additional cushion against terms of trade and other external shocks. Restrictions on riskier mortgage lending introduced in October should help reduce the likelihood of an unsustainable acceleration in house price inflation, although it is still too early to assess their full impact. Over the longer term, policies to address housing supply constrains will continue to play an important role in containing price pressures and increasing affordability.

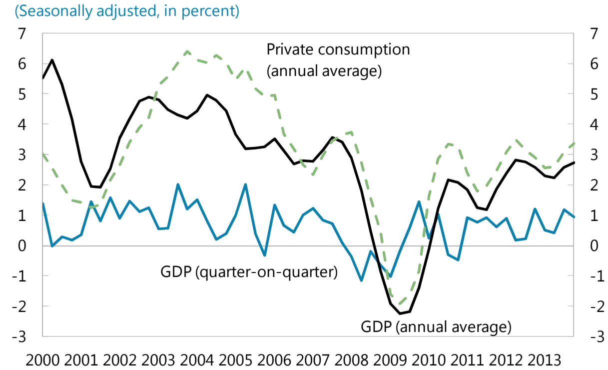
25. Financial sector issues. Banks remain sound, and recent stress tests show that the major banks would be able to withstand a sizeable shock to output, terms of trade, rising unemployment, and a fall in property prices. Nevertheless the banks face longstanding structural issues that will remain sources of risk over the medium term, including reliance on offshore borrowing. The recently introduced macro-prudential policy measures provide additional tools to safeguard financial sector resilience. These tools should be viewed as a complement to macroeconomic and micro-prudential measures. They should be used infrequently, with caution, and with the primary objective of limiting the buildup of system-wide risk.

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

Figure 1. Growth and Employment

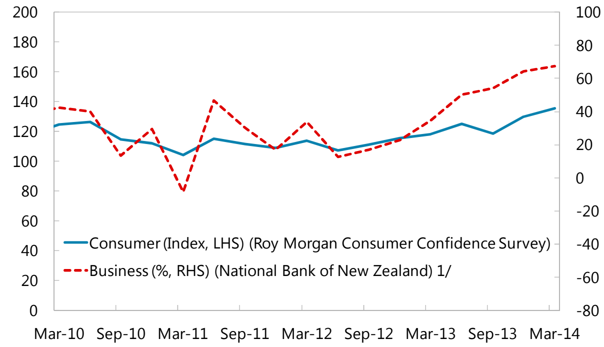
Growth momentum strengthened since the second half of 2013...

Real Growth
(Seasonally adjusted, in percent)



...driven in part by strong consumer and business confidence...

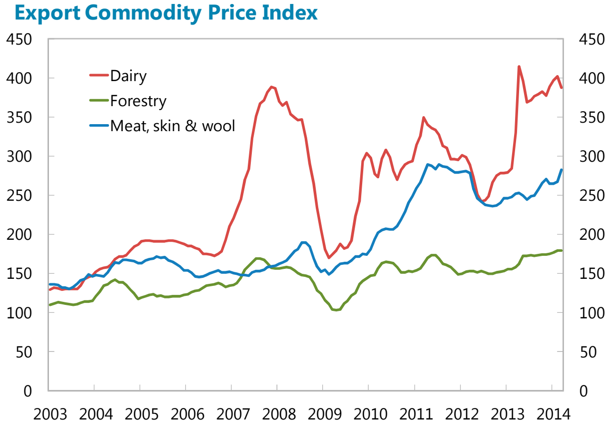
Consumer and Business Confidence



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

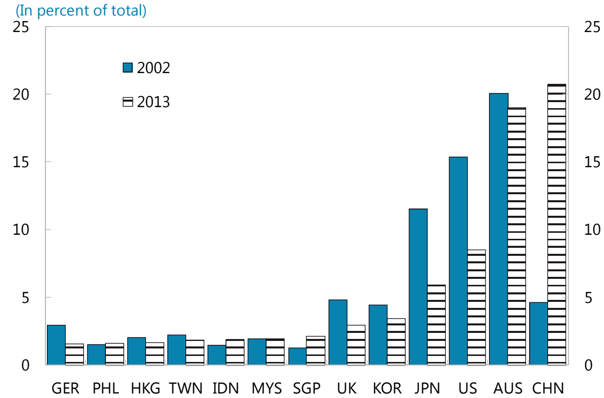
...and high export commodity prices.

Export Commodity Price Index



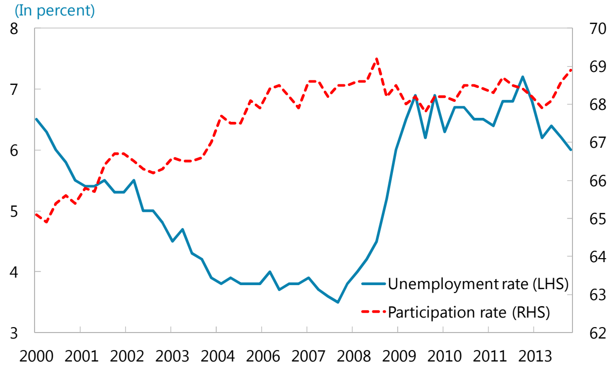
China overtakes Australia as New Zealand's top export market.

Export by Destination
(In percent of total)



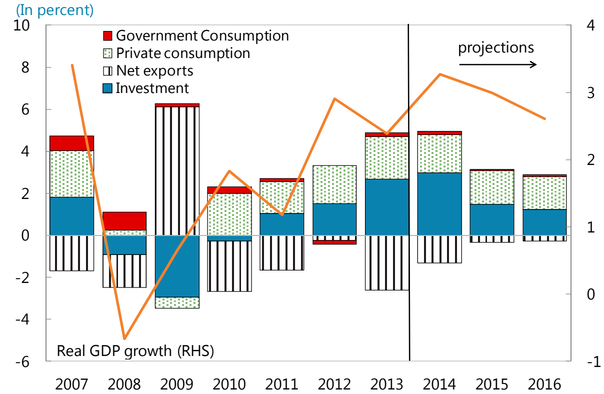
Labor market also improves as the economy strengthens.

Labor Market Indicators
(In percent)



Reconstruction investment will continue to support growth in the near term.

Contribution to Annual GDP Growth
(In percent)



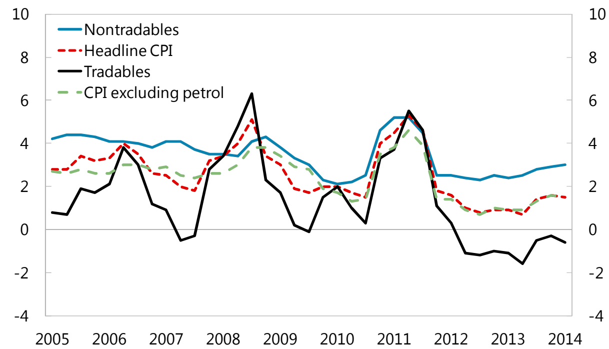
Sources: Statistics New Zealand; Reserve Bank of New Zealand; ANZ; Haver Analytics; World Economic Outlook; and Fund staff estimates.

Figure 2. A Tightening Monetary Stance

Headline inflation has remained subdued, with the high exchange rate damping tradable price inflation.

CPI Inflation

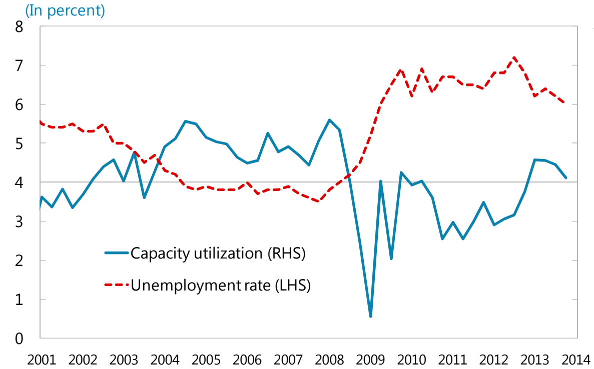
(Percent change, y/y)



As the spare capacity is being absorbed by the strengthening economic activities...

Indicators of Resource Pressure

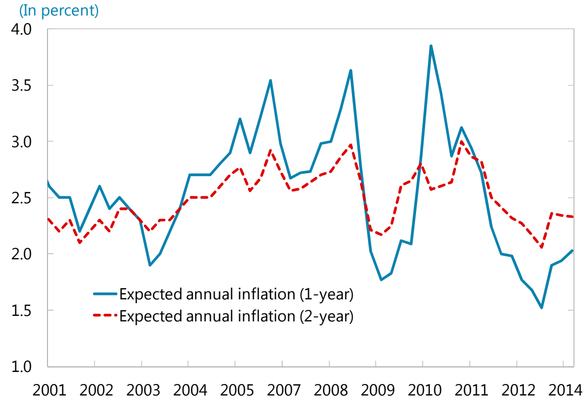
(In percent)



... inflation is expected to pick up towards the middle of the targeted range.

Inflation Expectations

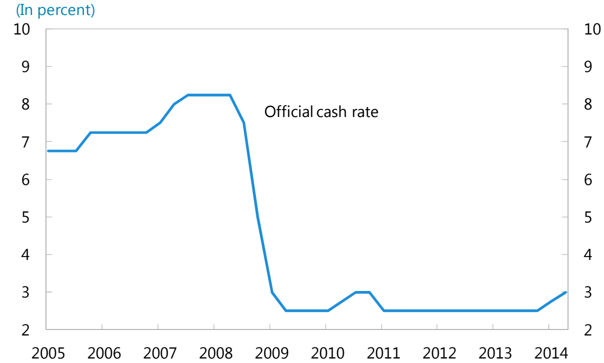
(In percent)



The RBNZ has raised the policy rate from 2.5 percent to 3 percent since March 2014.

