



May 2021

# NEW ZEALAND

## 2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NEW ZEALAND

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 2021 Article IV consultation with New Zealand, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 5, 2021 consideration of the staff report that concluded the Article IV consultation with New Zealand.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 5, 2021, following discussions that ended on March 11, 2021, 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 21, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for New Zealand

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

### Selected Issues

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

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Washington, D.C.**



## IMF Executive Board Concludes 2021 Article IV Consultation with New Zealand

FOR IMMEDIATE RELEASE

**Washington, DC – May 5, 2021:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with New Zealand.

New Zealand's economy has weathered the COVID-19 shock relatively well. A sound public health response was effective in bringing infection rates quickly under control. While the pandemic and hard lockdown led to an unprecedented decline in activity in the first half of 2020, activity rebounded strongly in the second half on successful virus suppression and unprecedented fiscal and monetary policy support. Due to the ongoing border closure, tourism and education exports are lagging other sectors in the recovery. By contrast, low interest rates together with a structural housing supply shortage have led to rapidly rising house prices and strong construction activity. As in most advanced economies, inflation has remained subdued and the financial system has remained resilient.

Despite expected near-term sluggish growth on account of the missed tourist season, real GDP is projected to grow by 4 percent in 2021, driven by domestic demand. However, the ongoing global pandemic and border closure will continue to depress migration and tourism flows. The unemployment rate is expected to peak at around 5.1 percent, while wage growth should remain modest. Inflation could experience temporary increases in the near term but, with output and employment below potential, is expected to durably reach the two-percent midpoint of the Reserve Bank of New Zealand (RBNZ)'s target range only from 2024.

Key near-term risks to the economic outlook relate to the domestic and global paths of the COVID-19 pandemic. Renewed domestic outbreaks and the potential for health risks to delay the border opening constitute important downside risks to growth, as does COVID-19's impact on New Zealand's trading partners and its export commodity prices. By contrast, faster-than-expected vaccine rollout could prompt a faster border reopening and stronger external demand.

### Executive Board Assessment<sup>2</sup>

Executive Directors commended the authorities' successful response to the COVID-19 pandemic. Comprehensive public health measures and economic policies have cushioned the impact on the vulnerable, sustained financial stability, and helped set the stage for a rapid economic recovery. Directors noted, however, that the recovery remains uneven and risks are still elevated. It will, therefore, be necessary for macroeconomic policies to remain

<sup>1</sup> 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.

<sup>2</sup> 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. An explanation of any qualifiers used in summing up can be found here: <http://www.IMF.org/external/hp/sec/misc/qualifiers.htm>.

accommodative, while accelerating structural reforms to limit scarring, boost productivity, and foster green, inclusive growth.

Directors emphasized the importance of avoiding a premature removal of fiscal and monetary policy support. They welcomed the authorities' intention to stand ready to deploy additional measures in case downside risks materialize. Directors noted that the pace of policy normalization needs to be calibrated to economic and financial developments. As the recovery strengthens, shifting from job retention to active labor market policies will help mitigate economic scarring and make the recovery more inclusive. Medium-term fiscal targets can be reviewed and updated once the uncertainty subsides.

Directors welcomed the authorities' comprehensive approach to tackling housing imbalances amid a rapid increase in house prices. They agreed that recently announced measures would help limit near-term house price increases and strengthen housing supply. Directors recommended, as a durable solution, freeing up land supply, improving planning and zoning, and fostering infrastructure investments to enable fast-track housing developments.

Directors highlighted the need to continue monitoring the financial system's resilience. While the banking system remains well capitalized and liquid, Directors encouraged the authorities to stand ready to deploy additional macroprudential measures when deemed necessary to mitigate financial risks, particularly those related to elevated house prices and banks' concentrated exposure to the real estate sector. They noted that the ongoing review of the central bank act provides an opportunity to further strengthen the governance and operational autonomy of the Reserve Bank and to equip it with the tools needed to respond flexibly to financial stability risks. Directors stressed the importance of maintaining the focus of monetary policy on its inflation and employment objectives.

Directors encouraged continued efforts to foster durable, inclusive, and green growth. They recommended reforming product markets, expanding research and development spending, and streamlining the approval process for foreign direct investment. Directors called on the authorities to prioritize infrastructure investment, with a focus on reducing infrastructure gaps and supporting a green recovery. They looked forward to the finalization of the authorities' emissions reduction plan.

