May 2004
IMF Country Report No. 04/128

New Zealand: 2004 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **February 18, 2004,** with the officials of New Zealand on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 8, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its April 30, 2004 discussion** of the staff report that concluded the Article IV consultation.

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

Financial System Stability Assessment
Selected Issues Paper

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

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

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INTERNATIONAL MONETARY FUND

NEW ZEALAND

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for
the 2004 Consultation with New Zealand

Approved by David Burton and Carlos Muñiz

April 8, 2004

- The 2004 Article IV consultation discussions were held in Auckland and Wellington between February 9–18, 2004.
- The staff team comprised Messrs. Kronenberg (Head), Salgado, Senhadji, and Zhang (all APD). Mr. Dunaway (APD), Ms. Gulde-Wolf (MFD), and Mr. Reddell (Alternate Executive Director) joined the mission for the discussions held in Wellington.
- The mission met with Minister of Finance Michael Cullen; Reserve Bank of New Zealand Governor Alan Bollard; Treasury Secretary John Whitehead; other senior government officials; and representatives of the private sector, labor unions, and academia.
- New Zealand has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. New Zealand has accepted the Fourth Amendment of the Articles of Agreement.
- New Zealand publishes an array of high-quality statistics, and the authorities are actively working to address outstanding issues that preclude subscription to the SDDS.
- The FSAP mission was conducted during October 30–November 18, 2003. The FSSA report is expected to be discussed during the 2004 Article IV consultation.

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EXECUTIVE SUMMARY

Economic Background

- **The New Zealand economy has continued to perform strongly.** Real GDP growth moderated to 3½ percent in 2003. Domestic demand remained buoyant owing to the strength in net immigration, solid employment growth, the wealth effects from rising house prices, and real income gains from the New Zealand dollar's substantial appreciation since end-2001. Net exports, however, acted as a drag on the economy. The unemployment rate declined below 5 percent to a 16-year low, while inflation fell to the lower half of the official 1–3 percent target range.

- **Growth is projected to ease further to 3 percent in 2004.** However, the outlook is subject to considerable uncertainty with the economy operating at a high level of resource utilization, slowing net immigration, continued strength in domestic demand, an improving world economy, and the specter of further currency appreciation.

Policy Discussions

- **The authorities and the Fund staff broadly agree on the settings for macroeconomic policies.** In the near term, the challenge for monetary policy will be to assess the countervailing pressures on inflation. The staff supports the Reserve Bank of New Zealand's decision to cautiously wait and watch the data to see whether further monetary policy changes are needed.

- **The fiscal position remains strong and the stance of fiscal policy is fundamentally sound.** The recent improvement in fiscal prospects provides room to introduce some new fiscal initiatives. However, as the government recognizes, the scope for additional spending is limited, and continued prudence and discipline in making expenditure decisions need to be maintained. The government has begun to take actions to address the fiscal implications of population aging, including partial pre-funding of future pension liabilities. Consideration should also be given to possible parametric reforms in the pension and health care systems.

- **Further strengthening the growth performance remains a key goal.** Government efforts in welfare and education reforms and expanding New Zealand's linkages with the rest of the world should contribute to enhancing growth.

- **New Zealand's financial sector has a high degree of short-term stability and an overall sound outlook.** The main recommendations of the Financial Sector Assessment Program aim at preserving stability in the medium and longer term in the context of the country's disclosure-based regulatory regime and the high share of foreign ownership of the banking system.

I. Recent Economic Developments and Outlook

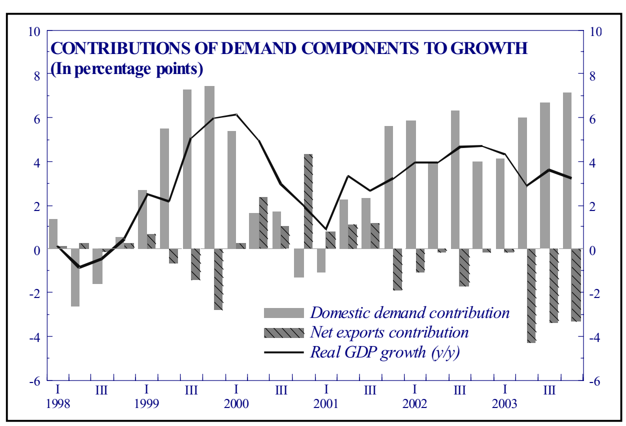
A. Introduction

1. **The New Zealand economy has performed strongly in recent years.** Despite the global slowdown and periods of drought at home, real GDP growth averaged about 3¾ percent during 1999–2003. The unemployment rate has been brought down, inflation has generally remained within the Reserve Bank of New Zealand's (RBNZ's) target range at (currently 1-3 percent average over the medium term), and the budget has recorded sizeable and growing current surpluses, resulting in a significant reduction in public sector debt. The strong economic performance reflects the ongoing benefits from the extensive structural reforms that have been implemented since the early 1980s and the continued confidence in the macroeconomic environment fostered by transparent monetary and fiscal policy frameworks. Strong net immigration flows have also buttressed the economy in recent years by increasing labor supply and spurring domestic demand—notably residential investment.

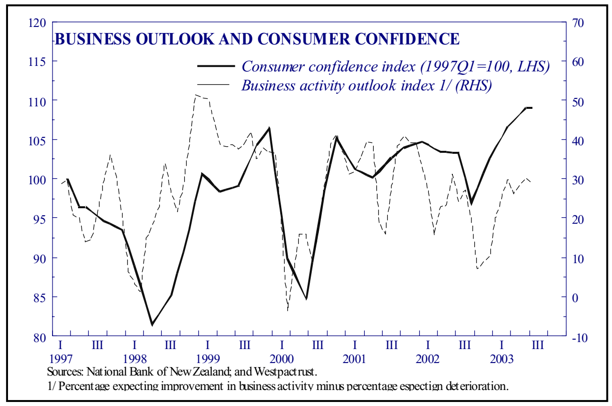
2. **At the conclusion of the 2003 Article IV consultation on April 30, 2003 (IMF Country Report No. 03/121, 5/2/03), Directors agreed with the short-term stance of macroeconomic policies and noted the significant long-term challenges posed, in part, by population aging.** They concurred with the authorities' approach to try to adopt suitable measures early on. Directors pointed to the labor market as a key area where policy changes could raise potential growth, and they encouraged the authorities to consider measures to foster greater labor force participation. Directors also saw merit in simplifying the income support system and making complementary changes in the income tax system to encourage individuals to take up employment. They considered that New Zealand continues to be well placed to manage adverse economic shocks. For their part, the authorities have taken some actions to address the fiscal implications of population aging, including a partial pre-funding of future pension liabilities. They are also looking at other policy measures to enhance the economy's growth potential, including welfare reform, improving education, and expanding New Zealand's linkages with the rest of the world.

B. Economic Developments

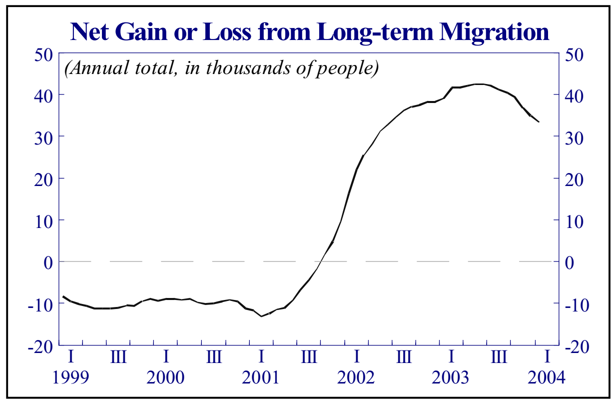
3. **Growth slowed in early 2003 but rebounded in the latter part of the year** (Figure 1 and Table 1)**.** Real GDP growth declined from 4¼ percent in 2002 to a seasonally adjusted annualized rate (SAAR) of 2¾ percent in the first half of 2003, amid heightened international geopolitical tensions, concerns about SARS, and declines in farm output and hydroelectric generation



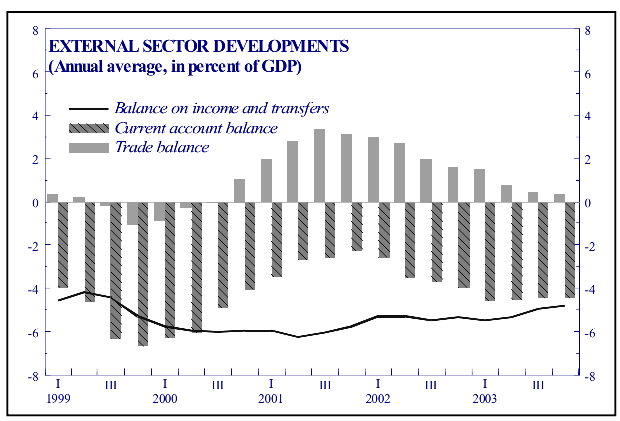
related to a drought. However, with an improved international environment and better weather conditions, output growth rebounded to over 4 percent (SAAR) in the second half of the year.



4. **Activity has been supported by buoyant domestic demand, while net exports have acted as a drag on growth.** Residential investment and household spending—especially on consumer durables—have been robust, reflecting strong income growth, real income gains from the New Zealand dollar's appreciation, the strength in net immigration, solid employment growth, wealth effects from rising house prices, lower interest rates, and financial innovation. Business investment growth has also strengthened in response to emerging capacity constraints, lower interest rates, and declining prices (in New Zealand dollars) for capital goods imports. The deterioration in net exports reflects the relative cyclical position and the continued appreciation of the New Zealand dollar.



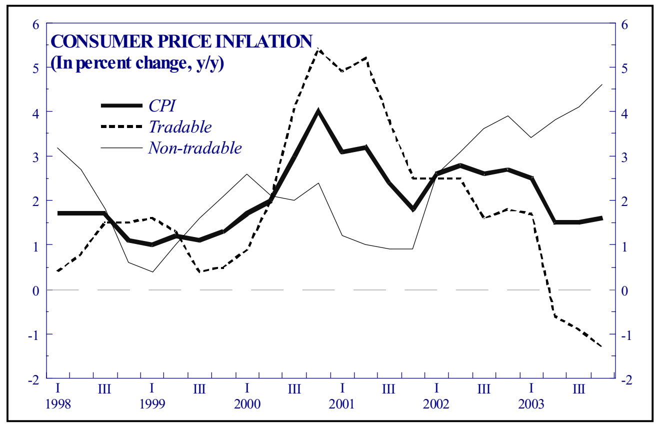
5. **Although the current account deficit has widened, external liabilities have declined relative to GDP** (Figure 2 and Table 2). The current account deficit widened from about 2½ percent of GDP in 2001—the lowest level as a share of output in more than a decade—to 4½ percent of GDP in 2003, which is back to about the historical average.[1] Deteriorations in the merchandise trade and services balances were partly offset by an improvement in net income and transfers, mostly attributable to lower global interest rates. Net external liabilities declined from their peak of 87 percent of GDP at end-1998 to 76 percent of GDP at

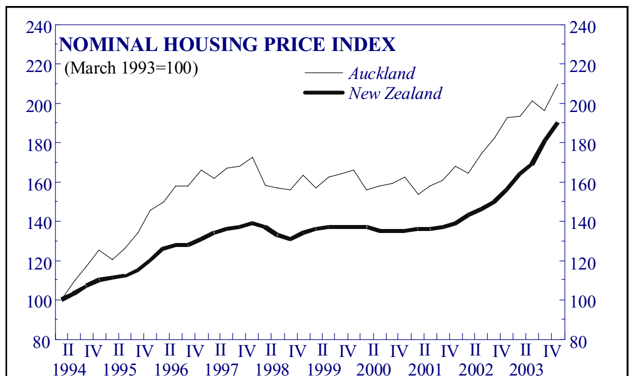


[1] The 10-year average for the current account deficit is 4.7 percent of GDP.

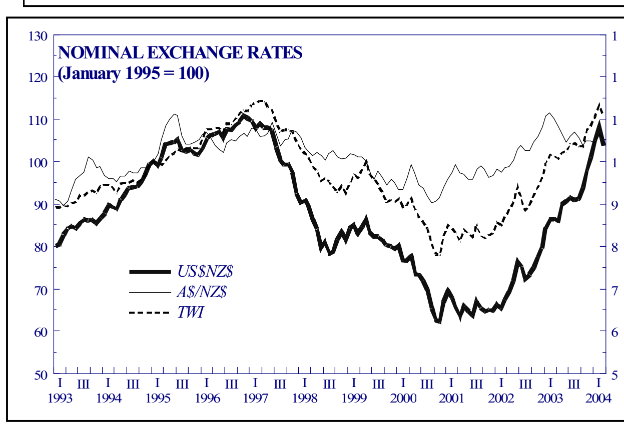
end-2003, reflecting both the strong GDP growth over this period and valuation gains from the recent appreciation of the New Zealand dollar.

6. **Strong demand conditions have led to increasing resource constraints.** With employment growth averaging over 2½ percent during 2002 and 2003, the unemployment rate declined to a 16-year low of 4.4 percent in September before rising slightly to 4.6 percent in December (Figure 3). Although businesses are reporting increased labor shortages, particularly of higher-skilled workers, measures of private sector wage growth have so far picked up only moderately. Thus, the Labor Cost Index (LCI), rose by 2.4 percent in the year to December 2003, compared to an increase of 2.2 percent in the year to December 2002. At the same time, the capacity utilization rate is at a relatively high level (see Figure 1).





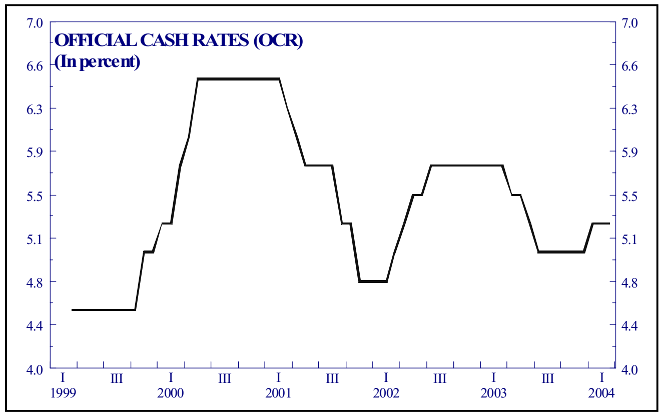
Sources: SNZ; RBNZ March MPS; and Fund staff estimates.



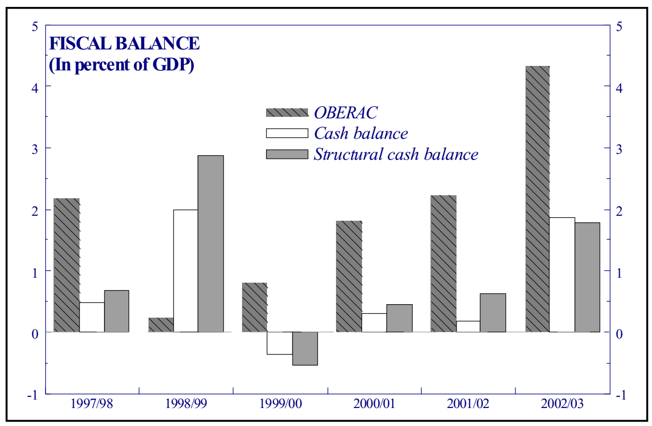
7. **Inflation has remained within the official 1–3 percent target range.** CPI inflation declined to 1½ percent in the December quarter of 2003 from 2¾ percent in 2002, and measures of core inflation have also fallen sharply (see Figure 3). Underlying the decrease in inflation, however, there were sharply divergent trends in the major components of the CPI. In particular, tradables inflation is now negative, owing to the impact of the sizable appreciation of the New Zealand dollar. In contrast, nontradables inflation has increased substantially, led by a 22 percent jump in housing prices in 2003—the highest rate in 13 years. Even excluding the housing component, nontradables price inflation is running at a 3½ percent rate.