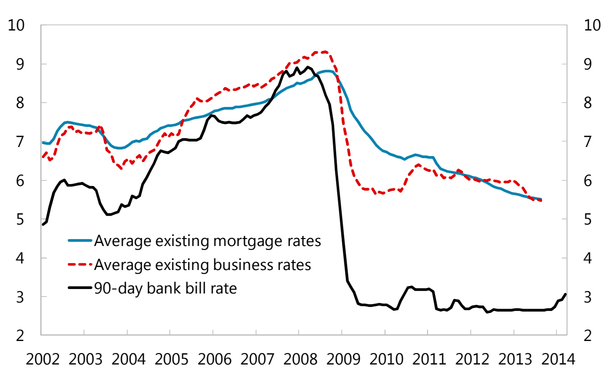
Policy Rate

(In percent)



The market interest rates are below their long run average levels...

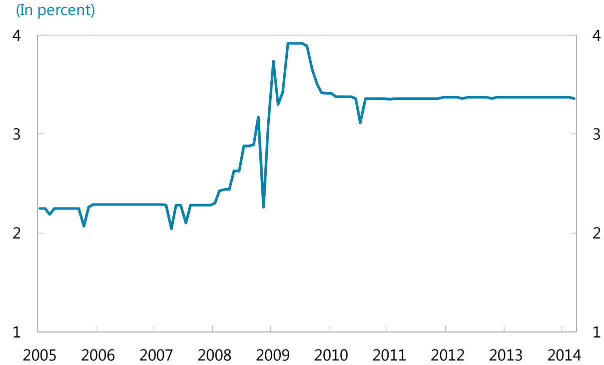
Nominal Interest Rates



... but the mortgage spreads are stable and high.

Floating Mortgage Rate to OCR Spread

(In percent)



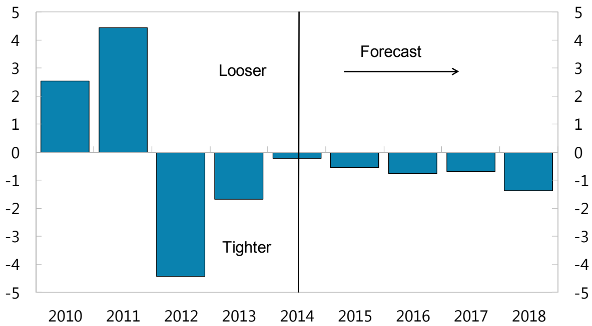
Sources: Reserve Bank of New Zealand; Statistics New Zealand; New Zealand Institute of Economic Research; Haver Analytics database; and Fund staff estimates.

Figure 3. The Government's Deficit Reduction Plan

The deficit reduction plan of the authorities…

Fiscal Impulse[1/]

(In percent of GDP, fiscal year)

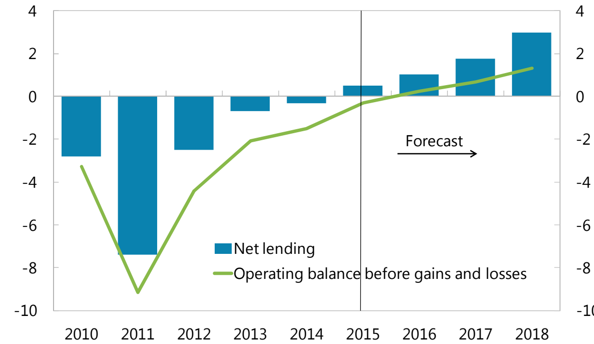


1/ Based on cyclically adjusted balances, including earthquake-related spending.

… is expected to build increasing surplus beginning in 2015…

Fiscal Balance

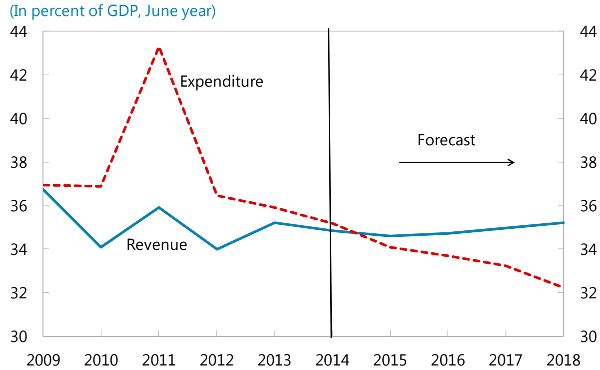
(In percent of GDP, June year)



…owing to steady expenditure restraint…

Revenue and Expenditure

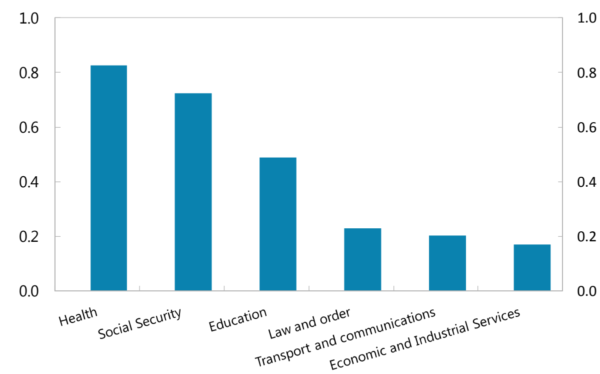
(In percent of GDP, June year)



…on a broad range of government functions..

Expenditure Reduction, 2012-2016

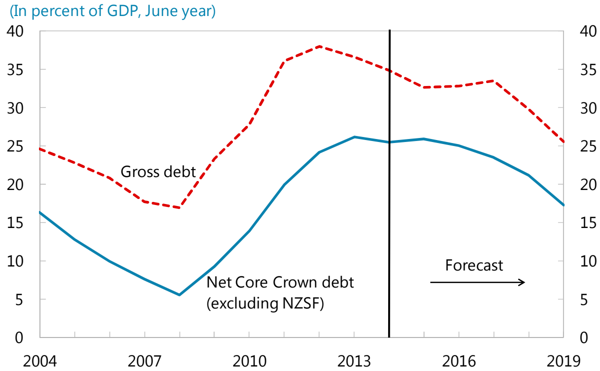
(In percent of GDP)



Net debt will peak at about 26 percent of GDP…

Gross and Net Debt

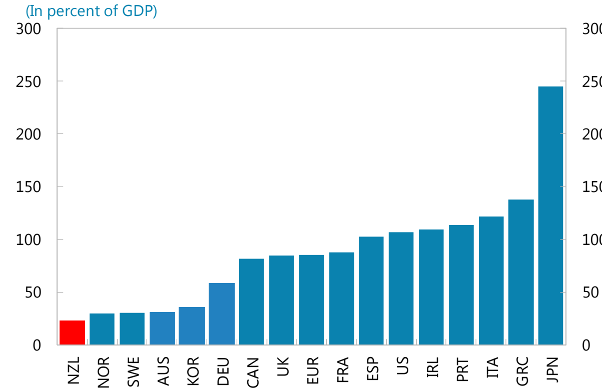
(In percent of GDP, June year)



… and gross debt will remain among the lowest in advanced economies.

General Government Gross Debt, 2019

(In percent of GDP)



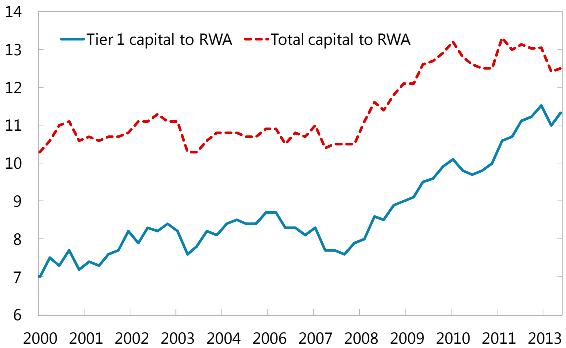
Sources: The New Zealand Treasury; Statistics New Zealand; World Economic Outlook database; and IMF staff calculations and projections.

Figure 4. Banking Sector Developments

Banks' capital is increasing …

Capital Adequacy Ratios

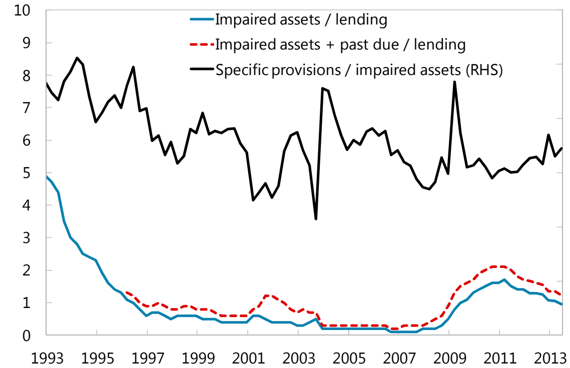
(In percent)



…and asset quality continues to improve…

New Zealand Banks Asset Quality

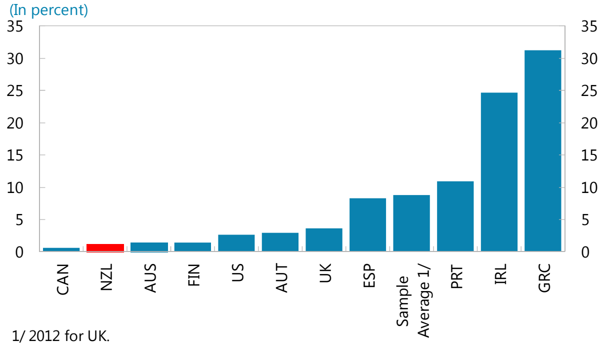
(In percent)



…with low nonperforming loans by advanced country standards.