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

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Projections										
<b>NATIONAL ACCOUNTS</b>											
Real GDP (production)	3.9	3.5	3.4	2.4	-2.9	4.0	3.2	2.6	2.5	2.4	2.5
Real GDP (expenditure)	4.2	4.0	4.3	3.0	-1.1	3.0	2.8	2.5	2.4	2.4	2.3
Domestic demand	4.6	5.3	5.3	2.9	-2.5	5.4	2.7	2.3	2.3	2.4	2.6
Private consumption	5.9	5.6	4.4	3.6	-1.8	3.7	3.4	2.7	2.5	2.8	3.1
Public consumption	2.0	3.4	3.4	5.4	5.8	2.2	0.9	0.8	0.9	0.6	0.8
Investment	3.5	5.7	9.0	0.3	-10.3	9.5	2.7	2.3	2.9	2.7	2.5
Public	-1.1	7.1	3.8	-0.6	-4.8	5.6	0.6	-0.6	2.1	1.8	1.8
Private	4.6	4.2	8.5	4.3	-8.3	6.5	3.3	3.1	3.1	3.0	2.7
Private business	1.3	7.3	12.3	4.1	-10.1	3.1	3.2	2.8	3.2	3.1	2.7
Dwelling	11.4	-1.5	1.2	5.0	-4.4	13.4	3.5	3.8	3.0	2.7	2.7
Inventories (contribution to growth,	0.1	0.2	0.4	-0.7	-0.7	0.6	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	-0.5	-1.7	-1.4	-0.1	2.1	-2.8	-0.2	0.1	0.0	-0.2	-0.4
Real gross domestic income	4.6	5.4	3.7	3.0	-0.9	3.6	2.6	2.1	2.1	2.5	2.4
Investment (percent of GDP)	23.1	23.5	24.6	24.0	21.7	23.3	23.3	23.3	23.5	23.6	23.6
Public	5.3	5.4	5.4	5.3	5.0	5.1	5.1	4.9	4.9	4.9	4.8
Private	17.8	18.0	19.2	18.7	16.6	18.1	18.2	18.4	18.6	18.7	18.7
Savings (gross, percent of GDP)	20.9	20.5	20.4	20.7	20.9	21.2	21.2	20.9	20.8	20.8	20.8
Public	1.0	1.3	1.1	-2.3	-5.9	-5.5	-4.2	-2.9	-1.7	-0.6	-0.1
Private	19.9	19.2	19.3	23.0	26.8	26.7	25.4	23.9	22.5	21.4	20.9
Potential output	3.0	2.9	2.9	2.9	1.8	1.5	1.9	2.2	2.3	2.4	2.5
Output gap (percent of potential)	0.0	0.6	1.0	0.6	-4.2	-1.8	-0.6	-0.2	0.0	0.0	0.0
<b>LABOR MARKET</b>											
Employment	4.8	4.2	2.9	1.3	1.4	0.1	1.3	1.3	1.6	1.6	1.4
Unemployment (percent of labor force)	5.2	4.7	4.3	4.1	4.6	5.1	4.9	4.7	4.5	4.4	4.4
Wages (nominal percent change)	1.9	2.1	3.1	3.9	3.6	1.9	2.5	3.1	3.5	3.5	3.7
<b>PRICES</b>											
Terms of trade index (goods, % change)	1.1	7.3	-1.7	0.3	3.0	2.7	-1.1	-1.9	-1.6	-0.1	-0.1
Consumer prices (avg, % change)	0.6	1.9	1.6	1.6	1.7	1.8	1.6	1.7	2.1	2.1	2.2
GDP deflator (avg, % change)	1.8	3.3	1.2	2.2	2.2	1.8	1.5	1.4	1.9	2.2	2.3
<b>MACRO-FINANCIAL</b>											
Official cash rate (policy rate, percent, avg)	2.2	1.8	1.8	1.4	0.4	0.3	0.3	0.3	0.6	1.1	1.6
Credit to the private sector (percent change)	7.0	4.9	5.4	5.6	3.9	5.2	5.0	5.4	5.2	4.5	3.8
Interest payments (percent of disposable income)	8.1	7.7	7.5	7.1	6.2	6.4	6.5	6.6	7.4	8.1	8.6
Household savings (percent of disposable income)	3.2	3.3	3.2	3.4	3.6	3.5	3.2	3.2	3.0	3.0	3.0
Household debt (percent of disposable income)	159	159	158	160	166	167	169	171	172	171	169
<b>GENERAL GOVERNMENT (percent of GDP) 1/</b>											
Revenue	37.5	36.9	37.3	36.5	36.7	36.0	35.7	36.0	36.3	36.6	36.9
Expenditure	36.5	35.6	36.2	38.8	42.7	41.5	39.9	38.9	37.9	37.3	37.0
Net lending/borrowing	1.0	1.3	1.1	-2.3	-5.9	-5.5	-4.2	-2.9	-1.7	-0.6	-0.1
Operating balance	2.6	3.0	3.2	-0.4	-3.7	-2.8	-1.7	-0.8	0.1	1.1	1.6
Cyclically adjusted balance 2/	1.7	1.7	1.4	-1.1	-3.9	-3.9	-2.8	-1.6	-0.3	0.7	1.2
Gross debt	33.4	31.1	28.1	32.1	43.1	49.9	53.9	55.9	56.1	54.4	52.1
Net debt	6.6	5.5	4.7	7.0	14.9	22.3	26.3	28.2	27.7	25.9	23.7
Net worth	85.6	89.5	92.4	86.6	78.5	70.8	66.9	65.4	65.5	65.8	65.6
<b>BALANCE OF PAYMENTS</b>											
Current account (percent of GDP)	-2.2	-3.0	-4.2	-3.3	-0.8	-2.1	-2.1	-2.4	-2.7	-2.8	-2.8
Export volume	2.4	2.5	2.8	2.3	-12.1	-0.5	8.4	5.0	4.6	3.5	3.1
Import volume	3.8	7.3	6.5	2.2	-16.3	9.3	7.2	3.6	3.7	3.4	3.6
Net international investment position (percent of	-57.4	-52.1	-55.9	-53.7	-55.0	-54.5	-54.4	-54.7	-55.1	-55.4	-55.8
Gross official reserves (bn US\$)	18.2	20.3	17.6	17.0	13.0	...	...	...	...	...	...
<b>MEMORANDUM ITEMS</b>											
Nominal GDP (bn NZ\$)	267	287	303	319	322	337	352	366	382	400	418
Percent change	6.0	7.5	5.6	5.3	1.0	4.8	4.3	3.9	4.3	4.6	4.7
Nominal GDP per capita (US\$)	39,428	42,330	42,803	42,166	41,127	47,499	49,027	50,522	52,329	54,302	56,341
Real gross national disposable income per capita	50,225	51,374	52,372	53,537	52,499	54,068	55,006	55,304	55,587	55,950	57,807
Percent change	3.0	2.3	1.9	2.2	-1.9	3.0	1.7	0.5	0.5	0.7	3.3
Population (million)	4.7	4.8	4.9	5.0	5.1	5.1	5.2	5.3	5.3	5.4	5.5
US\$/NZ\$ (average level)	0.697	0.711	0.693	0.659	0.650	...	...	...	...	...	...
Nominal effective exchange rate	109.6	111.1	106.8	105.2	103.8	...	...	...	...	...	...
Real effective exchange rate	105.8	107.4	102.9	101.3	100.5	...	...	...	...	...	...