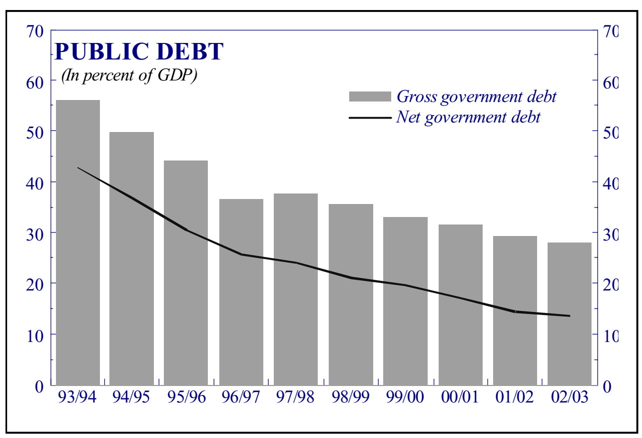
8. **The New Zealand dollar appreciated substantially during 2002 and 2003.** Since end-2001, the New Zealand dollar has risen by 58 percent vis-à-vis the U.S. dollar through end-March 2004, by 8 percent relative to the Australian

dollar, and by about 30 percent on a trade-weighted (TWI) basis (Figure 4). The TWI is now 12 percent above its 10-year average. The appreciation reflects a combination of strengthening commodity prices and the country's strong recent growth performance relative to most other developed countries, which have led to higher returns on New Zealand's assets (Box 1). Net capital inflows (including errors and omissions) have picked up over the past two years, reflecting a rise in portfolio investment.



9. **Monetary policy has successfully kept inflation in the target range.** Between April and July 2003, the RBNZ cut the official cash rate (OCR) by a total of 75 basis points in three moves—bringing the rate to 5 percent—based on its assessment that economic activity was likely to cool in response to weak external conditions, an appreciating currency, and slowing net immigration. In January 2004, the RBNZ increased the OCR by 25 basis points, when indicators of economic activity suggested that domestic demand going forward could be more robust than expected. The RBNZ left the OCR unchanged after its March 2004 meeting. In the accompanying *Monetary Policy Statement*, the Governor noted that the central bank continued to expect a slowdown in growth—easing capacity and inflation pressures—largely owing to the lagged effects of the New Zealand dollar's appreciation and reduced net immigration. However, recent activity measures remained quite robust, implying ongoing risks of price pressures. With the uncertainties in economic prospects, the RBNZ judged it appropriate at this stage to wait and see if a further increase in interest rates would be required in 2004.

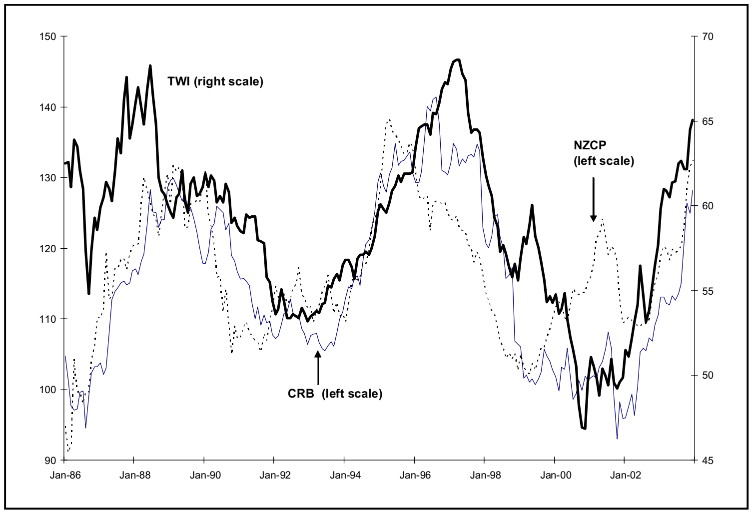




10. **The fiscal position has continued to strengthen during the past year.** The operating surplus

Box 1. New Zealand: The Exchange Rate and Commodity Prices

The New Zealand dollar has historically been regarded as a "commodity currency."[1] The trade-weighted index (TWI) of New Zealand dollar and the New Zealand Commodity Price Index (NZCP)[2] shared roughly a common trend during the late 1980s and early 1990s. However, the close correlation between the two indexes broke down in mid-1990s. The breakdown in the relationship is a puzzle and raises the possibility that New Zealand's flexible exchange rate might not be working as well as previously, as a shock absorber to offset movements in commodity prices.



Unlike the NZCP, the correlation of the New Zealand dollar exchange rate with the Commodity Research Bureau Index (CRB), a widely used index of *global* commodity prices, has remained consistently strong.[3] The tighter relationship between the exchange rate and the global commodity index, rather than the index based on New Zealand's own commodity bundle, is somewhat surprising. One possible explanation is that the global index is available in real time for currency traders and has been widely accepted and used in financial centers all over the world, while the NZCP index is much less well known in off-shore financial centers and is only published on a monthly basis with a lag of a couple of weeks.

Both the New Zealand commodity prices and the global commodity prices have been rising since the end of 2002. Two issues remain unclear. First, why has the correlation between the NZCP and the CRB indexes varied over time? Second, how important is the role of commodity prices versus other fundamentals such as interest rate differentials, and weakness of the U.S. dollar? Further research on these issues is warranted.

[1] Yu-chin Chen and Kenneth Rogoff, 2002, "Commodity Currencies and Empirical Exchange Rate Puzzles," IMF Working Paper 02/27.
[2] This commodity price index is provided by the ANZ Bank.
[3] A cointegration test indicates that the TWI is cointegrated with the CRB index but not the NZCP.

(OBERAC) nearly doubled to 4¼ percent of GDP in 2002/03 (fiscal year starting July 1), and the overall cash surplus widened to almost 2 percent of GDP (Table 3). Factors contributing to the improvement include significantly better-than-expected tax revenues, lower spending, and higher Crown entity (public enterprise) surpluses. According to staff estimates, there was a modest tightening in the fiscal stance. Gross government debt declined to 28 percent of GDP with net debt, excluding the assets held by the New Zealand Superannuation Fund (NZSF), falling to 13½ percent. [2]

C. Outlook

11. **Economic activity is expected to moderate in the near term.** Growth is projected to ease from 3½ percent in 2003 to 3 percent in 2004 and 2½ percent in 2005 (Table 4). Personal consumption is expected to slow somewhat, reflecting lower net immigration and the lagged effects of currency appreciation on exporters' incomes. Building permits and other forward indicators suggest that residential investment will remain strong in the coming months, although the pace of growth is unlikely to be as rapid as in 2003. Business investment is expected to continue to post strong growth based on the need to build additional capacity and the decline that has taken place in domestic prices for capital goods imports. Export volumes are projected to pick up on recovering international demand, although gains will be partly offset by the lagged impact of the currency's appreciation. Import volume growth is expected to slow from its very rapid pace as domestic demand growth eases. Nevertheless, the external current account deficit is forecast to increase modestly to 5 percent of GDP in 2004. Headline inflation is projected to move toward the upper end of the target range during the course of the year, reflecting some continued pressure on capacity utilization in nontradable sectors and the tight labor market.

12. **There are significant uncertainties in the near-term outlook.** At this juncture, it is unclear whether the economy will begin to execute the anticipated "soft landing" that has been expected for some time, or whether domestic demand will maintain its robust pace for a while longer before economic activity drops off more rapidly. Some signs that the economy may slow as expected have begun to emerge, with net immigration flows easing in recent months. However, there also are indicators pointing to continued short-term demand strength, and it is difficult to predict how quickly or smoothly the housing market might cool down. In addition, the prospect of further appreciation of the currency adds substantially to the uncertainties and increases the risk of a sharper slowdown in growth.

13. **Medium-term prospects remain favorable.** Beyond 2005, real GDP growth is projected to increase to an average of around 3¼ percent during 2007–09, owing mainly to a

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[2] The NZSF was created by the government to partially pre-fund the future obligations of the public pension system. The NZSF—like public pensions—is entirely funded by the government.

further, gradual improvement in net exports. The external current account deficit is forecast to decline modestly back to roughly its historical average, reflecting an unwinding of New Zealand's relative cyclical strength.[3] This would imply that the net external liability position relative to GDP increases modestly. The inflation rate is expected to be around 2 percent over the medium term.

II. Policy Discussions

14. **The authorities and the Fund staff broadly agree on the settings for macroeconomic policies in the period immediately ahead and over the medium term.** The discussions focused principally on: (i) the challenges for macroeconomic policy management in the short term; (ii) how economic policies might further enhance New Zealand's medium-term growth prospects; and (iii) financial sector policy issues in the context of the ongoing FSAP.

A. Monetary Policy and the Exchange Rate

15. **The challenge for monetary policy has been to assess the countervailing pressures on inflation.** As noted earlier, the current benign headline inflation picture reflects the offsetting influences of relatively strong domestic inflationary pressures arising from the strength of domestic demand, and weak tradable goods prices due to the sharp New Zealand dollar appreciation. While tradables prices could decline further in the short term, this might not be sufficient to keep inflationary pressures in check if domestic demand does not slow and help to ease pressure on nontradables prices.

16. **The authorities and the staff agreed that uncertainties in near-term prospects have substantially increased the difficulty in determining how to set monetary policy in the period immediately ahead.** The authorities' expectation at the time of the discussions was that some small additional tightening of monetary conditions might be needed to contain inflationary pressures. However, there was a risk that a subsequent slowdown in economic growth could be sharper than currently expected, especially if a rise in interest rates would contribute to a further appreciation of the New Zealand dollar. In general, uncertainty regarding the future path of the exchange rate is a factor significantly complicating the task of assessing the short-term outlook. In deciding in March 2004 to leave the OCR unchanged, the Governor pointed to all of the uncertainties in the economic situation as making it appropriate to wait and watch the data to see whether a further small increase in interest rates would be required this year. The staff fully supports this view.

17. **The sharp pick-up in New Zealand housing prices has raised questions of whether a housing price bubble is developing and how monetary policy should respond.**

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[3] Consistent with the World Economic Outlook practice, the real exchange rate for projection purposes is assumed to remain constant, which would be over its historical average.

The authorities' assessment of the situation, with which the staff concurs, is that the acceleration in housing prices has been driven largely by fundamental factors, such as low mortgage interest rates relative to the recent past and high net immigration, combined with the relatively long lags inherent in adjusting the housing supply to changes in demand. While some element of speculation might also be present, this does not appear to be large enough to generate a significant fallout for the general economy, particularly in view of the strong health of the financial sector. Accordingly, the authorities and the staff agreed that conditions in the housing market do not currently appear to warrant greater weight in determining monetary policy settings.[4]

18. **The rapid rise in the value of the New Zealand dollar since 2001 has been a greater source of concern.** With the nominal effective value of the currency above its long-term average and a significant appreciation of the bilateral rate with the Australian dollar, there is a concern that the exchange rate is moving out of line with the fundamental determinants of its value, although significant uncertainty remains about the level of the equilibrium exchange rate.[5] Current circumstances raised a question as to whether more reliance might be placed on fiscal policy, rather than monetary policy, in managing short-term demand pressures. There was general agreement between the authorities and the staff that the existing medium-term orientation of fiscal policy brings an important degree of predictability and transparency. The staff noted that short-term economic conditions always should be taken into account in setting fiscal policy to avoid sharp conflicts with monetary policy. However, a more active use of fiscal policy in short-term demand management did not appear feasible or desirable, owing to difficulties in carefully targeting fiscal policy and relatively long lags in implementing policy changes.

19. **New Zealand has been reviewing its policy toward foreign exchange market intervention and the level of the country's international reserves.** The floating exchange rate regime is seen as continuing to serve New Zealand well. In March 2004, the RBNZ Governor made a statement reiterating the RBNZ's longstanding policy option to intervene in the foreign exchange market if disorderly conditions were ever to occur as a result of an exceptional adverse shock. New Zealand has not significantly increased the level of its official international reserves since the mid-1980s. Given the changes that have taken place in the international economy since that time, the authorities have decided that some increase

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[4] For a more detailed discussion, see the Address by Governor Bollard to the Canterbury Employers' Chamber of Commerce in Christchurch entitled "*Asset Prices and Monetary Policy,*" delivered on January 30, 2004.

[5] In the March 2004 CGER assessment of the real effective exchange rate, the overvaluation of the New Zealand dollar was estimated to be in the range of 5 percent to 20 percent.

would be appropriate to ensure that they have adequate capacity to implement this policy.[6] The RBNZ has also stated that it would contemplate exchange market intervention if the exchange rate was viewed as being "exceptionally and unjustifiably" high or low.[7] It emphasized that interventions will in all cases be consistent with the inflation targeting framework, that the RBNZ would not defend a particular exchange rate level, and that it would not attempt to stand in the way of market trends. While modalities are still being worked out, the RBNZ Governor has stressed that he would expect that conditions calling for such intervention would be infrequent. The staff agreed that intervention could influence the exchange rate if used in such exceptional and extraordinary circumstances by potentially altering perceptions and expectations of market participants. The staff noted that this approach to intervention is in line with common practice in other industrial countries, including Australia and Canada.

B. Fiscal Policy

20. **Fiscal policy is formulated in a transparent and predictable medium-term framework, and the fiscal position is strong.** The fiscal objectives of the government call for it to run operating surpluses on average over the economic cycle sufficient to cover contributions to the New Zealand Superannuation Fund (NZSF), while meeting capital spending requirements and maintaining government debt at prudent levels. Projections in the *December Economic and Fiscal Update 2003* (DEFU) call for the OBERAC surplus to increase from 3.8 percent of GDP in 2003/04 to 4.4 percent of GDP in 2004/05 before narrowing to 3.7 percent of GDP in 2007/08.[8] Gross government debt is expected to decline to 20½ percent of GDP by 2007/08. These projections include new spending from 2004/05, which the government recently confirmed it would be in a position to accommodate within its medium-term framework in light of sustained improvements in revenue. The *2004 Budget Policy Statement* announced that the government would proceed with plans foreshadowed in the 2003 Budget to deliver a social dividend to low- and middle-income families. This Future Directions package will include some increase in direct support to these households and

[6] This is consistent with a study in the context of the ongoing FSAP which suggests that the level of reserves necessary to restore liquidity in the exchange market in the event of a severe disruption in the foreign exchange market and avoid possible systemic risks for the New Zealand economy could be significantly higher than actual reserves.