Nonperforming Loans to Total Loans, latest available 2013 quarter 1/

(In percent)



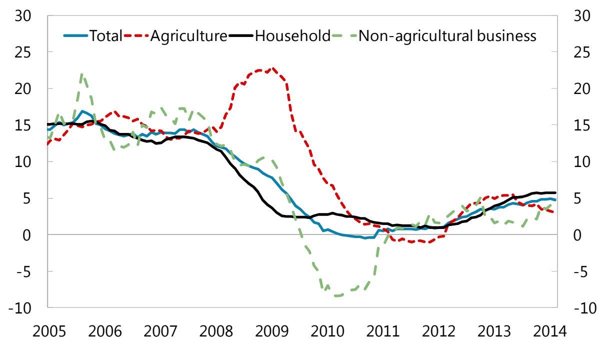
1/ 2012 for UK.

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

Credit growth is slowly picking up.

Credit Growth

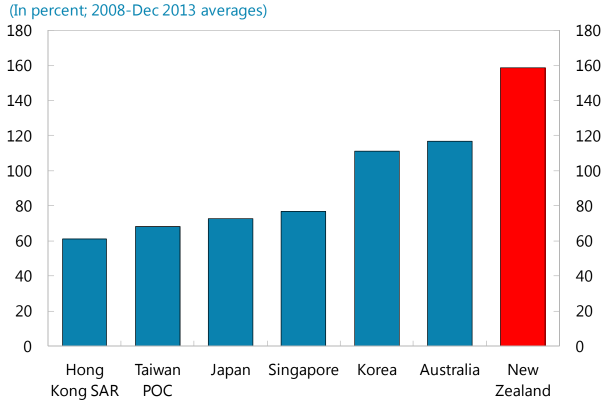
(Year on year percentage change)



Loan-to-deposit ratio is high in the region …

Loan-to-Deposit Ratios in Asian Countries

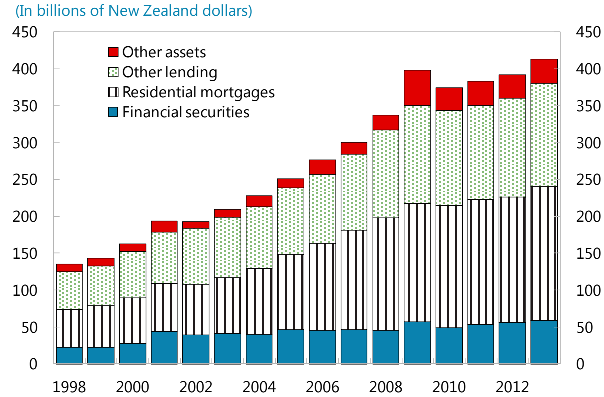
(In percent; 2008-Dec 2013 averages)



…with mortgages constituting a large proportion of banks' assets.

Bank Asset Composition

(In billions of New Zealand dollars)



Sources: Reserve Bank of New Zealand, Financial Stability Report; Statistics New Zealand; Bankscope; Reserve Bank of Australia; Haver Analytics database; and IMF staff estimates.

Table 1. New Zealand: Selected Economic and Financial Indicators, 2009–14

Nominal GDP (2013): US$181.7billion — Per capita GDP (2013): US$40,539
Population (2013): 4.4 million — Quota: SDR 894.6 million

	2009	2010	2011	2012	2013	2014 Proj.
Real growth (percent change)						
GDP (production basis)	-1.4	2.1	1.9	2.6	2.7	3.5
Final domestic demand	-3.2	2.0	2.7	3.2	4.3	4.8
Private consumption	-0.8	3.3	2.5	2.9	3.4	3.5
Government consumption	0.7	1.8	0.9	-1.0	0.9	0.5
Fixed investment	-11.7	-1.2	4.8	7.1	9.4	11.2
Inventories 1/	-2.1	1.9	-0.2	0.2	0.0	0.0
Exports of goods and services	2.0	3.4	2.5	2.2	2.1	1.7
Imports of goods and services	-14.4	10.8	7.0	2.7	2.6	5.0
Output gap	-1.8	-1.0	-0.8	-0.4	-0.2	0.7
Headline CPI inflation (percent change)	2.1	2.3	4.0	1.1	1.1	1.8
End of period (percent change)	2.0	4.0	1.8	0.9	1.6	2.2
Unemployment rate (period average, in percent)	6.2	6.5	6.5	6.9	6.7	5.6
Investment and saving (in percent of GDP)						
Investment	19.0	19.2	18.9	20.2	20.1	21.9
National saving 2/	16.7	17.0	16.0	16.1	14.0	18.6
Public finance (in percent of GDP) 3/						
Revenue	36.7	34.1	35.9	34.0	35.2	34.9
Expenditure	37.0	36.9	43.3	36.5	35.9	35.2
Net lending (+)/borrowing (–)	-0.2	-2.8	-7.4	-2.5	-0.7	-0.3
Operating balance before gains and losses	-2.1	-3.3	-9.2	-4.4	-2.1	-1.5
Gross debt	23.3	27.8	36.0	38.0	36.6	34.8
Net debt (financial assets excl. NZS Fund & Advances)	9.2	13.9	20.0	24.2	26.2	25.5
Stuctural balance (percent of potential GDP)	0.3	-2.2	-5.9	-1.6	-0.2	0.3
Cyclically adjusted balance (percent of potential GDP)	0.3	-2.2	-6.6	-2.2	-0.6	-0.3
Money and credit (end of period)						
Resident M3 (percent change) 4/	1.8	4.8	6.9	8.0	7.3	...
Private domestic credit (percent change) 4/	1.7	0.5	1.7	3.6	5.2	...
Interest rates (period average)						
Interest rate (90-day, in percent)	3.0	3.0	2.8	2.7	2.7	...
Government bond yield (10-year, in percent)	5.5	5.6	4.9	3.7	4.1	...
Balance of payments (in percent of GDP)						
Current account	-2.3	-2.3	-2.9	-4.1	-3.3	-3.3
(In billions of New Zealand dollars)	-4.3	-4.5	-5.9	-8.7	-7.4	-7.8
Trade balance (goods)	0.9	1.5	1.4	0.1	0.6	1.4
Terms of trade (percent change)	-10.1	10.3	4.6	-6.7	8.9	1.7
Foreign assets and liabilities ($NZ billion)						
Net international investment position	-154.1	-148.7	-149.9	-152.8	-147.6	-157.3
(In percent of GDP)	-81.8	-75.4	-72.9	-72.6	-66.6	-66.4
Official reserves	21.6	21.7	22.1	21.4	19.9	...
Exchange rate (period average)						
U.S. dollar per New Zealand dollar	0.63	0.72	0.79	0.81	0.82	...
Trade-weighted index (June 1979 = 100)	60.0	66.7	69.3	72.6	76.2	...
Nominal effective exchange rate 4/	84.3	92.2	95.1	99.6	103.6	...
Real effective exchange rate 4/	86.7	94.9	98.8	102.4	105.8	...
GDP (in billions of New Zealand dollars)	188.4	197.3	205.6	210.5	221.4	237.0

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

1/ Contribution in percent of GDP.
2/ Based on national accounts data.
3/ Fiscal years ending June 30.
4/ IMF Information Notice System index (2000 = 100).

Table 2a. New Zealand: Statement of Operations of Budgetary Central Government, 2009/10-2014/15 1/

(In billions of New Zealand dollars)

	2009/10	2010/11	2011/12	2012/13	2013/14 Proj.	2014/15 Proj.
Revenue	65.6	72.1	71.3	75.1	80.5	83.5
Taxes	54.3	55.8	59.2	62.5	67.3	70.5
Other revenue	11.3	16.4	12.1	12.5	13.2	13.0
Property income	3.1	3.0	2.4	3.0	3.5	3.2
Sales of goods and services and other revenues	8.3	13.4	9.7	9.5	9.7	9.8
Expenditure	71.0	87.0	76.5	76.6	81.2	82.3
Expense	69.1	86.1	75.0	76.1	78.7	80.0
Compensation of employees	18.4	18.8	19.2	19.6	19.9	20.0
Consumption of fixed capital	3.0	3.4	3.2	3.1	3.2	3.3
Interest	2.0	2.7	3.0	3.2	3.2	3.4
Grants and subsidies	3.9	4.7	4.2	4.9	5.5	5.3
Social benefits	20.8	21.7	21.8	22.3	22.8	23.3
Other expense 2/	21.0	34.7	23.6	23.0	24.0	24.8
Net acquisition of nonfinancial assets	1.9	0.9	1.5	0.4	2.5	2.3
Gross Operating Balance	-0.4	-10.5	-0.6	2.1	5.0	6.8
Net Operating Balance	-3.5	-13.9	-3.7	-1.1	1.8	3.5
Net lending (+)/borrowing (–)	-5.4	-14.8	-5.2	-1.5	-0.7	1.2
Net financial transactions	-5.4	-14.8	-5.2	-1.5	-0.7	1.2
Net acquisition of financial assets	4.8	19.4	0.7	-5.6	-2.4	-3.7
Domestic	4.8	19.4	0.7	-5.6	-2.4	-3.7
Debt securities 3/	1.3	8.1	-1.2	-5.9	-1.2	-5.4
Loans	3.4	1.6	1.2	0.9	1.2	1.2
Other accounts receivable	0.2	9.8	0.6	-0.6	-2.4	0.5
Net incurrence of liabilities	10.2	34.3	5.9	-4.1	-1.7	-4.9
Domestic	10.2	34.3	5.9	-4.1	-1.7	-4.9
Debt securities	8.9	20.8	7.4	-2.0	2.4	-2.4
Other accounts payable	1.3	13.4	-1.5	-2.1	-4.1	-2.5
Memorandum items:						
Cash receipts from operating activities	64.9	66.0	70.2	74.7	81.6	82.5
Cash payments from operating activities	65.8	71.7	75.0	74.9	80.9	79.5
Net cash inflow (outflow) from operating activities	-0.9	-5.7	-4.8	-0.2	0.7	3.0
Cash surplus (deficit)	-5.4	-10.1	-8.6	-4.1	-6.0	-3.4
Operating balance before gains and losses (total Crown)	-6.3	-18.4	-9.2	-4.4	-3.4	-0.7
Earthquake expenses (core Crown)		1.6	1.3	0.8	1.6	0.7
Residual cash balance (core Crown)	-9.0	-13.3	-10.6	-5.7	-4.1	-3.5
Cyclically adjusted balance	-4.3	-13.5	-4.7	-1.2	-0.8	0.5
Structural balance	-4.3	-11.9	-3.4	-0.4	0.8	1.2
Gross sovereign-issued debt 4/	53.6	72.4	79.6	78.0	80.5	78.8
Net core Crown debt 5/	26.7	40.1	50.7	55.8	58.9	62.5
Net worth (Core Crown) 6/	44.7	34.9	23.4	25.6	26.3	27.9
Nominal GDP	192.5	200.9	209.7	213.2	231.0	241.5

Source: New Zealand Treasury. The data on cyclically adjusted balance, structural balance and structural residual cash balance in this table are based on the IMF's Staff calculations and methodology.
1/ Fiscal year ending June 30. Includes core Crown (excluding RBNZ) and Crown entities.
2/ Includes use of goods and services.
3/ Includes currency, deposits and equities.
4/ Excluding Reserve Bank Settlement cash.
5/ Excluding NZ Superannuation Fund and advances.
6/ Includes financial assets of NZ Superannuation Fund.

Table 2b. New Zealand: Statement of Operations of Budgetary Central Government, 2009/10-2014/15 1/

(In percentage of GDP)

	2009/10	2010/11	2011/12	2012/13	2013/14 Proj.	2014/15 Proj.
Revenue	34.1	35.9	34.0	35.2	34.9	34.6
Taxes	28.2	27.8	28.2	29.3	29.1	29.2
Other revenue	5.9	8.2	5.8	5.9	5.7	5.4
Property income	1.6	1.5	1.1	1.4	1.5	1.3
Sales of goods and services and other revenues	4.3	6.7	4.6	4.5	4.2	4.1
Expenditure	36.9	43.3	36.5	35.9	35.2	34.1
Expense	35.9	42.8	35.8	35.7	34.1	33.1
Compensation of employees	9.5	9.4	9.2	9.2	8.6	8.3
Consumption of fixed capital	1.6	1.7	1.5	1.5	1.4	1.4
Interest	1.0	1.3	1.4	1.5	1.4	1.4
Grants and subsidies	2.0	2.3	2.0	2.3	2.4	2.2
Social benefits	10.8	10.8	10.4	10.4	9.9	9.6
Other expense 2/	10.9	17.3	11.2	10.8	10.4	10.3
Net acquisition of nonfinancial assets	1.0	0.5	0.7	0.2	1.1	1.0
Gross Operating Balance	-0.2	-5.2	-0.3	1.0	2.2	2.8
Net Operating Balance	-1.8	-6.9	-1.8	-0.5	0.8	1.4
Net lending (+)/borrowing (–)	-2.8	-7.4	-2.5	-0.7	-0.3	0.5
Net financial transactions	-2.8	-7.4	-2.5	-0.7	-0.3	0.5
Net acquisition of financial assets	2.5	9.7	0.3	-2.6	-1.1	-1.5
Domestic	2.5	9.7	0.3	-2.6	-1.1	-1.5
Debt securities 3/	0.7	4.0	-0.6	-2.8	-0.5	-2.2
Loans	1.7	0.8	0.6	0.4	0.5	0.5
Other accounts receivable	0.1	4.9	0.3	-0.3	-1.1	0.2
Net incurrence of liabilities	5.3	17.1	2.8	-1.9	-0.7	-2.0
Domestic	5.3	17.1	2.8	-1.9	-0.7	-2.0
Debt securities	4.6	10.4	3.5	-0.9	1.0	-1.0
Other accounts payable	0.7	6.7	-0.7	-1.0	-1.8	-1.1
Memorandum items:						
Cash receipts from operating activities	33.7	32.8	33.5	35.0	35.3	34.2
Cash payments from operating activities	34.2	35.7	35.8	35.2	35.0	32.9
Net cash inflow (outflow) from operating activities	-0.5	-2.8	-2.3	-0.1	0.3	1.2
Cash surplus (deficit)	-2.8	-5.0	-4.1	-1.9	-2.6	-1.4
Operating balance before gains and losses (total Crown)	-3.3	-9.2	-4.4	-2.1	-1.5	-0.3
Earthquake expenses (core Crown)		0.8	0.6	0.4	0.7	0.3
Residual cash balance (core Crown)	-4.7	-6.6	-5.1	-2.7	-1.8	-1.4
Cyclically adjusted balance (percent of potential GDP)	-2.2	-6.6	-2.2	-0.6	-0.3	0.2
Structural balance (percent of potential GDP)	-2.2	-5.9	-1.6	-0.2	0.3	0.5
Gross sovereign-issued debt 4/	27.8	36.0	38.0	36.6	34.8	32.6
Net core Crown debt 5/	13.9	20.0	24.2	26.2	25.5	25.9
Net worth (Core Crown) 6/	23.2	17.4	11.1	12.0	11.4	11.5
Nominal GDP (in billions of NZ dollars)	192.5	200.9	209.7	213.2	231.0	241.5

Source: New Zealand Treasury. The data on cyclically adjusted balance, structural balance and structural residual cash balance in this table are based on the IMF's Staff calculations and methodology.

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

2/ Includes use of goods and services.

3/ Includes currency, deposits and equities.

4/ Excluding Reserve Bank Settlement cash.

5/ Excluding NZ Superannuation Fund and advances.

6/ Includes financial assets of NZ Superannuation Fund.

Table 2c. New Zealand: Central Government Balance Sheet, 2009/10-2014/15

(In billions of New Zealand dollars)

	2009/10	2010/11	2011/12	2012/13	2013/14 Proj.	2014/15 Proj.
Net worth	91.8	77.8	57.0	65.6	67.3	70.4
Nonfinancial assets	84.5	84.8	86.3	88.5	91.4	93.3
Net Financial Worth	7.3	-7.0	-29.3	-22.9	-24.1	-22.9
Financial Assets	102.7	122.1	114.4	113.0	109.4	105.9
Currency and deposits	12.7	20.5	16.5	15.0	9.8	9.0
Debt securities	20.2	21.3	25.3	24.2	25.9	21.4
Loans	10.5	11.4	12.1	11.9	12.3	12.6
Equity and inv. fund shares	45.7	48.2	39.8	42.0	42.8	44.9
Other financial assets	13.7	20.8	20.7	20.0	18.7	18.0
Liabilities	95.4	129.0	143.8	135.9	133.5	128.8
Currency and deposits	5.4	7.4	6.8	6.4	5.9	5.7
Debt securities and loans	44.0	62.6	70.6	68.4	71.5	69.8
Insurance and pension liabilities	9.9	10.2	13.5	11.9	10.9	10.5
Other liabilities	36.0	48.9	52.8	49.2	45.2	42.8
Memorandum items:						
Net financial worth (in % of GDP)	3.8	-3.5	-14.0	-10.7	-10.4	-9.5
Financial assets (in % of GDP)	53.4	60.8	54.6	53.0	47.4	43.9
Liabilities (in % of GDP)	49.5	64.2	68.6	63.7	57.8	53.3
Nominal GDP	192.5	200.9	209.7	213.2	231.0	241.5

Source: New Zealand Treasury. The data in this table are based on the IMF's Staff calculations, methodology, and coverage for the central government.

Table 3. New Zealand: Balance of Payments and External Debt, 2009–13

(In percent of GDP)