[7] "Exceptionally and unjustifiably" high or low refers to situations where the exchange rate has moved well in excess of any relevant economic fundamentals, such as relative productivity, commodity prices, growth, or inflation. In remarks announcing the RBNZ's review, the Governor noted that this approach to intervention policy is similar to that used in Australia.

[8] The fiscal impulse for 2004/05 is -0.5 percent of GDP.

measures to facilitate the transition from unemployment to work at an expected cost of about $NZ 1 billion a year, when fully implemented after three years.

21. **In the discussions, the authorities indicated that, if necessary, the timing of new spending and/or tax measures would be kept under close review and adjusted, if necessary to avoid placing undue pressure on monetary policy.** Indeed, a withdrawal of fiscal stimulus in 2004/05 is projected as the OBERAC surplus is expected to increase. The authorities also discussed the potential impact of the significant uncertainties regarding the economic outlook and buoyancy of tax revenues on the medium-term fiscal outlook. To safeguard the fiscal position, they noted that the new fiscal initiatives would be implemented when there were reasonably strong assurances that sufficient fiscal resources would be available to pay for the package's costs. The staff supported this cautious fiscal strategy and suggested that prospective fiscal resources provided the authorities with a good opportunity to enact reforms that could have a lasting effect in lifting output growth.

22. **New Zealand faces significant long-term spending pressures owing to population aging and rising healthcare costs.** Estimates by the New Zealand Treasury suggest that demographic changes alone could push government spending on pensions and healthcare from the current level of around 11 percent of GDP to some 19 percent of GDP by 2051; under alternative cost assumptions, this could rise as high as 34 percent of GDP. To help meet anticipated pension-related pressures, the government created the NZSF to pre-fund part of the future pension liabilities. While this is recognized as an important step, the staff suggested that consideration would also need to be given at some point to possible parametric reforms in the pension and health care systems to help ensure that public spending is kept on a sustainable path over the longer term. This might include measures to lower pension costs (such as further raising the retirement age and lowering or means-testing pension benefits) and to increase private contributions to healthcare (such as imposing user fees for higher-income earners). However, the authorities also noted that the long-term cost projections were still highly uncertain and that building political consensus for additional reforms remains an important challenge. Some steps were likely to be needed and they should be adopted sufficiently early to smooth fiscal costs over time, allowing individuals time to adapt their saving behavior appropriately.

23. **The NZSF, while currently small, is expected to accumulate and invest substantial assets over the next 20 years.** The government contribution is expected to rise from $NZ 1¾ billion in 2004 to around $NZ 2½ billion per year in 2010–13. With no withdrawals from the fund before 2020, the balance is expected to reach 40 percent of GDP by the mid-2030s. Management of these assets is governed by an independent Board of Guardians, which is obligated to report regularly and publicly on the performance and the asset holdings of the NZSF (governance arrangements for the NZSF are described in Box 2). The Board's basic objective is to achieve average annual long-term returns of 2½ percent above the risk free rate of return (defined as the rolling average of returns on Treasury bills), while avoiding undue portfolio risks. The current plan is for the NZSF to invest 22 percent of its assets domestically (including in listed shares, fixed interest securities, and other

Box 2. New Zealand: Governance of the New Zealand Superannuation Fund

The NZSF is governed by a Board of Guardians. The Board was created as a separate Crown entity to act at arm's length from the government and make its own operating and investment decisions. The Board must comprise at least five, but no more than seven, members who are appointed for terms of five years (eligible for reappointment). The founding six Board members were appointed in August 2002.

Board members are appointed by the Governor-General on the recommendation of the Minister of Finance, following nominations from an independent nominating committee. In making the recommendations, the Minister must consult with representatives of other political parties in Parliament. Board members are chosen mainly for their experience, training, and expertise in the management of financial investments.

The Guardians are charged with managing and administering the NZSF in a prudent and cautious manner. They are given the objective of maximizing the value of the fund's assets without subjecting it to a high degree of risk. The Guardians are responsible for establishing investment policies and standards and procedures for the Fund, including the portfolio allocation. The Guardians appoint investment managers to manage different parts of the Fund, but are not involved in allocating funds to specific securities or other assets. The Minister may give directions, which are tabled in Parliament, to the Guardians regarding the government's expectations as to the Fund's performance, but must not give any direction which is inconsistent with the duty to invest the Fund on a prudent commercial basis. The Guardians must consider these directions from the Minister. In general, governance arrangements for the NZSF are similar to best practices in governing private pension funds. In addition, provision is made for an independent assessment of the NZSF and the Guardians' performance at least every five years by a person appointed by the Minister of Finance, and this report is provided to Parliament and made publicly available.

investments such as property and private equity), with the remaining 78 percent invested abroad (60 percent in international shares). The authorities noted that a close watch would need to be kept over the fund's asset allocation and its investment strategy to ensure that the NZSF does not become too large a player in the domestic market or exert an excessive influence on macroeconomic conditions.

C. Growth and Structural Policy Issues

24. **The government's goal is to further strengthen New Zealand's growth performance so as to restore the country's per capita income ranking to the upper half of OECD countries.** The strategy to achieve this goal is outlined in the Growth and Innovation Framework (GIF), which focuses on the need to develop a more skilled labor force, improve New Zealand's links to the global economy, and strengthen innovation in order to help overcome disadvantages stemming from the country's small size and long distance from global economic centers.

25. **Promoting movement from welfare to work is one of the pillars of the government's strategy.**[9] The centerpiece of the 2004 Budget, the new Future Directions package, is expected to include measures to simplify the income support system, streamline income assistance to families, improve the targeting of disability benefits and the hardship allowance, make housing more affordable for those in hardship, and improve the provision of childcare.[10] The staff supports the basic thrust of this initiative, especially those elements of the package designed to lower high effective marginal tax rates when income support recipients make the transition to work. Steps to tighten up and strictly enforce eligibility requirements for benefits would be useful. In addition, limitations on the duration of unemployment benefits would also provide additional encouragement for people to move into employment.

26. **The government over the past year has passed or proposed a few pieces of labor legislation.** The Holiday Bill, passed in December 2003, increased annual leave from three to four weeks starting in 2007. Following a review of the Employment Relations Act (ERA), the government introduced the Employment Relations Law Reform Bill (ERLRB) in December 2003. Key objectives of the Bill are to clarify the requirement to bargain in good faith; protect low-paid service sector employees when there is a sale of a business, a transfer

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[9] New Zealand has some 400,000 working age people receiving some form of income support, about 22 percent of whom receive disability benefits.

[10] Budget 2003 introduced some modest measures, amounting to some $59 million over four years, including increases in the maximum number of subsidized childcare hours for parents entering full-time work and raising income thresholds for the Family Support, Child Tax credit, and Parental Tax credits.

of undertakings, or contracting out; and update the Equal Pay legislation and require employers to respond in good faith to equal pay queries. The staff stressed that care has to be taken to ensure that new initiatives and the ways in which they are implemented do not introduce significant labor market rigidities that might hamper employment and growth prospects. The authorities said that enacted and proposed labor legislation should not have these effects. They noted that the ERLRB was intended to be the government's last major piece of labor legislation. The bill addressed those areas where the ERA could be strengthened to better achieve its key objectives of promoting collective bargaining and effective disputes resolution.

27. **Transport and electricity infrastructure are two areas where significant bottlenecks have emerged.** To address the former, the government recently increased the petrol levy starting in 2005 and established an integrated regional agency to develop a plan for Auckland-area transportation. As regards electricity, the government announced the establishment of an Electricity Commission to regulate the electricity industry. In addition, provisions will be made to provide for sufficient electricity generating capacity to be held in reserve to meet New Zealand's needs in the event of a severe drought.

28. **Given the small size of its domestic market, New Zealand has long recognized the crucial importance of an open international trade regime in promoting competition, innovation, and growth.** Tariffs on most products are low or zero, and in the few sectors that continue to receive significant import protection (such as textiles, clothing, footwear, and carpets), the government has announced a further gradual reduction of tariff rates starting in July 2006.[11] In contrast, New Zealand continues to face substantial foreign trade barriers in key areas where it could be expected to have a significant comparative advantage, like dairy products and meat. While continuing to explore bilateral and regional avenues to promote trade liberalization, the authorities stressed that the government remains deeply committed to the multilateral system as the foundation of its trade relations, and it has participated actively in all major areas of the Doha Round.

D. Economic Vulnerability and the Soundness of the Financial System

29. **The authorities and the staff agreed that New Zealand remains generally well placed to absorb adverse economic shocks.** The external current account deficit has widened recently but remained slightly below its average of the past decade, and the deterioration mainly reflects the sharp appreciation of the New Zealand dollar and the

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[11] New Zealand's tariff and nontariff barriers ratings are 1 and 2, respectively, on the IMF's trade restrictiveness index (on a scale ranging from 1 to 5 for tariffs and 1 to 3 for nontariff barriers, 1 being the least restrictive).

relatively strong cyclical position of the economy.[12] The low and declining level of public debt, the relatively stable source of external financing, and the strong risk management culture in New Zealand's financial institutions should significantly limit New Zealand's external vulnerability (Annex I). Nevertheless, the size of the external debt position could leave New Zealand potentially vulnerable to shifts in market sentiment, and the situation should be carefully monitored. Corporate and banking sector balance sheets are generally sound and have proven to be resilient to large swings in exchange and interest rates. While debt servicing remains manageable, households could be subject to somewhat more stress than in the past in the event of a substantial increase in both interest rates and unemployment. The authorities emphasized that they would maintain their close, ongoing surveillance of these sectoral balance sheets.

30. **The Financial Sector Assessment Program (FSAP) staff team found that New Zealand's financial sector is generally sound.** In conducting the FSAP discussions, the staff was mindful of two rather unique characteristics of New Zealand's financial system: the country's disclosure-based regulatory regime and the high share of Australian ownership of New Zealand's banking system. The banking sector is well capitalized, highly profitable, and adequately provisioned. The discipline of New Zealand's market-based disclosure regime is supplemented by active home country supervision of the major banks. Stress tests measuring the quantitative effects of large exchange rate swings, house price declines, and negative supply shocks show that the banks would face reduced profitability, but none of these shocks would pose a systemic risk. Nonbank financial institutions, while not systemically important, are allowed to compete with banks in all areas of business. Their regulation and supervision are covered under the Securities Act and are not subject to the same stringent disclosure requirements as banks. The foreign exchange market is sufficiently deep and functions well, hedging is widespread, and banks are readily able to provide adequate cover.

31. **The FSAP mission's main recommendations aim at preserving the financial system's stability in the medium and longer term.** In particular, the FSAP recommends: (i) maintaining the disclosure-based supervisory regime, but reinvigorating it by strengthening the RBNZ's ability to do timely and subject-specific monitoring of the banks; (ii) further developing the RBNZ's ability to handle financial stresses by reviewing

[12] Stress tests using the external sustainability framework template do not suggest major concerns (Table 5). A large exchange rate depreciation produces (in a relatively static and mechanical fashion) a sizable jump in the external debt to GDP ratio. However, the experience in the late 1990s underscores the flexibility of the New Zealand economy in handling such shocks without significant dislocation. Moreover, the mitigating influence in the event of a substantial depreciation of having foreign currency debt positions that are predominantly hedged (either by natural hedges or by financial derivatives) is not captured in the framework.

alternative approaches to manage a situation in which the solvency of a systemically important bank comes into question; and (iii) enhancing cooperation and coordination between the New Zealand and Australian regulators. The authorities have already initiated a process for closer collaboration with Australia, which was recently agreed between the finance ministers of both countries. In addition, the staff welcomed New Zealand's invitation to the Financial Action Taskforce to send a mission team to examine Anti-Money Laundering and Countering the Financing of Terrorism issues.

III. Staff Appraisal

32. **New Zealand continues to experience solid economic growth with low inflation.** This strong performance reflects ongoing benefits from the extensive structural reforms that have been implemented since the 1980s and continued confidence in the transparent monetary and fiscal policy frameworks. The foundations for sustained growth remain firmly in place. However, with the economy operating at a high level of resource utilization, continued strength in domestic demand, an improving world economy, and the specter of further appreciation of the New Zealand dollar, there are considerable uncertainties regarding the short-term economic outlook and distinct challenges for macroeconomic policies.

33. **The monetary authorities face a particularly difficult task in sorting through current and incoming information on economic conditions and prospects to determine the appropriate path for policy in the period immediately ahead.** Given the potentially conflicting economic forces at play presently, the staff supports the RBNZ's decision to leave interest rates unchanged in March 2004 and to cautiously wait and watch the data to see whether further monetary policy changes are needed.

34. **The floating exchange rate regime has served New Zealand well.** The authorities' recent decisions to raise the level of international reserves and possibly to intervene in the exchange market if the exchange rate was viewed as being "exceptionally and unjustifiably" high or low do not represent significant changes in the regime. Raising New Zealand's level of reserves would provide insurance against disorderly markets in the event of an exceptional adverse shock, and this action is consistent with a staff assessment of the country's reserve position in the context of the FSAP. The staff also agrees with the authorities' decision to adopt an approach to exchange market intervention, which is in line with that used in other industrial countries. Exceptional and extraordinary circumstances—which are difficult to define a priori—may occur where market participants have pushed the value of the exchange rate significantly out of line with its fundamental determinants, and well-timed intervention could influence the exchange rate by altering market perceptions and expectations.

35. **Fiscal policy continues to be soundly anchored.** The government has set itself the fiscal objectives of achieving budget operating surpluses over the economic cycle sufficient to meet contributions to the NZSF, while keeping gross government debt below 30 percent of GDP and trending down over the longer term and meeting capital spending requirements. An improvement in fiscal prospects relative to Budget 2003 provides the authorities with an

opportunity to introduce some new fiscal initiatives, including the Future Directions package, beginning in Budget 2004. The staff supports the basic thrust of this initiative, but notes, as the government recognizes, that the scope for additional spending is very limited. Moreover, to support monetary policy in the near-term, fiscal policy should hold the line on operating and capital spending to what is proposed in the DEFU, with any unanticipated gains in revenue saved in the short-term. In this connection, it should be recognized that unanticipated developments in tax revenue generally have been favorable, and this may not continue. Therefore, the prudence and discipline that the government has shown up to now in making its expenditure decisions should be maintained.

36. **Over the longer term, New Zealand will face significant spending pressures owing to population aging and rising healthcare costs.** With the establishment of a partial pre-funding of future pension liabilities through the NZSF, the government has taken an important step to address some of these pressures, confirming New Zealand's reputation for innovative and far-sighted policymaking. However, other measures are likely to be needed to contend fully with the long-term fiscal challenges. Among measures that may need to be considered are further parametric changes in the pension and healthcare systems. Such measures should be adopted sufficiently early to help smooth fiscal costs over time and allow individuals time to adapt their savings behavior.

37. **The labor market remains one of the most important areas where policy changes could help raise potential growth.** The staff strongly supports the government efforts to raise the participation rate and build a more skilled workforce, including providing the right incentives to move people from welfare to work; improving education, training, and access to childcare; and maintaining labor market flexibility. In this context, the Future Directions package can play a significant role by providing in-work benefits that can lower the high effective marginal tax rates currently faced by welfare recipients when they take up employment. Labor force participation could also be enhanced by tightening up and strictly enforcing eligibility requirements for receiving benefits. In addition, care needs be taken to ensure that recent and proposed changes in labor legislation, and the ways they are implemented, do not impair the flexibility of New Zealand's labor market.

38. **The government recognizes that an open international trade regime is crucial for promoting domestic competition, innovation, and growth.** Tariffs on most products are low or zero, and tariffs in the few remaining heavily-protected sectors are slated for further reduction starting in 2006. In contrast, New Zealand continues to face substantial foreign trade barriers in key areas where it could be expected to have significant comparative advantages. While improved market access and decreased subsidization of agricultural production by other countries are, understandably, New Zealand's highest trade policy priorities, the government remains deeply committed to all aspects of the multilateral trading system, and it has participated actively in all major areas of the Doha Round. New Zealand continues to pursue bilateral and regional trade liberalization initiatives to the extent that these remain supportive of multilateral trade liberalization.

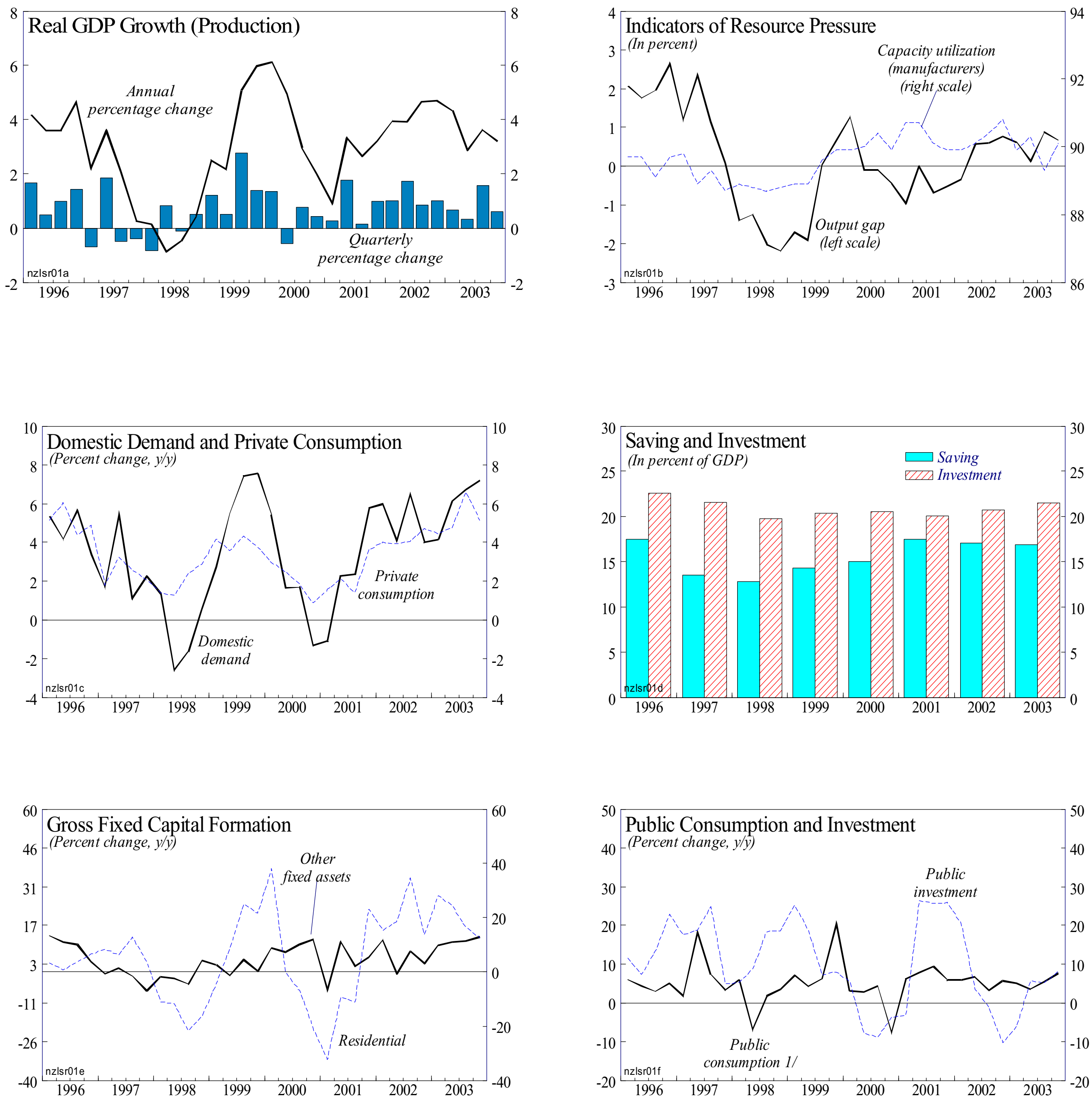
39. **New Zealand remains generally well placed to absorb adverse shocks without undue economic distress.** Although the external current account deficit has widened, the deterioration has mainly reflected the sharp appreciation of the New Zealand dollar and the relatively strong cyclical position of the economy. The low and declining level of public debt, the relatively stable source of external financing, and the strong risk management culture in New Zealand's financial institutions should limit significantly New Zealand's external vulnerability. Nevertheless, the size of the external debt position could leave New Zealand potentially vulnerable to shifts in market sentiment and should be closely monitored. Corporate and banking sector balance sheets are generally sound and have proven to be resilient to large swings in exchange and interest rates in the past. While debt servicing remains manageable, households could be subject to somewhat more stress than in the past in the event of a substantial increase in both interest rates and unemployment.

40. **As part of the 2004 Article IV consultation, New Zealand has participated in the Financial Sector Assessment Program (FSAP).** The general finding of the FSAP is that New Zealand's financial sector has a high degree of short-term stability and an overall sound outlook. The banking sector, which dominates the financial system, is financially sound, highly profitable, and adequately provisioned. The discipline of New Zealand's market-based disclosure regime is supplemented by home country supervision of the major banks. In addition to comfortable capital levels, high profitability rates, and sophisticated risk management systems, short-term financial stability is also supported by a well-functioning market environment and sound economic policies. Stress tests measuring the effects of large exchange rate swings, house price declines, and negative supply shocks show that the banks would face reduced profitability, but none of these shocks would pose a systemic risk.

41. **The FSSA's main recommendations aim at preserving stability in the medium and longer term.** In particular, the FSSA recommends: strengthening the RBNZ's ability to undertake timely, focused monitoring of bank risks; further developing the RBNZ's ability to manage a situation in which the solvency of a systemically important bank comes into question and to handle associated stresses on the financial system; and, given the unique role of Australian-owned banks in New Zealand, enhancing cooperation and coordination between supervisors in the two countries. In this connection, the staff welcomes the recent announcement by the New Zealand Finance Minister and the Australian Treasurer of their intention to strengthen collaboration in these areas.

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

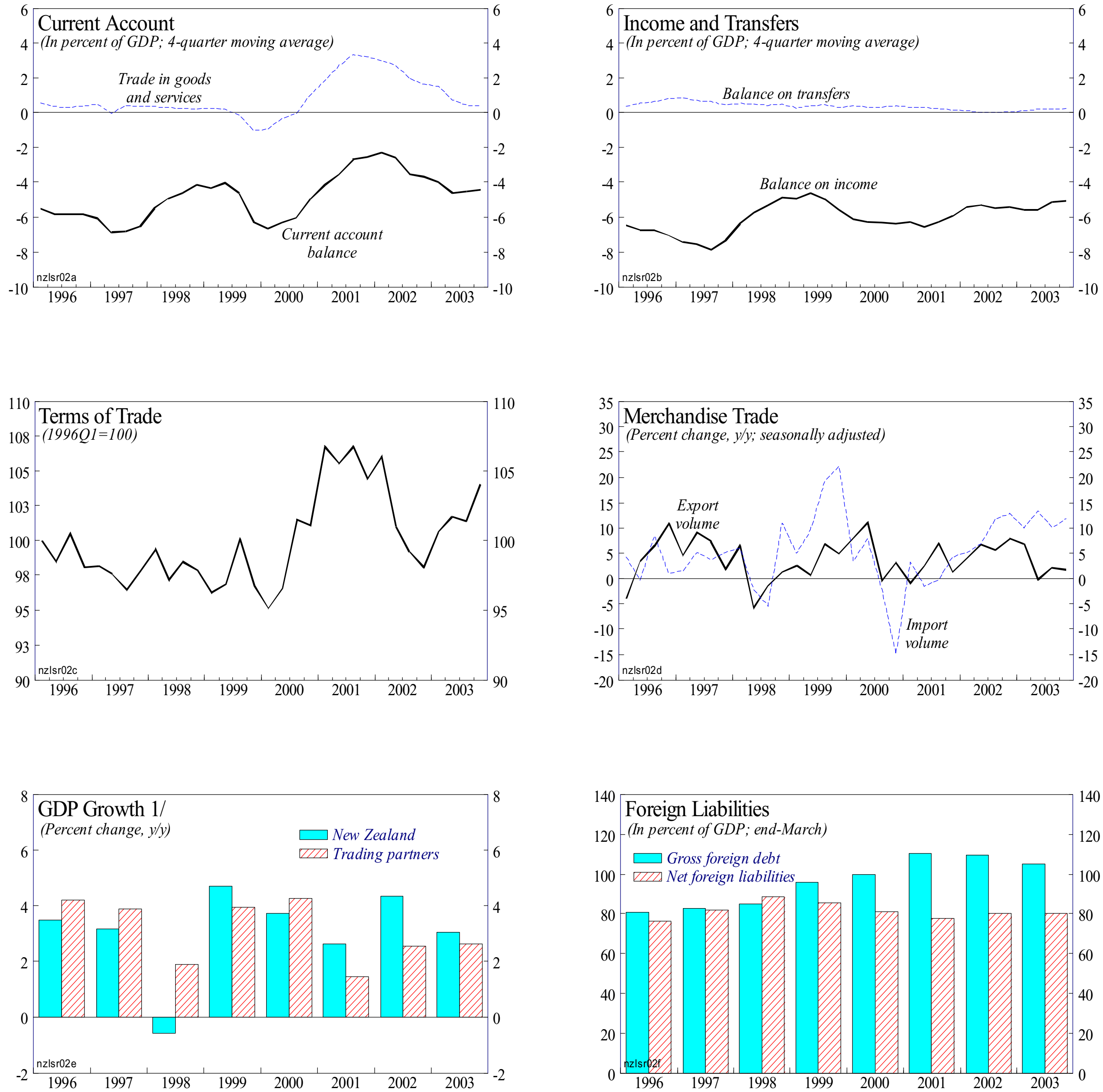
Figure 1. New Zealand: Selected Real Economic Indicators, 1996–2003



Sources: Statistics New Zealand; and staff estimates.

1/ 1999Q4 excludes purchases of naval frigate equipment, equivalent to 0.6 percent of GDP.

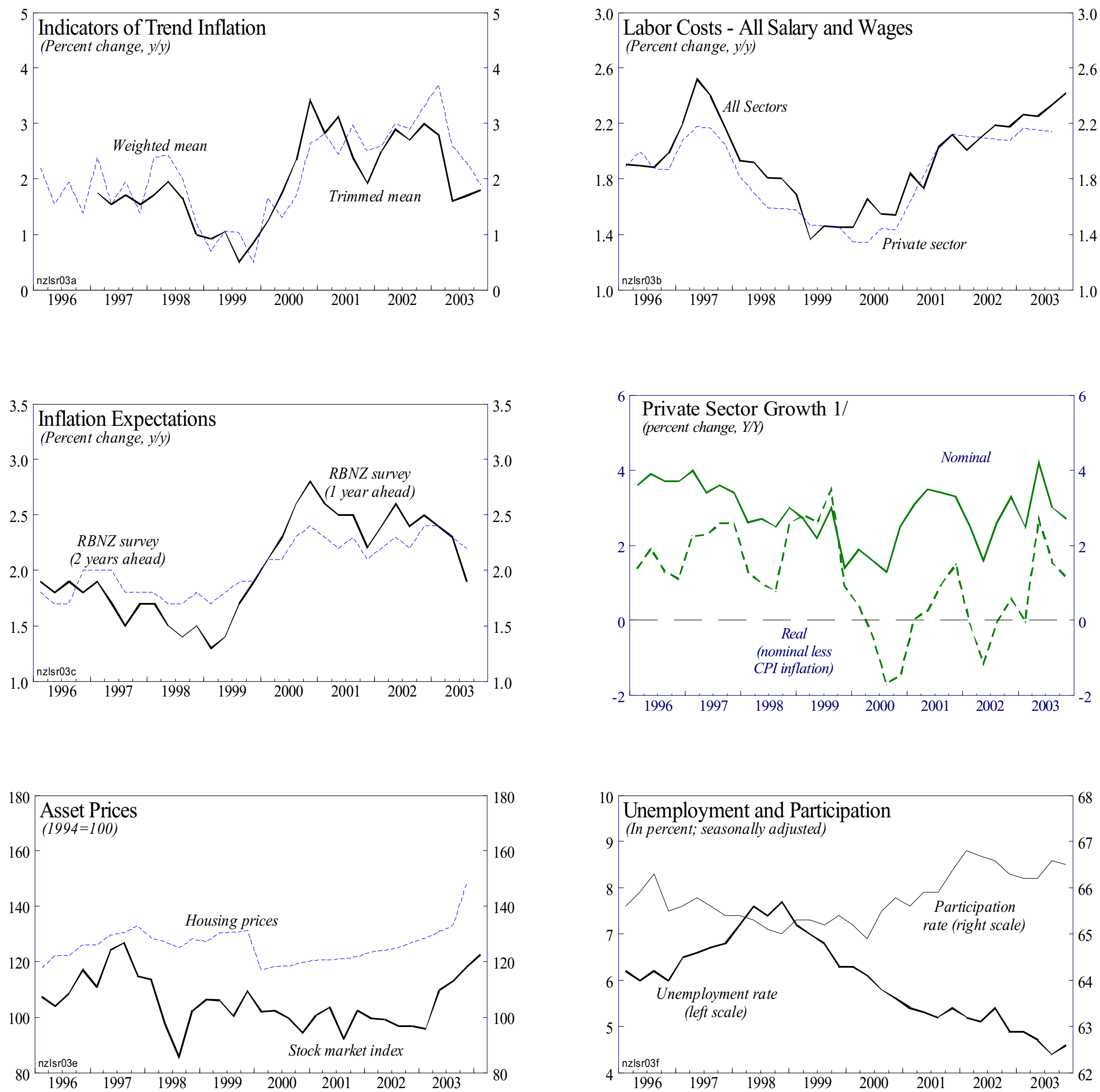
Figure 2. New Zealand: Balance of Payments and External Indicators, 1996-2003



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

1/ New Zealand data are expenditure based.