	2009	2010	2011	2012	2013
Current account balance	-2.3	-2.3	-2.9	-4.1	-3.3
Goods balance	0.9	1.5	1.4	0.1	0.6
Exports, f.o.b.	21.4	22.4	23.6	22.2	22.0
Imports, f.o.b.	-20.5	-20.9	-22.2	-22.2	-21.4
Services balance	1.4	1.0	0.7	0.6	0.5
Receipts	8.5	8.0	8.0	7.7	7.3
Payments	-7.2	-7.0	-7.3	-7.1	-6.8
Income balance	-4.3	-4.8	-4.9	-4.6	-4.3
Receipts	2.9	3.2	3.2	3.4	3.3
Payments	-7.1	-7.9	-8.2	-7.9	-7.6
Transfers balance	0.2	0.0	-0.1	-0.2	-0.2
Receipts	1.0	0.7	0.6	0.6	0.6
Payments	-0.8	-0.7	-0.8	-0.9	-0.8
Capital and financial account balance	1.1	3.9	5.9	2.2	1.7
Capital account (net)	0.3	2.5	6.5	-0.2	-0.2
Financial account (net)	0.7	1.4	-0.7	2.5	1.9
Direct investment (net)	0.6	0.0	1.0	1.6	1.3
Outward	0.9	-0.3	-1.6	0.3	0.1
Inward	-0.3	0.3	2.5	1.3	1.2
Portfolio investment (net)	1.1	2.5	2.0	2.5	2.1
Assets	-3.2	-1.0	-0.5	-3.0	-3.6
Equity securities	-1.9	-0.8	0.4	-1.2	-1.0
Debt securities	-1.4	-0.2	-0.9	-1.8	-2.5
Liabilities	4.3	3.6	2.6	5.5	5.6
Equity securities	0.8	-0.2	1.0	0.3	0.8
Debt securities	3.5	3.8	1.5	5.2	4.8
Other investment (net)	-1.0	-1.1	-3.7	-1.6	-1.5
Assets	-3.3	-2.2	-3.3	0.9	0.4
Liabilities	2.4	1.0	-0.3	-2.6	-1.8
Net errors and omissions 1/	1.1	-1.6	-3.0	1.9	2.1
Overall balance	-0.1	0.0	0.0	0.0	0.4
(Assets and liabilities as of end-December)					
Gross external debt	131.3	129.8	127.4	123.9	112.5
Short-term (less than one year on residual maturity basis)	58.3	51.5	50.6	49.5	42.1
Long-term	73.0	78.3	76.8	74.4	70.5
Gross external debt	131.3	129.8	127.4	123.9	112.5
Of which: Denominated in New Zealand dollars	65.3	67.6	72.1	73.4	70.2
Gross external debt	131.3	129.8	127.4	123.9	112.5
Public sector	12.3	16.6	17.6	19.4	20.6
Private sector	119.0	113.3	109.8	104.5	91.9
Net international investment position 2/	-81.8	-75.4	-72.9	-72.6	-66.6
Net equity	1.7	3.4	-0.7	-1.6	-0.1
Net debt	-83.5	-78.8	-72.2	-71.0	-66.6
Gross official reserves	11.5	11.0	11.6	11.2	11.2
Gross reserves in months of future imports of g&s	9.3	8.8	9.8	10.0	10.8
Gross reserves as percent of short-term debt	19.6	21.4	23.0	22.6	26.6

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

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

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

Table 4. New Zealand: Balance of Payments and External Debt, 2009–13

(In billions of U.S. dollars)

	2009	2010	2011	2012	2013
Current account balance	-2.7	-3.2	-4.7	-7.0	-6.1
Goods balance	1.1	2.1	2.3	0.1	1.2
Exports, f.o.b.	25.6	31.9	38.4	37.9	40.0
Imports, f.o.b.	-24.5	-29.8	-36.1	-37.8	-38.8
Services balance	1.6	1.4	1.2	1.0	0.9
Receipts	10.2	11.4	13.1	13.1	13.3
Payments	-8.6	-10.0	-11.9	-12.2	-12.3
Income balance	-5.1	-6.8	-7.9	-7.8	-7.7
Receipts	3.5	4.5	5.3	5.7	6.0
Payments	-8.5	-11.3	-13.3	-13.5	-13.8
Transfers balance	0.2	0.0	-0.2	-0.4	-0.4
Receipts	1.2	1.0	1.0	1.0	1.0
Payments	-1.0	-1.0	-1.2	-1.5	-1.5
Capital and financial account balance	1.3	5.5	9.5	3.8	3.1
Capital account (net)	0.4	3.5	10.6	-0.4	-0.3
Financial account (net)	0.9	2.0	-1.1	4.2	3.4
Direct investment (net)	0.7	0.0	1.6	2.7	2.4
Outward	1.0	-0.4	-2.5	0.5	0.2
Inward	-0.3	0.4	4.1	2.2	2.2
Portfolio investment (net)	1.3	3.6	3.3	4.3	3.7
Assets	-3.9	-1.5	-0.9	-5.0	-6.5
Equity securities	-2.2	-1.1	0.6	-2.0	-1.9
Debt securities	-1.6	-0.3	-1.5	-3.1	-4.6
Liabilities	5.1	5.1	4.1	9.3	10.2
Equity securities	0.9	-0.3	1.6	0.4	1.5
Debt securities	4.2	5.4	2.5	8.9	8.7
Other investment (net)	-1.1	-1.6	-5.9	-2.8	-2.7
Assets	-4.0	-3.1	-5.4	1.6	0.7
Liabilities	2.9	1.5	-0.5	-4.4	-3.4
Net errors and omissions 1/	1.3	-2.3	-4.9	3.2	3.8
Overall balance	-0.1	0.1	0.0	0.0	0.8
(Assets and liabilities as of end-December)					
Gross external debt	178.5	197.4	202.1	213.9	204.3
Short-term (less than one year on residual maturity basis	79.3	78.3	80.3	85.4	76.4
Long-term	99.2	119.1	121.8	128.5	128.0
Gross external debt	178.5	197.4	202.1	213.9	204.3
Of which: denominated in New Zealand dollars	88.7	102.8	114.4	126.8	127.6
Gross external debt	178.5	197.4	202.1	213.9	204.3
Public sector	16.7	25.2	27.9	33.5	37.4
Private sector	161.8	172.2	174.2	180.4	166.9
Net international investment position 2/	-111.2	-114.6	-115.7	-125.3	-121.0
Net equity	2.2	5.1	-1.1	-2.8	-0.2
Net debt	-113.5	-119.8	-114.6	-122.6	-120.9
Gross official reserves	15.6	16.7	18.5	19.3	20.3
RBNZ net short position in forex swaps	7.4	9.3	10.4	0.0	0.0
RBNZ net open foreign currency position	2.5	2.1	1.7	0.0	0.0
U.S./New Zealand exchange rate (e.o.p.)	0.7	0.8	0.8	0.8	0.8
U.S./New Zealand exchange rate (period average)	0.6	0.7	0.8	0.8	0.8

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

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

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

Table 5. New Zealand: Medium-Term Scenario, 2013–19

	Average		Projections					
	2001-12	2013	2014	2015	2016	2017	2018	2019
Real growth (percent change)								
GDP (production basis)	2.5	2.7	3.5	2.9	2.5	2.5	2.5	2.5
GDP (expenditure basis)	2.5	2.5	3.6	2.8	2.6	2.4	2.5	2.5
Final domestic demand	3.1	4.3	4.8	3.6	2.7	2.4	2.5	2.5
Consumption	3.1	2.8	2.9	2.5	2.2	2.1	2.2	2.2
Private consumption	3.2	3.4	3.5	3.0	2.6	2.5	2.5	2.5
Government consumption	2.8	0.9	0.5	0.4	0.6	0.7	0.8	0.8
Fixed investment	3.3	9.4	11.2	6.9	4.3	3.2	3.2	3.3
Changes in inventories 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	2.8	0.9	1.7	2.4	2.3	2.2	2.2	2.2
Imports of goods and services	5.0	6.2	5.0	4.7	2.7	2.1	2.2	2.2
Net exports (contribution to growth)	-0.6	-2.0	-1.4	-1.0	-0.4	-0.2	-0.1	-0.2
Saving and investment (percent of GDP)								
Gross capital formation	21.8	21.2	21.9	23.1	23.6	23.8	24.0	24.2
Fixed investment	21.2	20.4	21.7	22.9	23.4	23.6	23.8	24.0
Fixed investment excluding earthquakes	21.9	20.2	20.4	21.2	21.7	22.0	22.8	23.0
Changes in inventories	0.6	0.7	0.2	0.2	0.2	0.2	0.2	0.2
National saving 2/	17.8	17.8	18.6	18.4	18.2	18.0	18.0	18.2
Private	13.2	14.0	14.6	13.4	12.4	12.6	13.0	12.2
Public	4.5	3.8	4.0	5.0	5.8	5.4	5.0	6.0
Inflation and unemployment (percent)								
Headline CPI inflation (period average)	2.6	1.1	1.8	2.2	2.1	2.0	2.0	2.0
Headline CPI inflation (end of period)	2.5	1.6	2.2	2.1	2.0	2.0	2.0	2.0
Unemployment rate	5.1	6.2	5.6	5.1	5.0	5.0	5.0	5.0
Output gap (staff estimate)	-0.1	0.1	0.7	0.2	0.1	0.0	0.0	0.0
Central government budget (percent of GDP) 3/								
Revenue	36.4	35.2	34.9	34.6	34.7	35.0	35.2	35.2
Expenditure	35.3	35.9	35.2	34.1	33.7	33.2	32.2	32.2
Net lending (+)/borrowing (–)	1.1	-0.7	-0.3	0.5	1.0	1.7	3.0	3.0
Operating balance before gains and losses	0.5	-2.1	-1.5	-0.3	0.3	0.7	0.8	1.8
Gross debt	26.2	36.6	34.8	32.6	32.8	33.5	29.8	25.5
Net debt (financial assets excl. NZS Fund & Advances)	14.8	26.2	25.5	25.9	25.1	23.5	21.2	17.3
Stuctural balance (percent of potential GDP)	-0.7	-0.2	0.3	0.5	1.2	1.8	3.0	3.2
Cyclically adjusted balance (percent of potential GDP)	-0.9	-0.6	-0.3	0.2	1.0	1.7	3.0	3.2
Terms of trade (2002=100, goods and services)	112.0	128.2	129.8	126.5	125.6	125.6	125.1	124.8
Terms of trade (2002=100, goods)	112.4	130.1	132.3	128.8	128.0	127.7	127.1	126.6
Terms of trade (percent change, goods)	1.9	8.9	1.7	-2.6	-0.6	-0.2	-0.5	-0.3
Balance of payments (percent of GDP)								
Current account balance	-4.2	-3.3	-3.3	-4.6	-5.4	-5.8	-6.0	-6.0
Balance on goods and services	1.2	1.2	1.5	0.2	-0.1	-0.1	-0.2	-0.2
Balance on goods	-0.3	0.6	1.4	0.5	0.1	0.1	0.1	0.1
Balance on services	1.6	0.5	0.1	-0.3	-0.3	-0.2	-0.2	-0.3
Balance on income and transfers	-5.4	-4.5	-4.8	-4.8	-5.3	-5.7	-5.8	-5.8
Balance on income	-5.6	-4.3	-4.6	-4.7	-5.1	-5.5	-5.6	-5.6
Balance on transfers	0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Net foreign liabilities (percent of GDP) 4/	74.0	66.6	66.4	69.0	72.2	75.7	79.3	82.7
Gross external debt (percent of GDP) 4/	119.4	112.5	112.3	114.3	116.8	119.5	122.2	124.8
Nominal GDP (in billions of New Zealand dollars)	170.3	221.4	237.0	247.6	258.8	270.1	282.0	294.4
Partners' GDP growth	4.1	3.2	3.6	3.8	3.7	3.7	3.7	3.7

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

1/ Contribution in percent of GDP.

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

3/ Fiscal years ending June 30.

4/ Data for end-December.

Table 6. New Zealand: Indicators of External and Financial Vulnerability, 2009–13
(In percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013
External indicators					
Real exports of goods and services (percent change)	2.0	3.4	2.5	2.2	0.9
Real imports of goods and services (percent change)	-14.4	10.8	7.0	2.7	6.2
Terms of trade (goods; percent change)	-10.1	10.3	4.6	-6.7	8.9
Current account balance	-2.3	-2.3	-2.9	-4.1	-3.3
Capital and financial account balance	1.1	3.9	5.9	2.2	-0.7
Of which:					
Net portfolio investment	1.1	2.5	2.0	2.5	-1.5
Net direct investment	0.6	0.0	1.0	1.6	0.2
Total reserves (in billions of New Zealand dollars)	21.6	21.7	22.1	21.4	19.9
In months of imports of goods and services	9.3	8.8	9.0	9.1	8.7
Net foreign liabilities	81.8	75.4	72.9	72.6	66.6
Net foreign equity liabilities	-1.7	-3.4	0.7	1.6	-2.3
Net foreign debt liabilities	83.5	78.8	72.2	71.0	68.9
Of which:					
Net external public sector debt	-4.1	-1.9	1.9	5.4	5.0
Net external private sector debt	87.6	80.7	70.4	65.7	60.5
Investment income balance to exports (in percent)	-14.2	-15.7	-15.4	-15.2	-14.5
Nominal effective exchange rate (percent change)	-7.5	9.3	3.2	4.6	4.0
Financial market indicators					
General government gross debt	11.9	16.0	20.4	24.3	22.5
Interest rates (percent end-year)					
3-month T-bill	3.0	3.0	2.8	2.7	2.7
3-month T-bill, real	0.9	0.7	-1.2	1.6	1.5
Stock market index (percent change, end-year)	6.6	2.4	-1.6	24.9	16.5
Capital adequacy (in percent)					
Regulatory capital to risk-weighted assets 1/	12.6	12.8	13.3	13.1	12.4
Tier I capital to risk-weighted assets 1/	9.5	9.8	10.6	11.5	11.3
Asset quality (in percent)					
Nonperforming loans to total loans 2/	1.7	2.1	1.7	1.6	1.2
Provisions to impaired assets 1/	31.4	30.3	31.5	36.9	34.5
Asset composition (share of total)					
Agricultural	15.7	15.8	15.5	15.8	15.6
Business	24.8	24.2	24.3	24.0	23.7
Households	59.5	60.1	60.2	60.2	60.7
Of which: Housing	55.0	55.7	55.8	55.9	56.5

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

1/ Data for 2013 are for end-June.

2/ Data for 2013 are for end-September.

Annex I. New Zealand Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2002-2010 [2/]	2011	2012	2013	2014	2015	2016	2017	2018
Nominal gross public debt	23.7	37.0	37.5	35.9	33.3	32.1	32.6	31.2	27.3
Public gross financing needs	3.5	5.1	1.8	0.7	0.1	-0.7	-0.8	0.1	-0.6
Real GDP growth (in percent)	2.5	1.9	2.6	2.7	3.5	2.9	2.5	2.5	2.5
Inflation (GDP deflator, in percent)	2.6	2.3	-0.3	2.7	4.4	1.7	1.9	1.6	1.7
Nominal GDP growth (in percent)	5.2	4.2	2.2	5.1	7.8	4.8	4.5	4.2	4.2
Effective interest rate (in percent) [4/]	6.0	4.6	4.1	4.1	4.2	4.4	4.6	4.7	4.8

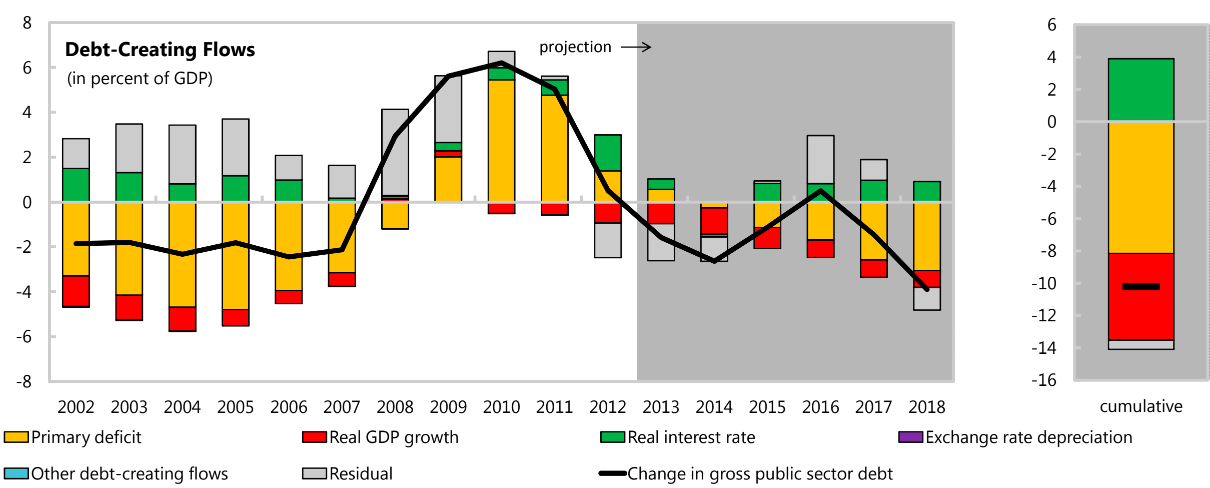
As of February 03, 2014

Sovereign Spreads	
EMBIG (bp) 3/	196
5Y CDS (bp)	47

Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AAA	AAA
Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.3	5.0	0.5	-1.6	-2.6	-1.1	0.5	-1.5	-3.9	-10.2	
Identified debt-creating flows	-1.8	4.9	2.0	0.1	-1.6	-1.2	-1.6	-2.4	-2.9	-9.6	
Primary deficit	-2.0	4.8	1.4	0.6	-0.3	-1.1	-1.7	-2.6	-3.1	-8.2	0.2
Primary (noninterest) revenue and grants	35.5	33.6	33.5	33.7	33.2	33.4	33.5	33.7	33.8	201.3	
Primary (noninterest) expenditure	33.5	38.3	34.9	34.2	32.9	32.2	31.8	31.1	30.7	193.1	
Automatic debt dynamics [5/]	0.2	0.1	0.7	-0.5	-1.3	-0.1	0.0	0.2	0.2	-1.5	
Interest rate/growth differential [6/]	0.2	0.1	0.7	-0.5	-1.3	-0.1	0.0	0.2	0.2	-1.5	
Of which: real interest rate	0.8	0.7	1.6	0.5	-0.1	0.8	0.8	1.0	0.9	3.9	
Of which: real GDP growth	-0.6	-0.6	-0.9	-1.0	-1.2	-0.9	-0.8	-0.8	-0.7	-5.4	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General government net privatization pr	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	
Please specify (2) (e.g., ESM and Euroare	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	2.1	0.2	-1.5	-1.7	-1.1	0.1	2.1	0.9	-1.0	-0.6	



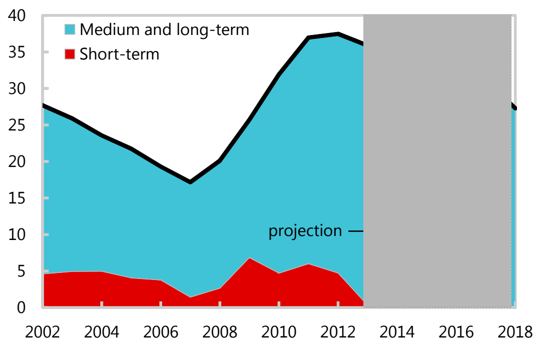
Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ Long-term bond spread over U.S. bonds.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times 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 - π (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.