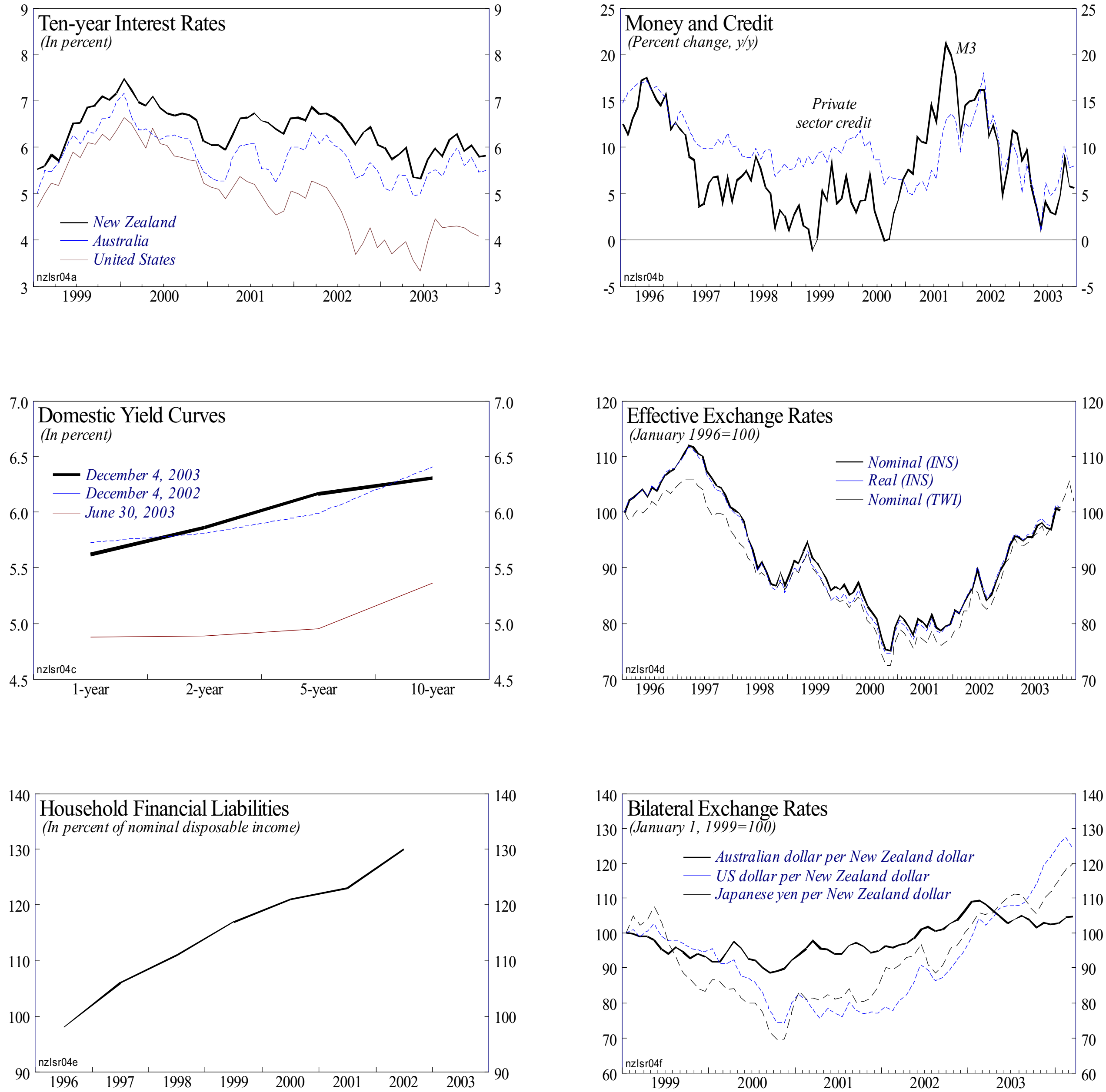
Figure 3. New Zealand: Inflation and Labor Market Indicators, 1996-2003



Sources: Statistics New Zealand; Reserve Bank of New Zealand; and staff estimates.

1/ Based on Quarterly Employment Survey (QES).

Figure 4. New Zealand: Monetary and Financial Indicators, 1996-2003



Sources: Statistics New Zealand; and staff estimates.

Table 1. New Zealand: Selected Economic and Financial Indicators, 1999-2004

Nominal GDP (2002):	US$ 58.8 billion
Population (2002):	4.0 million
GDP per capita (2002):	US$ 14,934
Quota:	SDR 894.6 million

	1999	2000	2001	2002	2003	Proj. 2004
Real growth (percent change)						
GDP (production basis)	3.9	4.0	2.5	4.3	3.5	3.0
Domestic demand	5.8	1.8	2.3	5.1	6.1	5.9
Private consumption	4.0	2.0	2.2	4.2	5.2	4.9
Fixed investment	4.4	7.3	-0.4	9.5	12.7	9.9
Exports of goods and services	8.0	6.5	2.4	5.8	1.1	3.6
Imports of goods and services	11.9	0.2	1.6	8.8	10.1	9.9
Headline CPI inflation (percent change)	-0.1	2.6	2.6	2.7	1.8	2.4
Unemployment rate (in percent)	6.8	6.0	5.3	5.2	4.7	4.9
Investment and saving (in percent of GDP)						
Investment	20.3	20.5	20.1	20.8	21.7	21.8
National saving 1/	14.3	15.0	17.5	17.1	17.2	16.9
Private saving	8.6	10.0	11.7	11.3	10.2	8.5
Public saving	5.7	5.1	5.8	5.8	7.0	8.4
Public finance (in percent of GDP) 2/						
Revenue	35.3	33.6	33.9	32.2	33.9	34.0
Expenditure	34.7	33.2	32.8	30.6	32.4	30.8
Operating balance 3/	1.7	1.3	1.2	1.9	1.5	4.5
OBERAC 4/	0.2	0.8	1.8	2.2	4.3	3.8
Estimated structural balance 5/	1.2	0.6	1.8	2.1	3.9	3.5
Net public debt	21.0	19.7	17.2	14.3	13.6	12.4
Money and credit (end of period)						
M3 (percent change)	6.9	6.5	11.4	11.5	5.6	4.0 6/
Private domestic credit (percent change)	10.8	6.4	9.5	9.1	8.0	9.6 6/
Interest rate (90-day, in percent)	5.7	6.7	4.9	5.9	5.4	5.6 6/
Government bond yield (10-year, in percent)	7.2	6.1	6.6	6.1	5.9	6.0 6/
Balance of payments ($NZ billion)						
Current account	-6.6	-5.4	-3.1	-4.6	-6.0	-7.0
(in percent of GDP)	-6.3	-4.8	-2.6	-3.7	-4.5	-5.0
Trade balance (goods)	-0.7	1.5	3.5	1.2	-0.7	-1.1
Exports	23.9	29.8	33.1	31.3	28.9	28.7
Imports	-24.6	-28.3	-29.6	-30.1	-29.5	-29.8
Terms of trade (percent change)	-0.7	1.2	7.2	-4.5	0.8	3.5
Foreign assets and liabilities ($NZ billion) 7/						
Net international investment position 8/	-87.1	-87.1	-88.1	-98.3	-101.0	-102.1
(in percent of GDP)	-85.5	-81.1	-77.4	-80.1	-79.3	-75.8
Gross short-term external debt 9/	43.7	54.1	65.2	73.0	66.0	...
Gross foreign currency denominated debt 10/	54.1	61.9	77.6	74.7	67.9	...
Official reserves	7.3	7.9	8.6	7.7	9.1	...
Exchange rate (end of period)						
US$/$NZ	0.52	0.44	0.42	0.52	0.65	0.66 11/
Trade-weighted index (June 1979 = 100)	54.3	49.7	49.9	58.8	65.3	65.5 11/
Nominal effective exchange rate 12/	93.3	85.9	86.5	98.5	108.7	...
Real effective exchange rate 12/	87.6	81.5	82.8	94.8	104.6	...

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

1/ Based on national accounts data.
2/ Fiscal years ending June 30. Significant changes have been made to fiscal data compilation. Thus, revenue and expenditure estimates from 2002 are not directly comparable with those for previous years.
3/ Equals revenue less expenditure plus net surplus attributable to state-owned and Crown entities.
4/ Operating balance net of revaluations and accounting changes.
5/ Fund staff estimates; equals operating balance net of cyclical effects, revaluations and changes in accounting rules.
6/ Data as of January 2004.
7/ Data for end-March of each year. Data from 2001 are not directly comparable with the historical data due to methodology changes to comply with BPM5.
8/ Data based on International Investment Position statistics.
9/ Residual maturity of less than one year. Data based on Total Overseas Debt until 2000, and on the International Investment Position thereafter.
10/ Includes debt that is unallocated in terms of foreign currency denomination.
11/ Data as of March 31, 2004.
12/ IMF Information Notice System index (1990 = 100).

Table 2. New Zealand: Balance of Payments and External Debt, 1998-2003

	1998	1999	2000	2001	2002	2003
			(In percent of GDP)			
Current account balance	-4.0	-6.3	-4.8	-2.6	-3.7	-4.5
Trade balance	1.7	-0.6	1.4	2.9	0.9	-0.5
Exports, f.o.b.	22.6	22.6	26.5	27.5	24.8	21.7
Imports, f.o.b.	-20.9	-23.3	-25.1	-24.6	-23.9	-22.2
Services balance	-1.3	-0.3	-0.2	0.3	0.7	0.8
Receipts	7.0	7.8	8.7	8.7	8.8	8.1
Payments	-8.3	-8.2	-8.9	-8.4	-8.1	-7.3
Income balance	-4.9	-5.6	-6.3	-5.9	-5.6	-5.1
Receipts	1.6	1.6	1.4	1.2	1.8	1.7
Payments	-6.5	-7.2	-7.7	-7.0	-7.4	-6.7
Transfers balance	0.5	0.3	0.4	0.1	0.4	0.4
Inflows	1.2	1.1	1.2	1.2	1.1	1.1
Outflows	-0.7	-0.8	-0.8	-0.8	-0.8	-0.7
Capital and financial account balance 1/	2.6	3.1	4.5	7.2	3.5	4.8
Capital account (net)	-0.3	-0.4	-0.3	0.9	1.3	0.7
Financial account (net)	2.9	3.5	4.9	6.3	2.2	4.1
Direct investment (net)	0.5	1.1	4.0	6.0	0.8	2.4
Portfolio investment (net)	-0.1	-5.3	-1.3	0.7	3.1	1.2
Equity securities (net)	0.3	-1.3	-4.2	-1.7	0.3	...
Debt securities (net)	-0.3	-4.0	2.9	2.4	2.8	...
Other investment (net)	2.5	7.7	2.2	-0.4	-1.7	0.5
Net errors and omissions 2/	0.5	3.5	0.0	-5.0	2.0	0.8
Overall balance	-0.9	0.3	-0.3	-0.4	1.9	1.0
			(Assets and liabilities as of end-March) 3/			
Total external debt 4/	85.0	95.9	99.9	110.2	108.8	103.9
Short-term 5/	35.0	40.9	49.6	57.3	59.5	51.8
Long-term	47.8	49.9	46.6	45.2	43.4	52.1
Unallocated estimate	2.2	5.1	3.7	7.7	5.9	0.0
Net international investment position	-88.7	-85.5	-81.1	-77.4	-80.1	-79.3
Net equity	-22.9	-12.2	-6.2	-18.8	-17.6	-20.7
Net debt	-65.7	-80.4	-82.2	-58.6	-62.5	-58.5
Official reserves (billions of NZ dollars)	7.6	7.3	7.9	8.6	7.7	9.1
(In months of future imports of g&s)	3.0	2.5	2.4	2.6	2.3	3.7
(As percent of short-term debt)	21.6	17.7	15.9	15.0	13.0	17.6

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

1/ Based on IFS data; 2003 data are from Statistics New Zealand.
2/ Calculated as a residual.
3/ Data from 2001 are not fully comparable with the historical data due to methodology changes to comply with BPM5.
4/ Data based on Total Overseas Debt statistics until 2000, and on the International Investment Position thereafter.
5/ Residual maturity of less than one year.

Table 3. New Zealand: Summary of Central Government Budget, 1998/99-2003/04 1/

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04 DEFU '03
			(In billions of New Zealand dollars)			
Revenue	36.4	36.5	39.5	39.9	43.6	46.3
Tax revenue	32.2	34.0	36.7	36.5	40.2	42.6
Direct taxation	20.3	21.5	23.9	24.5	27.2	29.0
Nontax revenue	4.2	2.5	2.8	3.5	3.5	3.7
Expenditure	35.8	36.2	38.2	38.0	41.7	41.9
Social security and welfare	12.9	12.9	13.2	13.5	13.9	14.3
New Zealand Superannuation	5.1	5.1	5.3	5.5	5.6	5.9
Other	7.8	7.8	7.9	8.0	8.3	8.4
Health	6.6	6.9	7.3	7.0	7.5	8.2
Education	5.9	6.3	6.7	6.5	7.0	7.6
Finance costs	2.5	2.4	2.5	2.1	2.4	2.2
Other	7.9	7.7	8.5	8.9	11.0	9.5
Revenue less expenses	0.5	0.4	1.3	1.9	1.9	4.5
Net surplus from SOEs and Crown entities 2/	1.2	1.1	0.1	0.5	0.1	1.6
Operating balance 3/	1.8	1.4	1.4	2.4	2.0	6.1
OBERAC 4/	0.2	0.9	2.1	2.8	5.6	5.2
Cash balance 5/	2.0	-0.4	0.3	0.2	2.4	0.8
Capital investment 6/	-1.7	1.3	1.6	3.6	2.4	4.0
Gross Crown debt	36.7	36.0	36.8	36.2	36.1	34.5
Net Crown debt	21.7	21.4	20.0	17.8	17.6	16.9
Net worth 7/	6.0	8.6	11.5	18.7	23.8	29.9
			(In percent of GDP)			
Revenue	35.3	33.6	33.9	32.2	33.9	34.0
Tax revenue	31.2	31.3	31.6	29.4	31.2	31.3
Direct taxation	19.7	19.8	20.5	19.8	21.1	21.3
Nontax revenue	4.1	2.3	2.4	2.8	2.7	2.7
Expenditure	34.7	33.2	32.8	30.6	32.4	30.8
Social security and welfare	12.5	11.8	11.4	10.9	10.8	10.5
New Zealand superannuation	4.9	4.7	4.5	4.4	4.4	4.3
Other	7.6	7.2	6.8	6.5	6.4	6.2
Health	6.4	6.3	6.3	5.7	5.8	6.1
Education	5.7	5.8	5.8	5.2	5.5	5.6
Finance costs	2.4	2.2	2.1	1.7	1.8	1.7
Other	7.7	7.1	7.3	7.2	8.5	7.0
Revenue less expenditure	0.5	0.3	1.1	1.6	1.5	3.3
Net surplus from SOEs and Crown entities	1.2	1.0	0.1	0.4	0.1	1.2
Operating balance 3/	1.7	1.3	1.2	1.9	1.5	4.5
OBERAC 4/	0.2	0.8	1.8	2.2	4.3	3.8
Cash balance 5/	2.0	-0.4	0.3	0.2	1.9	0.6
Capital investment 6/	-1.6	1.2	1.4	2.9	1.9	2.9
Structural cash balance 8/	2.8	-0.6	0.4	0.6	1.8	1.1
Gross Crown debt	35.6	33.1	31.6	29.2	28.0	25.3
Net Crown debt	21.0	19.7	17.2	14.3	13.7	12.4
Net worth 7/	5.8	7.9	9.9	15.1	18.5	22.0
Memorandum item (in billions of NZ dollars)						
Contributions to NZ Superannuation Fund	...	...	...	0.6	1.2	1.9

Sources: New Zealand Treasury; DEFU (December Economic and Fiscal Update) 2003 and Fund staff estimates.