Annex I. New Zealand Public DSA - Composition of Public Debt and Alternative Scenarios (Concluded)

Composition of Public Debt

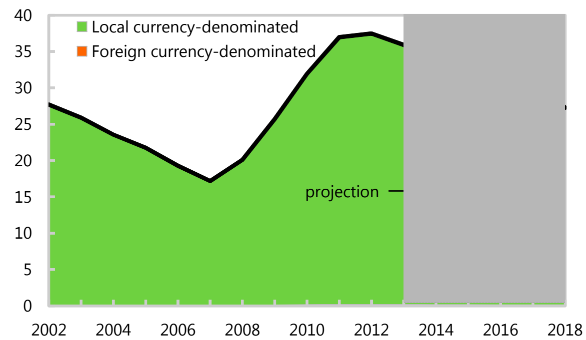
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

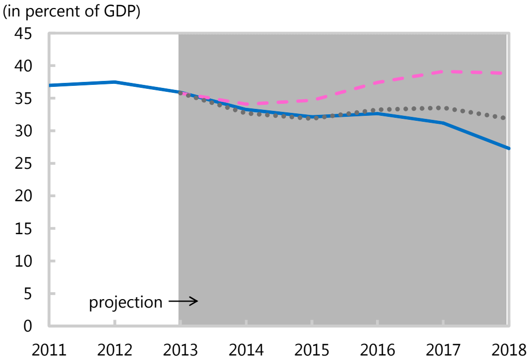


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

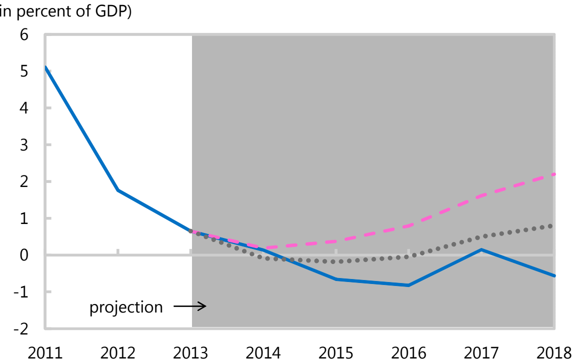
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

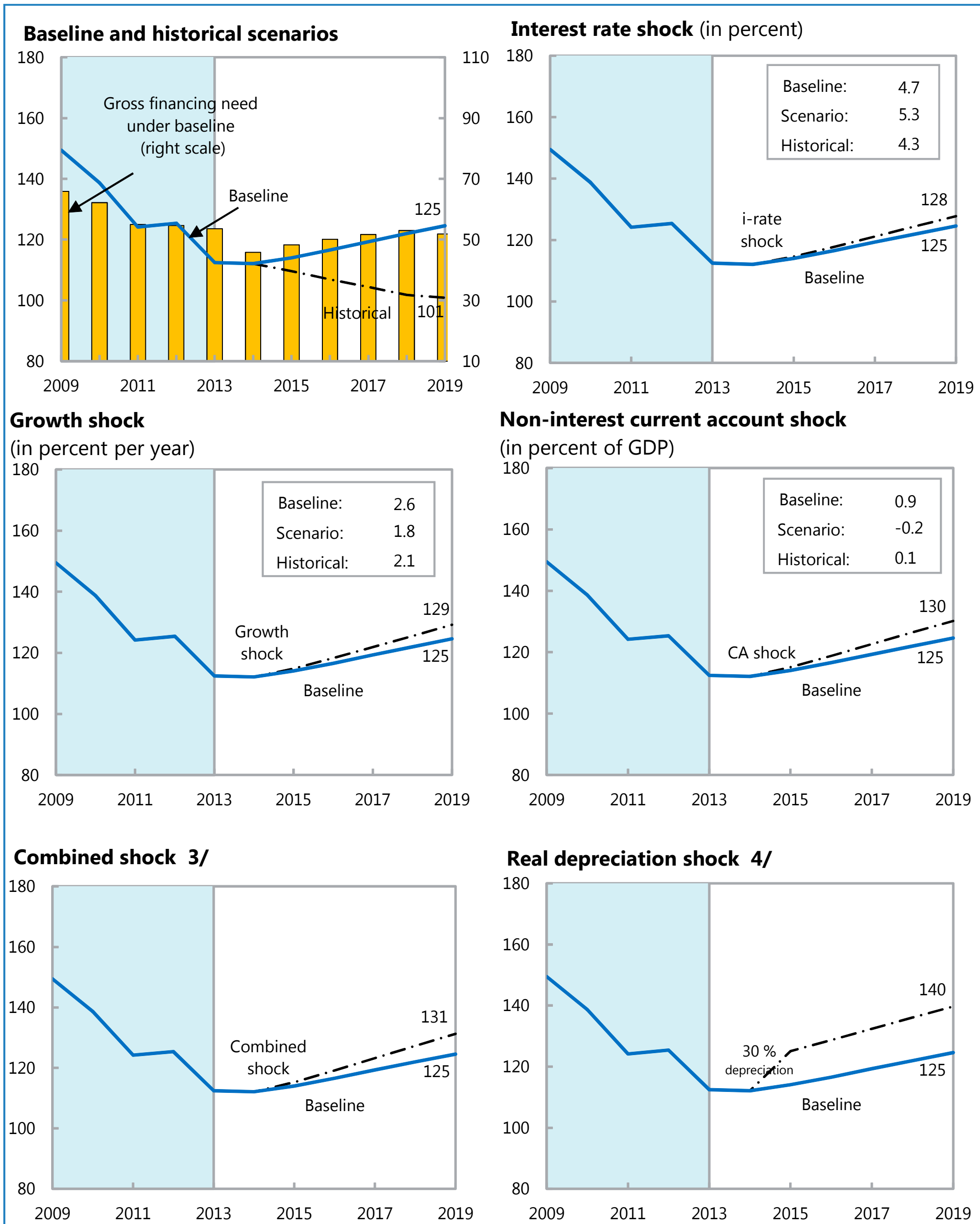
Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	2.7	3.5	2.9	2.5	2.5	2.5
Inflation	2.7	4.4	1.7	1.9	1.6	1.7
Primary Balance	-0.6	0.3	1.1	1.7	2.6	3.1
Effective interest rate	4.1	4.2	4.4	4.6	4.7	4.8
Constant Primary Balance Scenario						
Real GDP growth	2.7	3.5	2.9	2.5	2.5	2.5
Inflation	2.7	4.4	1.7	1.9	1.6	1.7
Primary Balance	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	4.1	4.2	4.3	4.8	4.8	4.6

Historical Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	2.7	2.2	2.2	2.2	2.2	2.2
Inflation	2.7	4.4	1.7	1.9	1.6	1.7
Primary Balance	-0.6	0.8	0.8	0.8	0.8	0.8
Effective interest rate	4.1	4.2	4.4	4.7	4.8	4.9

Source: IMF staff.

Annex II. 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 2013. This scenario assumes foreign exchange hedging effectively covers 90 percent of New Zealand's foreign currency-denominated debt, consistent with the findings of the RBNZ paper, "Sudden stops, external debt and the exchange rate" (RBNZ Bulletin Vol. 74 No.4, 2011).

Annex III. New Zealand: Main Recommendations of the 2013 Article IV Consultation

Fund Recommendations	Policy Actions
Fiscal policy: Staff regarded the pace of deficit reduction as striking the right balance between sustaining aggregate demand and limiting public debt growth. Withdrawing the fiscal stimulus at the right time makes room for the expanding private sector; reduces pressure on monetary policy; creates fiscal space for the future aging and health care costs; and helps raising national savings.	Supported by healthy output growth the government's aim of reducing the budget deficit is going according to plan. The deficit is projected to decline to less than ½ percent by 2014 due to restraint in expenditure growth including better targeting of social spending. The government just concluded selling stakes in state-owned enterprises.
Monetary policy: Staff supported the accommodative monetary stance, but warned that it would require changes if house price and credit expansion began to fuel excessive consumption spending and inflationary pressures.	Macroeconomic policies are moving in the right direction. With excess capacity largely exhausted the RBNZ has begun tightening monetary policy by increasing the policy rate from 2½ to 3 percent.
Financial sector policy: Staff agreed with the authorities' assessment that banks remain sound, and that stress tests show that the major banks would be able to withstand a sizeable shock to output, terms of trade, rising unemployment, and a fall in property prices. Staff supported the view that the macro-prudential measures would limit the risks in the housing market by allowing the RBNZ to guard against a loosening of bank lending standards.	In response to house price inflation and to boost financial sector resilience the RBNZ took a number of prudential measures including requirements for banks to hold higher levels of capital against their high loan-to-value (LVR) housing exposure and tight limits on lending above the 80 percent LVR threshold.

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 19, 2014

Prepared By: Asia and Pacific Department (In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of April 30, 2014)

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

General Resources Account:	SDR Million	Percent Quota
Quota	894.60	100.00
Fund Holdings of Currency	582.31	65.09
Reserve position in Fund	312.34	34.91
Lending to the Fund		
New Arrangements to Borrow	83.98	

SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	853.76	100.00
Holdings	812.13	95.12

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to Fund [1/]

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/Interest	0.04	0.06	0.06	0.06	0.06
Total	**0.04**	**0.06**	**0.06**	**0.06**	**0.06**

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 2013 Article IV consultation discussions were held during March 8-18, 2013; the Executive Board discussed the staff report (IMF Country Report No. 13/117) and concluded the consultation on May 13, 2013.

FSAP Participation and ROSCs:

FSAP mission took place during October 30–November 18, 2003. The FSSA and the Detailed Assessments of Observance of IOSCO Objectives and Principles of Securities Regulation and FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism were published under Country Reports No. 04/126, No. 04/417, and No. 05/284, respectively.

Technical Assistance: None

STATISTICAL ISSUES

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).

Table of Common Indicators Required for Surveillance
(As of May 2, 2014)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	5/2/14	5/2/14	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	3/14	4/29/14	M	M	M
Reserve/Base Money	3/14	4/29/14	M	M	M
Broad Money	3/14	4/29/14	M	M	M
Central Bank Balance Sheet	3/14	4/29/14	M	M	M
Consolidated Balance Sheet of the Banking System	3/14	4/29/14	M	M	M
Interest Rates[2]	5/2/14	5/2/14	D	D	D
Consumer Price Index	Q1 2014	4/16/14	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q4 2013	3/14/14	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2/14	4/8/14	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2/14	4/8/14	M	M	M
External Current Account Balance	Q4 2013	3/19/14	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2013	3/19/14	Q	Q	Q
GDP/GNP	Q4 2013	3/20/14	Q	Q	Q
Gross External Debt	Q4 2013	3/19/14	Q	Q	Q
International Investment Position[6]	Q4 2013	3/19/14	Q	Q	Q

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

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 14/271
FOR IMMEDIATE RELEASE
June 9, 2014

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

IMF Executive Board Concludes 2014 Article IV Consultation with New Zealand

On June 5, 2014, 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.[2]

The economic expansion is becoming increasingly embedded and broad-based, with growth exceeding 3 percent in the second half of 2013. The drivers include supportive financial conditions, record high export commodity prices, resurgent construction activity related to the Canterbury post-earthquake rebuild and general housing shortages, and a substantial increase in net immigration. Business and consumer confidence indicators have risen to the highest levels since the global financial crisis. The labor market continues to strengthen with the unemployment rate falling to 6 percent despite increasing labor force participation.

With the high exchange rate damping tradable price inflation, headline inflation has remained below the mid-point of the target band but underlying pressures may be building. Nominal wage inflation has so far remained subdued. Nevertheless, house prices appear elevated by historical and international comparisons and most measures of affordability.

Strong terms of trade have narrowed the 2013 current account deficit to 3¼ percent of GDP. Net foreign liabilities remain high at 67 percent of GDP ay end-2013. The current account deficits

[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] Article IV consultations are concluded without a Board meeting when the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact; (iii) in the event a parallel program review is being completed, it is also being completed on a lapse-of-time basis; and (iv) the use of Fund resources is not under discussion or anticipated.

are projected to widen in the medium term, partly related to the post-earthquake reconstruction investment.

After keeping the policy rate at 2½ percent for almost three years, the Reserve Bank of New Zealand (RBNZ) began tightening monetary policy in March 2014 and has raised the policy rate to 3 percent. The RBNZ also indicates that it expects to increase the policy rate steadily over the next two years.

In response to house price inflation and to boost financial sector resilience the RBNZ last year took a number of prudential measures including requirements for banks to hold higher levels of capital against their high loan-to-value (LVR) housing exposure and tight limits on lending above 80 percent LVR threshold. The result has been a sharp reduction in high LVR lending.

Supported by healthy output growth, the government's aim of reducing the budget deficit is going according to plan. The deficit is currently projected to decline almost ½ percent of GDP to less than ½ percent of GDP this year due to restraint in expenditure growth. The plan would reduce public debt from its peak of 26 percent of GDP in 2013 to about 20 percent by 2018. The government just concluded selling stakes in state-owned enterprises, which generated proceeds of about 2 percent of GDP.

Financial system remains sound. The banks are well capitalized—all comfortably meet the new Basel III minimum capital requirement—and liquidity buffers are solid. Non-performing loan ratios are low and declining. Banks continue to shift toward more stable funding sources, and use of offshore borrowing has been reduced and is of longer maturity.

Growth is forecast to increase to about 3½ percent this year and moderate to a trend rate of 2½ percent over the medium term. Strong construction activity is expected to remain an important driver for near-term growth. The terms of trade are projected to ease somewhat due to an assumed moderation in global dairy prices, but remain high relative to historical levels and continue to boost growth in national income. With the economy set to grow above trend in the near-term, pressure on core inflation should follow, particularly from the construction sector.

Executive Board Assessment

In concluding the 2014 Article IV consultation with New Zealand, Executive Directors endorsed the staff's appraisal as follows:

The economic expansion is becoming increasingly embedded and broad-based. Headline inflation has remained subdued, but with the economy set to continue to grow above trend in the near term, pressures on core inflation should follow. The key external risk to the outlook remains a sharp slowdown in growth in China, which would affect New Zealand directly through the terms of trade and indirectly through its impact on Australia, a key trading partner. Bouts of financial market volatility could also lead to widespread contagion and raise the cost of New Zealand banks' offshore borrowing. Domestically, house price inflation remains high and there remains a risk of house price overshooting and accompanying vulnerabilities.

Staff welcomes the Reserve Bank's shift toward a policy of withdrawing monetary stimulus, with the clear signal that rates would be increased further over the next two years. In addition to the longer-term benefits, deficit reduction will play an important role in supporting monetary policy through the current cycle, allowing for lower interest rates than would otherwise be the case and reducing pressure on the exchange rate.

New Zealand's large net external liabilities, although relatively stable, are a longstanding source of risk and reflect several decades of low household savings rates. Given a structural savings-investment imbalance, reducing pressure on the exchange rate and limiting current account deficits in a lasting way will require addressing the reasons for low savings, rather than being the task of short-term macroeconomic management. Aside from these structural factors, there are a number of short-term factors contributing to the currently overvalued exchange rate, including historically high terms of trade and an appetite for relatively safe New Zealand assets. If global monetary conditions were to become less stimulatory, the exchange rate would likely depreciate over time, reducing the current account deficit over the medium term.

With public debt relatively low and interest rates above the zero bound, the authorities have monetary and fiscal policy space to respond to shocks, and the free-floating New Zealand dollar provides an additional cushion against terms of trade and other external shocks. Restrictions on riskier mortgage lending introduced in October should help reduce the likelihood of an unsustainable acceleration in house price inflation, although it is still too early to assess their full impact. Over the longer term, policies to address housing supply constrains will continue to play an important role in containing price pressures and increasing affordability.

Banks remain sound, and recent stress tests show that the major banks would be able to withstand a sizeable shock to output, terms of trade, rising unemployment, and a fall in property prices. Nevertheless the banks face longstanding structural issues that will remain sources of risk over the medium term, including reliance on offshore borrowing. The recently introduced macro-prudential policy measures provide additional tools to safeguard financial sector resilience. These tools should be viewed as a complement to macroeconomic and micro-prudential measures. They should be used infrequently, with caution, and with the primary objective of limiting the buildup of system-wide risk.

New Zealand: Selected Economic and Financial Indicators, 2009-14

Nominal GDP (2013): US$181.7billion — Per capita GDP (2013): US$40,539

Population (2013): 4.4 million — Quota: SDR 894.6 million

	2009	2010	2011	2012	2013	2014 Proj.
Real growth (percent change)						
GDP (production basis)	-1.4	2.1	1.9	2.6	2.7	3.5
Final domestic demand	-3.2	2.0	2.7	3.2	4.3	4.8
Private consumption	-0.8	3.3	2.5	2.9	3.4	3.5
Government consumption	0.7	1.8	0.9	-1.0	0.9	0.5
Fixed investment	-11.7	-1.2	4.8	7.1	9.4	11.2
Inventories 1/	-2.1	1.9	-0.2	0.2	0.0	0.0
Exports of goods and services	2.0	3.4	2.5	2.2	2.1	1.7
Imports of goods and services	-14.4	10.8	7.0	2.7	2.6	5.0
Output gap	-1.8	-1.0	-0.8	-0.4	-0.2	0.7
Headline CPI inflation (percent change)	2.1	2.3	4.0	1.1	1.1	1.8
End of period (percent change)	2.0	4.0	1.8	0.9	1.6	2.2
Unemployment rate (period average, in percent)	6.2	6.5	6.5	6.9	6.7	5.6
Investment and saving (in percent of GDP)						
Investment	19.0	19.2	18.9	20.2	20.1	21.9
National saving 2/	16.7	17.0	16.0	16.1	14.0	18.6
Public finance (in percent of GDP) 3/						
Revenue	36.7	34.1	35.9	34.0	35.2	34.9
Expenditure	37.0	36.9	43.3	36.5	35.9	35.2
Net lending (+)/borrowing (–)	-0.2	-2.8	-7.4	-2.5	-0.7	-0.3
Operating balance before gains and losses	-2.1	-3.3	-9.2	-4.4	-2.1	-1.5
Gross debt	23.3	27.8	36.0	38.0	36.6	34.8
Net debt (financial assets excl. NZS Fund & Advances)						
Structural balance (percent of potential GDP)	0.3	-2.2	-5.9	-1.6	-0.2	0.3
Cyclically adjusted balance (percent of potential GDP)						
Money and credit (end of period)						
Resident M3 (percent change) 4/	1.8	4.8	6.9	8.0	7.3	...
Private domestic credit (percent change) 4/	1.7	0.5	1.7	3.6	5.2	...
Interest rates (period average)						
Interest rate (90-day, in percent)	3.0	3.0	2.8	2.7	2.7	...
Government bond yield (10-year, in percent)	5.5	5.6	4.9	3.7	4.1	...
Balance of payments (in percent of GDP)						
Current account	-2.3	-2.3	-2.9	-4.1	-3.3	-3.3
(In billions of New Zealand dollars)	-4.3	-4.5	-5.9	-8.7	-7.4	-7.8
Trade balance (goods)	0.9	1.5	1.4	0.1	0.6	1.4
Terms of trade (percent change)	-10.1	10.3	4.6	-6.7	8.9	1.7
Foreign assets and liabilities ($NZ billion)						
Net international investment position	-154.1	-148.7	-149.9	-152.8	-147.6	-157.3
(In percent of GDP)	-81.8	-75.4	-72.9	-72.6	-66.6	-66.4
Official reserves	21.6	21.7	22.1	21.4	19.9	...
Exchange rate (period average)						
U.S. dollar per New Zealand dollar	0.63	0.72	0.79	0.81	0.82	...
Trade-weighted index (June 1979 = 100)	60.0	66.7	69.3	72.6	76.2	...
Nominal effective exchange rate 4/	84.3	92.2	95.1	99.6	103.6	...
Real effective exchange rate 4/	86.7	94.9	98.8	102.4	105.8	...
GDP (in billions of New Zealand dollars)	188.4	197.3	205.6	210.5	221.4	237.0

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

1/ Contribution in percent of GDP.

2/ Based on national accounts data.

3/ Fiscal years ending June 30.

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