1/ Fiscal year ending June 30. Changes have been made to the compilation of fiscal data starting in 2001/02; data prior to that date are not fully comparable.
2/ The value for 1999/00 includes $NZ 0.519 billion corresponding to movements in ACC valuations.
3/ Equals revenue less expenditure plus net surplus attributable to state-owned and Crown entities.
4/ Operating balance net of revaluations and changes in accounting rules.
5/ Fund staff estimate; equals cash flows from operations less cash flows on investment.
6/ Excludes contribution to the New Zealand Superannuation Fund.
7/ Includes financial assets of the New Zealand Superannuation Fund, which are excluded from net Crown debt.
8/ Fund staff estimate; equals overall cash balance net of cyclical effects as a percent of potential GDP.

Table 4. New Zealand: Medium-Term Scenario, 2001–09

	2001	2002	2003	Proj. 2004	2005	2006	2007	2008	2009
Real growth (percent change)									
GDP (production basis)	2.5	4.3	3.5	3.0	2.5	3.0	3.3	3.3	3.3
Domestic demand	2.3	5.1	6.1	5.9	3.2	3.1	3.0	3.0	3.1
Consumption	2.6	3.8	4.7	5.1	3.4	3.0	2.8	2.7	2.7
Private consumption	2.2	4.2	5.2	4.9	3.0	2.8	3.0	3.0	3.0
Fixed Investment	-0.4	9.5	12.7	9.9	4.4	3.5	3.9	4.1	4.3
Exports of goods and services	2.4	5.8	1.1	3.6	3.3	5.6	6.4	6.4	6.7
Imports of goods and services	1.6	8.8	10.1	9.9	5.3	5.5	5.3	5.2	5.9
Saving and investment (percent of GDP)									
Gross capital formation	20.1	20.8	21.7	21.8	21.7	21.7	21.8	21.3	21.4
Fixed investment	18.9	19.6	20.9	21.4	21.6	21.6	21.7	21.3	21.4
Increase in stocks	1.1	1.2	0.8	0.5	0.1	0.1	0.1	0.0	0.0
National saving 1/	17.5	17.1	17.2	16.9	16.8	16.7	17.0	16.6	16.7
Private	11.7	11.3	10.2	8.5	8.6	8.9	9.4	9.2	9.4
Public	5.8	5.8	7.0	8.4	8.1	7.7	7.6	7.5	7.4
Inflation and unemployment									
Headline CPI inflation	2.6	2.7	1.8	2.4	2.4	2.0	2.0	2.0	2.0
Unemployment rate	5.3	5.2	4.7	4.9	5.2	5.3	5.3	5.3	5.3
Government budget (percent of GDP) 2/									
Revenue	33.9	32.2	33.9	34.0	34.1	33.9	33.8	33.7	33.6
Expenditure	32.8	30.6	32.4	30.8	30.7	31.2	31.2	31.1	31.1
Net surplus from SOEs and Crown entities	0.1	0.4	0.1	1.2	1.0	1.1	1.1	1.1	1.1
Operating balance 3/	1.2	1.9	1.5	4.5	4.4	3.8	3.7	3.7	3.7
OBERAC 4/	1.8	2.2	4.3	3.8	4.4	3.8	3.7	3.7	3.7
Cash balance 5/	0.3	0.2	1.9	0.6	1.8	1.4	1.2	1.1	1.1
Gross Crown debt	31.6	29.2	28.0	25.3	23.1	21.9	21.2	20.4	19.7
Net Crown debt	17.2	14.3	13.6	12.4	10.8	9.7	8.8	8.1	7.4
Net Worth 6/	9.9	15.1	18.5	22.0	25.4	27.9	30.3	32.5	34.9
Balance of payments (percent of GDP)									
Current account balance	-2.6	-3.7	-4.5	-5.0	-5.0	-5.0	-4.8	-4.7	-4.7
Balance on goods and services	3.2	1.6	0.3	-0.5	-0.8	-0.3	0.0	0.2	0.6
Balance on goods	2.9	0.9	-0.5	-0.8	-1.0	-0.7	-0.4	0.0	0.3
Balance on services	0.3	0.7	0.8	0.3	0.2	0.4	0.3	0.2	0.3
Balance on income and transfers	-5.8	-5.2	-4.7	-4.5	-4.2	-4.6	-4.7	-5.0	-5.2
Balance on income	-5.9	-5.6	-5.1	-4.8	-4.6	-5.0	-5.1	-5.4	-5.6
Balance on transfers	0.1	0.4	0.4	0.4	0.3	0.3	0.4	0.4	0.4
Net foreign liabilities (percent of GDP) 7/	77.4	80.1	79.3	75.8	76.9	79.0	80.3	81.9	83.5
Gross external debt	110.2	108.8	103.9	101.5	102.5	104.4	105.7	107.5	108.8

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

1/ Fund staff estimates; based on national accounts data.
2/ Fiscal years ending June 30. Significant changes have been made to fiscal data compilation. Thus, figures from 2002 are not directly comparable with the historical data.
3/ Equals revenue less expenditure plus net surplus of state-owned and Crown entities.
4/ Operating balance net of revaluations and accounting changes.
5/ Fund staff estimates; equals cash flows from operations less cash flows on investment.
6/ Includes the financial assets of the New Zealand Superannuation Fund, which are excluded from net Crown debt.
7/ Data for end-March. Data from 2001 are not directly comparable with the prior data due to methodology changes to comply with BPM5.

Table 5. New Zealand: External Debt Sustainability Framework, 1999–2009

(End-March data in percent of GDP, unless otherwise indicated)

	Actual							Projections						
	1998/99	1999/00	2000/01	2001/02	2002/03			2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	
								I. Baseline Projections						Debt-Stabilizing Non-Interest Current Account 7/
External debt	95.9	99.9	110.2	108.8	103.9			101.5	102.5	104.4	105.7	107.5	108.8	1.0
Change in external debt	10.9	4.0	10.2	-1.3	-5.0			-2.4	1.0	2.0	1.3	1.8	1.3	
Identified external debt-creating flows (4+8+9)	4.6	2.6	2.0	-13.2	-8.6			-0.5	0.8	2.4	0.8	1.1	0.7	
Current account deficit, excluding interest payments	-2.2	-0.8	-0.9	-2.8	-1.4			-0.7	-0.3	-0.3	-0.6	-0.8	-1.1	
Deficit in balance of goods and services	-0.3	0.9	-1.9	-3.0	-1.5			0.5	1.2	1.4	0.8	0.6	0.3	
Exports	29.9	31.2	36.4	35.5	32.8			28.5	27.4	27.7	28.7	29.8	31.1	
Imports	29.6	32.1	34.5	32.5	31.3			29.0	28.6	29.1	29.5	30.4	31.4	
Net nondebt creating capital inflows (negative)	-0.2	-2.3	-8.3	-2.3	3.0			-3.3	-1.7	-1.3	-1.4	-1.1	-1.2	
Automatic debt dynamics 1/	7.0	5.8	11.2	-8.1	-10.1			3.5	2.8	3.9	2.9	3.0	3.0	
Contribution from nominal interest rate	6.5	7.5	5.0	5.0	5.4			6.0	6.0	6.1	6.2	6.3	6.4	
Contribution from real GDP growth	-0.3	-4.7	-3.1	-3.1	-3.7			-2.5	-3.2	-2.2	-3.3	-3.3	-3.4	
Contribution from price and exchange rate changes 2/	0.9	3.0	9.3	-10.1	-11.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.3	1.4	8.2	11.9	3.6			-1.9	0.1	-0.4	0.4	0.6	0.6	
External debt-to-exports ratio (in percent)	320.8	320.4	302.7	306.4	316.5			356.5	373.7	377.2	368.8	361.1	350.1	
Gross external financing need (in billions of U.S. dollars) 4/	28.5	30.7	32.2	31.3	40.1			47.8	58.5	61.8	65.0	68.4	71.8	
In percent of GDP	52.7	57.7	70.1	57.9	56.7			52.7	61.7	62.8	63.3	64.4	64.3	
Key macroeconomic assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	0.4	4.8	2.7	3.3	4.4	3.7	1.8	3.0	3.3	2.2	3.3	3.2	3.3	3.0
GDP deflator in U.S. dollars (change in percent)	-3.4	-6.1	-16.1	13.9	25.3	3.3	14.3	24.4	1.2	1.5	1.1	0.3	1.8	5.7
Nominal external interest rate (in percent)	7.4	7.7	4.3	5.4	6.5	6.7	3.3	7.3	6.2	6.2	6.2	6.2	6.2	6.4
Growth of exports (U.S. dollar terms, in percent)	2.3	2.8	0.6	14.8	20.9	7.2	12.0	11.1	0.6	4.8	8.1	7.5	9.7	6.4
Growth of imports (U.S. dollar terms, in percent)	2.4	6.9	-7.4	11.0	26.0	7.7	13.6	18.6	3.1	5.6	5.8	6.7	8.4	8.0
Current account balance, excluding interest payments	2.2	0.8	0.9	2.8	1.4	0.6	2.6	0.7	0.3	0.3	0.6	0.8	1.1	0.6
Net nondebt creating capital inflows	0.2	2.3	8.3	2.3	-3.0	3.1	3.6	3.3	1.7	1.3	1.4	1.1	1.2	1.7
								II. Stress Tests for External Debt Ratio						Debt-Stabilizing Non-Interest Current Account 6/
Alternative scenarios														
Key variables are at their historical averages in 2005-08 5/								101.5	98.7	95.7	93.0	89.8	87.9	-2.0
Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 6/								101.5	102.5	104.4	105.7	107.5	108.8	1.0
Selected variables are consistent with market forecast in 2005-08								101.5	102.8	104.8	106.1	107.9	109.2	1.0
Bound tests														
Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								101.5	109.3	118.9	120.3	122.3	123.8	1.3
Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								101.5	105.7	110.1	111.5	113.4	114.8	1.1
Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								101.5	123.4	152.0	154.3	157.5	160.4	1.1
Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								101.5	107.4	114.3	115.7	117.7	119.1	1.2
Combination of 1-4 using one standard deviation shocks								101.5	124.7	153.0	154.9	157.5	159.4	1.6
One time 30 percent nominal depreciation in 2005								101.5	126.3	128.9	130.7	133.1	135.2	1.1

Sources: Statistics New Zealand; and Fund staff estimates and projections.

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

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

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

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

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

6/ The implied change in other key variables under this scenario is discussed in the text.

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

NEW ZEALAND—ECONOMIC VULNERABILITY ASSESSMENT

1. **The basic assessment of New Zealand's economic vulnerability remains broadly unchanged.**[13] The country does not appear to face major economic vulnerabilities, and the economy remains well placed to manage adverse economic shocks. While net foreign liabilities remain high, they have declined from their peak. Foreign debt has become more concentrated in the banking sector and its maturity has shortened, reflecting increased intermediation of flows by banks. The foreign currency composition of the debt remains a large, but declining, share of the total, with currency risk mitigated through substantial hedging. Corporate and banking sector balance sheets continue to look strong, and they have proven in the past to be resilient to large swings in exchange rates and interest rates. Household balance sheets and finances also look to be reasonably sound, and they too have been resilient to past interest swings. Housing remains the main household asset, and mortgage debt is the major household liability and a major asset of the banking system. With higher indebtedness, households might be subject to somewhat more stress now in the event of a substantial increase in interest rates and unemployment.

A. External Position

2. **Net external liabilities have remained broadly unchanged over the last four years, as assets have kept pace with the rise in debt.** Gross external debt increased from 85 percent of GDP at end-March 1998 to 110 percent at end-March 2001, and has since declined to 104 percent at end-March 2003 (Table 1).[14] Banks account for a growing proportion of external debt, with their external debt nearly doubling from 33 percent of GDP at end-March 1998 to 58 percent at end-March 2003, and accounting for some 55 percent of

New Zealand: Key External Vulnerability Statistics

	1998	1999	2000	2001	2002	2003
	(In percent of GDP at end-March)					
Current account (annual)	-5.5	-4.3	-6.7	-4.1	-2.3	-4.0
Net foreign liabilities	88.7	85.5	81.1	77.4	80.1	79.3
Gross external debt	85.0	95.9	99.9	110.2	108.8	103.9
Of which :						
Local currency denominated	45.5	45.2	43.2	41.1	48.2	51.2
Short-term (residual maturity)	35.0	40.9	49.6	57.2	59.8	52.4
Official government	20.1	17.1	16.5	14.9	16.4	14.0
Foreign-currency denominated debt (in $NZ billions)	43.2	48.7	57.9	76.5	68.4	62.4
Total Hedging (in percent of total debt)	94.9	97.2	96.6	99.8	94.4	89.0
Of which : with financial derivatives	54.1	64.5	65.1	62.6	63.8	61.4
naturally hedged	40.7	32.7	31.5	37.2	30.5	27.5
	(Annual percentage growth at end-December)					
Exports of goods and services (y-o-y volume)	1.8	8.0	6.5	2.4	5.8	1.1
Imports of goods and services (y-o-y volume)	1.4	11.9	0.2	1.6	8.8	10.1
Terms of trade (quarterly index)	-0.6	-1.3	1.1	5.4	-3.0	9.3
Real effective exchange rate (1990=100)	88.8	87.6	81.5	82.8	94.8	104.6

Source: Statistics New Zealand.

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[13] This annex updates the vulnerability assessment provided in *New Zealand: 2003 Article IV Consultation*, IMF Staff Country Report No. 03/121, 2003, which concluded that there were no major vulnerability concerns.

[14] Data from 2001 are not fully comparable to earlier data due to methodology changes in the New Zealand balance of payments accounts.

total gross external debt. At the same time, foreigners' holdings of New Zealand government debt have declined and represented only some 13 percent of total debt at end-March 2003.

3. **The maturity profile of the external debt has been shortening, while there has recently been a decline in the foreign currency component.** As the financial sector raises most of its funds at shorter maturities than the government and corporate sectors, the rise in the share of banks' external debt has caused a shortening of the maturity. The foreign currency component of the external debt has declined to 52 percent of total debt at end-March 2003, after rising to 63 percent at end-March 2001. The risks from foreign currency exposure are greatly mitigated by a substantial degree of hedging. Recent survey data indicate that exchange rate risk for most of the foreign currency debt is hedged (Table 2).[15] For the debt covered by the survey, some 90 percent has been hedged either through natural hedges or using financial derivatives. Dependence on financial derivatives for hedging has increased sharply since end-March 1998. The market for these instruments appears to be reasonably deep and has proven to be rather resilient, given the large swings in the value of the New Zealand dollar in recent years.

B. Sectoral Balance Sheets

Banks

4. **New Zealand's banking sector performance remains very strong.** With a robust domestic economy, New Zealand banks remained solidly profitable in 2002; return on assets for the banks was some 1¼ percent and return on equity was over 25 percent.[16] The banks are well capitalized, maintaining total capital of more than 11 percent and tier-one capital of

New Zealand: Banks' Balance Sheet Indicators
(Share of total assets)

	End-December						
	1996	1997	1998	1999	2000	2001	2002
Loans	67.4	66.6	66.9	66.6	61.9	63.0	63.5
Loans to households	39.8	39.5	39.5	39.3	36.9	37.9	38.5
Housing loans	36.5	36.5	36.3	36.1	33.8	34.7	35.2
Resident business loans	27.5	27.1	27.3	27.4	25.0	25.1	25.0
Profitability measures							
Net Interest Margin 1/	2.7	2.5	2.1	2.4	2.3	2.3	2.6
Return on Average Assets	1.0	0.9	0.8	1.1	1.1	1.0	1.3
Return on Average Equity	22.6	23.0	20.3	22.5	24.0	24.6	26.1
Capital adequacy measures 2/							
Total	10.5	10.5	10.5	10.3	11.1	10.7	11.3
Tier one	6.8	6.9	7.3	7.1	7.7	7.6	8.5
Impaired assets	0.9	0.6	0.6	0.5	0.4	0.4	0.3

Sources: Bankscope database; RBNZ; "Macro-financial stability and macroprudential analysis," RBNZ Bulletin (2001), and "Developments in the New Zealand Banking Industry", RBNZ Bulletin (2002, 2003).
1/ Ratio to average interest-earning assets.
2/ Capital as a percentage of risk-weighted exposure.

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

[16] Stress tests from the recently concluded FSAP indicate that banks would be resilient to significant market and credit risk shocks, including a major decline in demand for agricultural exports, or a substantial increase in the cost of foreign capital inflows.

8½ percent of risk-weighted assets.[17] The overall asset quality of the banking system remains very high, with the ratio of impaired assets to total assets at about ¼ percent, a historic low and well below levels in other developed countries. The overall strength of the banks in New Zealand is reflected in their ratings by the independent credit rating agencies.[18] All of the major banks have strong ratings; the five largest banks, which account for 90 percent of total assets and deposits, have credit ratings of AA- or better.

Corporations

New Zealand: Business Indicators
(In percent)

	1999	2000	2001	2002
Operating surplus before tax/GDP	29.8	27.0	24.9	33.8
Net interest expense/operating surplus 1/	18.7	12.6	16.2	11.0
Current assets/current liabilities	80.1	82.1	94.7	94.0
Return on equity	9.5	9.5	9.6	12.4
Return on total assets	4.0	3.7	3.6	4.6

Source: Statistics New Zealand.
1/ Excludes state-owned enterprises and finsnce and insurance industry.

New Zealand: Corporate Sector's Balance Sheet Indicators 1/

	Operating Income to Sales			ROPC			EBITDA (interest cover)			Total Debt to Capital		
	2000	2001	2002	2000	2001	2002	2000	2001	2002	2000	2001	2002
New Zealand companies median	29.4	28.4	26.5	10.1	9.8	8.4	5.0	4.4	4.8	37.3	42.6	36.4
Total survey population median	24.5	25.0	25.1	10.4	9.1	9.0	5.0	4.7	5.0	41.6	41.6	38.5

Source: Australia & New Zealand Credit Stats various issues, Standard & Poor's.
1/ Figures in percent, except EBITDA (earnings before interest, tax, depreciation and amortization). ROPC means return on permanent capital.

5. **Overall financial indicators for the corporate sector in New Zealand remain sound.** The ratio of operating income to sales, return on assets, and return on equity all have risen in 2002, and they continue to be strong. Net interest expense has generally been small in relation to operating surplus, even prior to the decline of global interest rates in 2001. Leverage ratios for New Zealand firms are in line with comparators in Australia; a big rise in the debt to capital ratio in 2001 was accounted for by large, debt-funded acquisitions and valuation adjustments to foreign currency denominated debt.

Households

6. **The recent boom in the property market has contributed to a significant increase in household net worth in 2002.** Net housing wealth increased as housing prices rose

[17] Registered banks in New Zealand are required to maintain a minimum tier-one capital ratio of 4 percent and a total capital ratio of 8 percent of risk-weighted assets. While capital requirements for branches of overseas banks operating in New Zealand are not mandatory, the RBNZ has requested that branches, which are deemed as systemically important and with retail deposits exceeding $NZ 200 million, incorporate domestically.

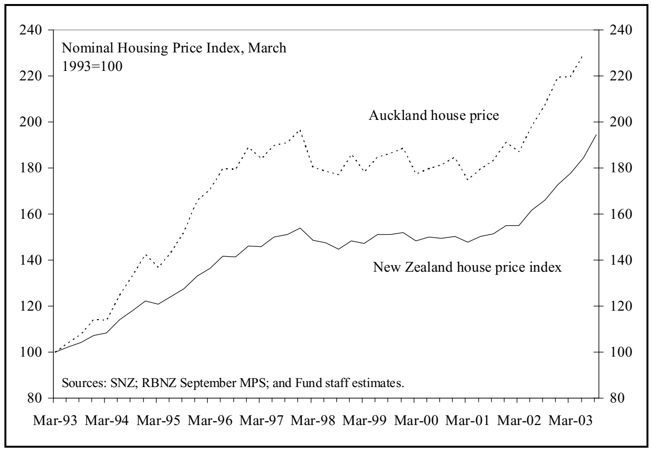
[18] All New Zealand banks are required to have credit ratings independent of their foreign parents.

substantially faster than disposable income. Meanwhile, mortgage debt has gradually risen from 92 percent of disposable income in 1998 to 106 percent in 2002, supported by lower interest rates, lower inflation, and financial deregulation. At the same time, debt servicing costs have declined from 9 percent of disposable income in 1998 to just under 8 percent in 2002; however, servicing costs have risen in the last two years. Net financial wealth continued to decline in 2002 relative to disposable income, primarily reflecting weaknesses in the equity markets. Households are likely to be resilient to a major rise in interest rates, as they have been in the past, provided that there is no major correction in employment.

New Zealand: Household Sector Balance Sheet Indicators 1/
(In percent of annual disposable income)

	1998	1999	2000	2001	2002
Net wealth	411	412	394	387	404
Net financial wealth	176	181	173	168	158
Assets	195	200	195	191	183
Liabilities	19	19	21	23	24
Net housing wealth	235	231	220	219	246
Housing value	327	329	319	319	352
Housing loan	92	98	99	100	106
Debt-servicing costs 1/	8.9	8.4	7.1	7.7	7.9
Savings rate 1/	-4	-4.8	-0.8	-4.4	-3.1

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



7. **Housing prices have recently risen sharply.** Since end-2001, house prices have increased at an average annual rate of 11 percent, with a 12½ percent annual rate increase in the first three quarters of 2003, following a period of relative stability over the preceding five years. Lower interest rates and easier access to credit have enhanced housing affordability, which combined with the recent increase in net immigration have contributed to the price increase.

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

(In billions of New Zealand dollars)

	End-March						
	1997	1998	1999	2000	2001	2002	2003
Total gross external debt	80.7	85.6	97.7	107.3	125.5	133.6	132.4
By sector							
Official government	20.6	20.2	17.4	17.7	16.9	20.1	17.7
Corporate sector	60.1	65.3	80.3	89.6	108.5	113.5	114.7
By sub-sector							
Banks	24.4	32.9	39.5	51.0	63.7	71.1	73.6
Other corporate	35.6	32.4	40.8	38.6	44.8	42.4	41.1
By relation 2/							
Related party	31.0	43.6	45.8	55.5	...	...	
Nonrelated party	29.0	21.8	34.5	34.0	...	...	
By currency 3/							
New Zealand dollar	44.2	45.8	46.1	46.4	46.8	58.9	64.6
Foreign currency	36.5	39.8	51.6	60.9	79.2	74.8	68.9
U.S. dollar	20.3	24.1	31.5	38.0	52.9	49.3	45.9
Japanese yen	4.0	4.3	5.2	8.0	10.4	7.3	4.9
Australian dollar	3.1	3.2	4.1	5.0	7.9	9.2	7.8
Other	5.8	6.0	5.6	5.8	4.9	6.1	7.7
Unallocated	3.3	2.2	5.2	4.0	3.1	2.9	2.6
By (residual) maturity 3/							
Short term (under 1 year) 4/	37.9	35.3	41.7	53.3	65.1	73.1	66.1
Medium term (1-5 years)	20.9	30.2	29.2	33.8	28.3	30.2	27.5
Long term (over 5 years)	18.5	17.9	21.7	16.3	23.8	23.2	29.2
Unallocated	3.3	2.2	5.2	4.0	8.8	7.3	10.7
Nominal GDP (in $NZ)	97.2	100.7	101.9	107.4	113.9	122.7	127.4

Sources: Statistics New Zealand; and Fund staff estimates.

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

2/ Data not available for 2001 and 2002.

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

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

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

(In percent of GDP)

	End-March						
	1997	1998	1999	2000	2001	2002	2003
Total gross external debt	83.1	85.0	95.9	99.9	110.2	108.8	103.9
By sector							
Official government	21.2	20.1	17.1	16.5	14.9	16.4	13.9
Corporate sector	61.8	64.9	78.8	83.4	95.3	92.5	90.0
By sub-sector							
Banks	25.2	32.7	38.8	47.5	55.9	58.0	57.7
Other corporate	36.7	32.2	40.0	35.9	39.3	34.5	32.3
By relation							
Related party	31.9	43.3	45.0	51.7	…	…	…
Nonrelated party	29.9	21.6	33.8	31.7	…	…	…
By currency							
New Zealand dollar	45.5	45.4	45.2	43.2	41.1	48.0	50.7
Foreign currency	37.6	39.6	50.7	56.7	69.6	61.0	54.1
U.S. dollar	20.9	24.0	30.9	35.4	46.5	40.2	36.0
Japanese yen	4.1	4.2	5.1	7.5	9.1	5.9	3.9
Australian dollar	3.2	3.2	4.1	4.7	7.0	7.5	6.1
Other	5.9	6.0	5.5	5.4	4.3	5.0	6.0
Unallocated	3.4	2.2	5.1	3.7	2.7	2.4	2.0
By (residual) maturity							
Short term (under 1 year)	39.0	35.0	40.9	49.6	57.2	59.6	51.9
Medium term (1-5 years)	21.5	30.0	28.6	31.4	24.9	24.6	21.6
Long term (over 5 years)	19.1	17.8	21.3	15.2	20.9	18.9	22.9
Unallocated	3.4	2.2	5.1	3.7	7.7	5.9	8.4

Sources: Statistics New Zealand; and Fund staff estimates.

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

(In percent of total gross external debt)

	End-March						
	1997	1998	1999	2000	2001	2002	2003
Total gross external debt	100.0	100.0	100.0	100.0	100.0	100.0	100.0
By sector							
Official government	25.6	23.6	17.8	16.5	13.5	15.0	13.4
Corporate sector	74.4	76.4	82.2	83.5	86.5	85.0	86.6
By sub-sector							
Banks	30.3	38.5	40.4	47.5	50.8	53.3	55.6
Other corporate	44.1	37.9	41.7	36.0	35.7	31.7	31.1
By relation							
Related party	38.5	50.9	46.9	51.8	…	…	…
Nonrelated party	36.0	25.4	35.3	31.7	…	…	…
By currency							
New Zealand dollar	54.7	53.5	47.2	43.3	37.3	44.1	48.8
Foreign currency	45.3	46.5	52.8	56.7	63.1	56.0	52.0
U.S. dollar	25.2	28.2	32.2	35.4	42.2	36.9	34.7
Japanese yen	5.0	5.0	5.3	7.5	8.3	5.4	3.7
Australian dollar	3.8	3.8	4.2	4.7	6.3	6.9	5.9
Other	7.2	7.0	5.8	5.4	3.9	4.6	5.8
Unallocated	4.1	2.6	5.3	3.7	2.4	2.2	1.9
By (residual) maturity							
Short term (under 1 year)	47.0	41.2	42.7	49.6	51.9	54.8	49.9
Medium term (1-5 years)	25.9	35.3	29.8	31.5	22.6	22.6	20.8
Long term (over 5 years)	23.0	20.9	22.2	15.2	19.0	17.3	22.0
Unallocated	4.1	2.6	5.3	3.7	7.0	5.4	8.1

Sources: Statistics New Zealand; and Fund staff estimates.

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

(In billions of New Zealand dollars)

	End-March					
	1998	1999	2000	2001	2002	2003
Foreign currency external debt 1/	43.2	48.7	57.9	76.5	68.4	62.4
Of which : covered by SNZ hedging supplement	32.4	38.0	47.0	56.5	61.9	50.9
Coverage of supplement (percent)	75.1	78.0	81.2	73.8	90.5	81.5
Type of hedge 2/						
Financial derivatives	17.6	24.5	30.6	35.4	39.5	38.4
Naturally hedged (against assets/receipts)	13.2	12.4	14.8	21.0	18.9	17.2
Unhedged	1.7	1.1	1.6	0.1	3.5	6.9
By sector						
Banks	15.9	23.8	31.9	37.7	39.7	36.8
Financial derivatives	11.6	19.3	26.0	27.3	27.4	26.1
Naturally hedged (against assets/receipts)	4.3	4.4	5.3	10.4	…	9.5
Unhedged	0.1	0.0	0.6	0.0	…	1.2
Corporate and official	16.5	14.2	15.0	18.8	22.2	25.7
Financial derivatives	6.0	5.2	4.6	8.1	12.1	12.3
Naturally hedged (against assets/receipts)	9.0	8.0	9.5	10.6	...	...
Unhedged	1.6	1.0	1.0	0.1	...	...

Sources: Statistics New Zealand; Fund staff estimates.

(1) Data through 2000 are as published in Total Overseas Debt. From March 2001, FX denominated overseas debt is total debt less $NZ debt less financial derviatives in a net liability position denominated in foreign currencies.
(2) For 2003, refers to total FX denominated overseas debt. For previous periods data are FX denominated overseas debt encompassed by the hedging supplement.

NEW ZEALAND—FUND RELATIONS
(As of February 29, 2004)

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

II.	**General Resources Account:**	**SDR Million**	**Percent Quota**
	Quota	894.60	100.0
	Fund Holdings of Currency	525.07	58.69
	Reserve position in Fund	369.55	41.31

III.	**SDR Department:**	**SDR Million**	**Percent Allocation**
	Net cumulative allocation	141.32	100.0
	Holdings	19.91	14.09

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund: None

VII. Exchange Arrangement:

The New Zealand dollar has floated freely since March 1985. New Zealand maintains an exchange system that is free of restrictions on international payments and transfers for current and capital transactions, with the exceptions of restrictions maintained in accordance with relevant U.N. Security Council Resolutions against Iraq, the Federal Republic of Yugoslavia (Serbia/Montenegro), the UNITA movement in Angola, Libya, and Taliban. These were all notified to the Fund pursuant to Decision No. 144.

VIII. Article IV Consultation:

New Zealand is on the 12-month consultation cycle. The 2003 Article IV consultation discussions were held during January 29–February 7, 2003, the Executive Board discussed the staff report (IMF Country Report No. 03/121, 5/2/03) and concluded the consultation on April 30, 2003.

IX. FSAP Participation and ROSCs:

FSAP mission took place during October 30–November 19, 2003 and will be concluded with 2004 Article IV consultation.

X. Technical Assistance: None

XI. Resident Representative/Advisor: None

NEW ZEALAND: CORE STATISTICAL INDICATORS

(As of March 29, 2004)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	External Public Debt	GDP/GNP
Date of latest observation	3/29/2004	Jan. 2004	Jan. 2004	Jan. 2004	Jan. 2004	3/29/2004	Dec. 2003	Jan. 2004	Dec. 2003	Jan. 2004	Jan. 2004	Dec. 2003
Date received	3/29/2004	2/26/2004	2/26/2004	2/16/2004	2/26/2004	3/29/2004	1/20/2004	3/9/2004	3/25/2004	3/12/2004	3/12/2004	3/26/2004
Frequency of data	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Quarterly	Monthly	Quarterly	Monthly	Monthly	Quarterly
Frequency of reporting	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Quarterly	Monthly	Quarterly	Monthly	Monthly	Quarterly
Source of data	Reuters	RBNZ	RBNZ	RBNZ	RBNZ	Reuters	SNZ	SNZ	SNZ	Treasury	Treasury	SNZ
Mode of reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of publication	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Quarterly	Monthly	Quarterly	Monthly	Quarterly	Quarterly

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 04/50
May 5, 2004

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

IMF Concludes 2004 Article IV Consultation with New Zealand

On April 30, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with New Zealand.[1]

Background

The New Zealand economy has performed strongly in recent years. Despite the global slowdown and periods of drought at home, real GDP growth averaged about 3¾ percent during 1999–2003. The strong economic performance reflects the ongoing benefits from the extensive structural reforms that have been implemented since the early 1980s and the continued confidence in the macroeconomic environment fostered by transparent monetary and fiscal policy frameworks.

Growth slowed in early 2003 but rebounded in the latter part of the year. Real GDP growth declined from 4¼ percent in 2002 to a seasonally adjusted annualized rate of 2¾ percent in the first half of 2003, amid heightened international geopolitical tensions, concerns about SARS, and declines in farm output and hydroelectric generation related to a drought. However, with an improved international environment and better weather conditions, output growth rebounded to over 4 percent seasonally adjusted annualized rate in the second half of the year. Residential investment and household spending have been robust, reflecting strong income growth, real income gains from the New Zealand dollar's appreciation, the strength in net immigration, solid employment growth, wealth effects from rising house prices, lower interest rates, and financial

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

innovation. Business investment growth has also strengthened, in response to emerging capacity constraints, lower interest rates, and declining prices (in New Zealand dollars) for capital goods imports. However, net exports deteriorated reflecting the relative cyclical position and the continued appreciation of the New Zealand dollar.

Although the external current account deficit has widened, external liabilities have declined as a share of GDP. The current account deficit widened from about 2½ percent of GDP in 2001 to 4½ percent of GDP in 2003. Net external liabilities declined from their peak of 87 percent of GDP at end-1998 to 76 percent of GDP at end-2003, reflecting both the strong GDP growth over this period and valuation gains from the recent appreciation of the New Zealand dollar.

Inflation has remained within the official 1–3 percent target range, despite increasing resource constraints. CPI inflation declined to 1½ percent in each of the four quarters through March 2004 from 2¾ percent in 2002. There were, however, sharply divergent trends in the major components of the CPI. In particular, tradables inflation is now negative owing to the impact of the sizable currency appreciation, while nontradables inflation has increased sharply, led by a jump in housing-related costs, most notably for the purchase and construction of new dwellings. Even excluding the housing component, however, nontradables price inflation is running at over 3 percent. Employment growth averaged over 2½ percent during 2002 and 2003, and the unemployment rate declined to a 16-year low of 4.4 percent in September before rising slightly to 4.6 percent in December. Although businesses are reporting increased labor shortages, particularly of higher-skilled workers, measures of private sector wage growth have so far picked up only moderately. At the same time, the capacity utilization rate is at a relatively high level.

The New Zealand dollar appreciated substantially during 2002 and 2003, but has depreciated somewhat since reaching a seven-year high in mid-February 2004. Overall, since end-2001, the New Zealand dollar has risen by nearly 50 percent vis-à-vis the U.S. dollar through end-April 2004, by 7 percent relative to the Australian dollar, and by 27 percent on a trade-weighted (TWI) basis. The TWI is now 8 percent above its ten-year average. The medium-term appreciation reflects a combination of comparatively high interest rates in New Zealand, the country's strong recent growth performance relative to most other developed countries, and strengthening commodity prices in U.S. dollar terms, along with weakness in the U.S. dollar.

Monetary policy has successfully kept inflation in the target range. Between April and July 2003, the Reserve Bank of New Zealand cut the official cash rate (OCR) by a total of 75 basis points in three moves—bringing the rate to 5 percent—based on its assessment that economic activity was likely to cool in response to weak external conditions, an appreciating currency, and slowing net immigration. However, the RBNZ increased the OCR by 25 basis points each in January and April 2004, when indicators of economic activity suggested that domestic demand going forward could be more robust than expected. The RBNZ also noted in April that it would continue to watch economic indicators closely to determine if further rate increases would be required later in 2004.

The fiscal position has continued to strengthen during the past year. The operating surplus nearly doubled to 4¼ percent of GDP in 2002/03 (fiscal year starting July 1), and the overall cash surplus widened to almost 2 percent of GDP. Factors contributing to the improvement include significantly better-than-expected tax revenues, lower spending, and higher Crown entity surpluses. Gross government debt declined to 28 percent of GDP, with net debt (excluding the assets of the New Zealand Superannuation Fund) falling to 13½ percent.

Real GDP growth is projected to ease to 3 percent in 2004 and 2½ percent in 2005. However, the outlook is subject to considerable uncertainty with the economy operating at a high level of resource utilization, slowing net immigration, continued strength in domestic demand, an improving world economy, and the specter of further currency appreciation. Medium-term prospects remain favorable. Beyond 2006, real GDP growth is projected to increase to an average of around 3¼ percent, owing mainly to a gradual improvement in net exports. The external current account deficit is forecast to remain broadly unchanged, with improvements on the goods and services account offset by a widening investment income deficit. The inflation rate is expected to be around 2 percent over the medium term.

Executive Board Assessment

Executive Directors welcomed the strong performance of New Zealand's economy in recent years, which reflects the authorities' continued skillful management of macroeconomic policies and the ongoing benefits from the extensive structural reforms that have been implemented since the 1980s.

Directors considered that the foundations for sustained economic growth remain firmly in place. Nevertheless, with the economy operating at a high level of resource utilization, continued strength in domestic demand, volatility in the exchange rate, and slowing net immigration, they urged the authorities to be ready to adapt policies as needed to ensure that the economy remains on a sound growth path.

Directors noted that in the current environment, with resource pressures still tight and an uncertain path for the exchange rate, determining the appropriate monetary policy setting is particularly challenging. In this context, they considered that the Reserve Bank of New Zealand's (RBNZ) recent decision to raise the official cash rate was prudent and consistent with the monetary policy framework.

Directors emphasized that the floating exchange rate regime has served New Zealand well. Reflecting New Zealand's strong relative cyclical performance and strengthening commodity prices, they noted that the real effective exchange rate had appreciated significantly from its cyclical trough in late 2000 to its peak in February 2004, when it was well above its 10-year average. They concurred with the authorities' decision to increase the level of international reserves given the changes that have taken place in the international economy since the mid 1980s when the RBNZ last significantly raised these reserves. In connection with the indication that the RBNZ would contemplate exchange market intervention if the exchange rate were viewed as being "exceptionally and unjustifiably" high or low, Directors were generally of the view that this policy was consistent with the inflation targeting framework and would be in line with that used in many other developed countries provided, as the central bank has emphasized, it would not defend a particular exchange rate level. Some Directors, however, noted that the efficacy of such intervention to moderate exchange rate cycles is unproven.

Directors continued to support the sound medium-term orientation of fiscal policy. In this connection, they endorsed the government's objective of achieving budgetary operating surpluses over the economic cycle sufficient to meet contributions to the New Zealand Superannuation Fund (NZSF), while keeping gross debt trending down over the longer term and meeting capital spending requirements. Directors agreed that the improvement in fiscal prospects relative to the 2003 budget provides the authorities with an opportunity to introduce a limited number of new fiscal initiatives, including the Future Directions package, beginning in the 2004 budget. However, to support monetary policy in the near term, they stressed that the authorities should hold the line on spending to what was proposed in the *December Economic and Fiscal Update*, maintain prudence and discipline in making expenditure decisions, and save any further unanticipated gains in revenue.

Over the longer term, New Zealand will face significant spending pressures owing to population aging and rising healthcare costs. Directors considered that the establishment of a partial pre-funding of future pension liabilities through the NZSF was an important step to address some of these pressures. Nonetheless, they suggested that other measures are likely to be needed to contend fully with the long-term fiscal challenges, including further changes in the structural parameters of the pension and healthcare systems. They emphasized that such measures should be adopted sufficiently early to help smooth fiscal costs over time and allow individuals to adapt their savings behavior.

Directors emphasized the importance of the government's efforts to raise the labor force participation rate and build an even more skilled workforce, including by providing the right incentives to move people from welfare to work; improving education, training, and access to childcare; and maintaining labor market flexibility. In this context, they noted that the Future Directions package could play a significant role by providing in-work benefits that lower the high effective marginal tax rates currently faced by welfare recipients when they take up employment. They also supported enhancing labor force participation by tightening up and strictly enforcing eligibility requirements for receiving benefits. In addition, Directors stressed that recent and proposed changes in labor legislation should be implemented in ways that do not impair the flexibility of New Zealand's labor market. To reduce infrastructural bottlenecks, they advocated further investments in the electricity and transport sectors.

Directors strongly backed New Zealand's ongoing commitment to the multilateral trading system, and its active participation in the Doha Round. They noted that the tariffs imposed by New Zealand on most imports are low or zero, and that tariffs in the few remaining heavily-protected sectors are slated for further reduction starting in 2006. Directors observed that New Zealand continues to face substantial trade barriers in key areas, including agricultural products, and many Directors urged industrial countries to reduce these barriers.

Directors agreed that New Zealand remains generally well placed to absorb adverse shocks without undue economic distress. They concurred that the recent substantial widening of the external current account deficit mainly reflected the sharp appreciation of the New Zealand dollar and the relatively strong cyclical position of the economy. Directors believed that the low and declining level of public debt, the relatively stable source of external financing, the general soundness of corporate and banking sector balance sheets, and the strong risk management culture in New Zealand's financial institutions should limit New Zealand's vulnerability significantly. Nevertheless, they cautioned that the size of the external debt position could leave New Zealand potentially vulnerable to sharp shifts in market sentiment and recommended strengthening national savings. Also, while debt servicing remains manageable, they observed that households could be subject to somewhat more stress than in the past in the event of a substantial increase in interest rates. Directors, therefore, endorsed continued close monitoring of sectoral balance sheets.

In this context, Directors welcomed New Zealand's participation in the Financial Sector Assessment Program. They concurred with the general finding of the Financial System Stability Assessment (FSSA) that New Zealand's financial sector has a high degree of short-term stability and an overall sound outlook. They noted that the discipline of New Zealand's market-based disclosure regime is supplemented by home country supervision of the major foreign banks and supported by a well-functioning market environment and sound economic policies. They observed that the banking system is well capitalized, highly profitable, and employs sophisticated risk management systems. They also noted that the banking system is highly resilient to shocks from large exchange rate swings, house price declines, and negative supply shocks. Nevertheless, Directors recommended continued vigilance in regard to potential shocks and the need to ensure prudent lending practices in the housing market.

Directors endorsed the FSSA's main recommendations, which aim at preserving stability in the medium and longer term. These recommendations included strengthening the RBNZ's ability to undertake timely, focused monitoring of bank risks; further developing its ability to manage a situation in which the solvency of a systemically important bank comes into question and to handle associated stresses on the financial system; and, given the unique role of Australian-owned banks in New Zealand, enhancing cooperation and coordination between supervisors in the two countries.

Directors welcomed New Zealand's invitation to the Financial Action Taskforce to send a team to examine Anti-Money Laundering and Countering the Financing of Terrorism issues.

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

Table 1. New Zealand: Selected Economic Indicators

	1999	2000	2001	2002	2003
Real economy (percent change)					
GDP (production basis)	3.9	4.0	2.5	4.3	3.5
Domestic demand	5.8	1.8	2.3	5.1	6.1
Exports of goods and services	8.0	6.5	2.4	5.8	1.1
Imports of goods and services	11.9	0.2	1.6	8.8	10.1
Headline CPI inflation	-0.1	2.6	2.6	2.7	1.8
Unemployment rate (in percent)	6.8	6.0	5.3	5.2	4.7
Investment (in percent of GDP)	20.3	20.5	20.1	20.8	21.7
National saving (in percent of GDP) 1/	14.3	15.0	17.5	17.1	17.2
Public finance (in percent of GDP) 2/					
Revenue	35.3	33.6	33.9	32.2	33.9
Expenditure	34.7	33.2	32.8	30.6	32.4
OBERAC 3/	0.2	0.8	1.8	2.2	4.3
Estimated structural balance 4/	1.2	0.6	1.8	2.1	3.9
Net public debt	21.0	19.7	17.2	14.3	13.6
Money and credit (end of period)					
M3 (percent change)	6.9	6.5	11.4	11.5	5.6
Private domestic credit (percent change)	10.8	6.4	9.5	9.1	8.0
Government bond yield (10-year, in percent)	7.3	6.0	6.8	6.1	5.9
Balance of payments ($NZ billion)					
Current account	-6.6	-5.4	-3.1	-4.6	-6.0
(in percent of GDP)	-6.3	-4.8	-2.6	-3.7	-4.5
Trade balance (goods)	-0.7	1.5	3.5	1.2	-0.7
Foreign assets and liabilities ($NZ billion) 5/					
Net international investment position 6/	-87.1	-87.1	-88.1	-98.3	-101.0
(in percent of GDP)	-85.5	-81.1	-77.4	-80.1	-79.3
Gross short-term external debt 7/	43.7	54.1	65.2	73.0	66.0
Official reserves	7.3	7.9	8.6	7.7	9.1
Exchange rate (end of period)					
US$/$NZ	0.52	0.44	0.42	0.53	0.65
Trade-weighted index (June 1979 = 100)	55.7	50.5	50.3	58.8	65.2
Nominal effective exchange rate 8/	93.3	85.9	86.5	98.5	109.5
Real effective exchange rate 8/	87.6	81.5	82.7	94.8	105.3

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

1/ Based on national accounts data.
2/ Fiscal years ending June 30. Significant changes have been made to fiscal data compilation. Thus, revenue and expenditure estimates from 2002 are not directly comparable with those for previous years.
3/ Operating balance net of revaluations and accounting changes.
4/ Fund staff estimates; equals operating balance net of cyclical effects, revaluations, and changes in accounting rules.
5/ Data for end-March of each year. Data from 2001 are not directly comparable with the historical data due to methodology changes.
6/ Data based on International Investment Position statistics.
7/ Residual maturity basis. Data based on Total Overseas Debt until 2000, and on International Investment Position thereafter.
8/ IMF Information Notice System index (1990 = 100).