Sources: Authorities' data and IMF staff estimates and projections

1/ Calendar year.

2/ In percent of potential GDP.



# NEW ZEALAND

## STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

April 20, 2021

### KEY ISSUES

**Context.** New Zealand's sound management of the COVID-19 crisis has been effective in bringing infection rates quickly under control. Decisive fiscal and monetary policy responses have been instrumental in cushioning the economic impact. Although economic activity was hit hard initially, it has recovered faster than expected. That said, the recovery has been uneven, with some sectors and workers disproportionately affected.

**Outlook and Risks.** The economy is expected to grow by 4 percent in 2021, with all domestic demand components contributing. However, New Zealand's continued travel restrictions will depress migration and tourism in the near term. Inflation is expected to durably reach the two-percent midpoint of the Reserve Bank of New Zealand's (RBNZ) target range only by 2024. Significant downside risks to growth remain, centered on the domestic and global course of the pandemic, although a faster-than-expected international rollout of vaccines could lead to a faster border reopening and a more rapid domestic recovery. Surging house prices and elevated household debt aggravate affordability concerns and may amplify the housing cycle and financial-stability risks.

#### Policy recommendations

- **Macroeconomic policies.** Policies remain appropriately accommodative. With output remaining below potential and the recovery still uneven, support should not be withdrawn prematurely, so long as wage and inflation pressures remain muted. In an environment of continued high uncertainty, the authorities should stand ready to deploy additional monetary and fiscal stimulus in case downside risks materialize.
- **Financial sector policies.** Financial sector vulnerabilities from surging house prices are being addressed by tightening macroprudential measures. Broadening the available macroprudential toolkit would increase the RBNZ's ability to flexibly react to any newly emerging vulnerabilities.
- **Structural policies** should focus on demand and supply imbalances in the housing market to support housing affordability, and on reforms to help limit scarring from the pandemic, which has hit disadvantaged groups hardest. Active labor market policies for employment should be expanded where possible, and additional policies to encourage research and development could help address low productivity growth, an issue of concern in New Zealand well before the pandemic.

**Approved By**  
**Jonathan D. Ostry (APD)**  
**and Martin Cihak (SPR)**

Virtual consultations took place from February 22–March 11, 2021. The mission team comprised: Harald Finger (Head), Yosuke Kido, Elena Loukoianova, Narayanan Raman, and Yu Ching Wong (all APD). Chris White (OED) joined the discussions. Mr. Ostry joined the concluding meetings. Ioana Hussiada and Nadine Dubost assisted in the preparation of this report.

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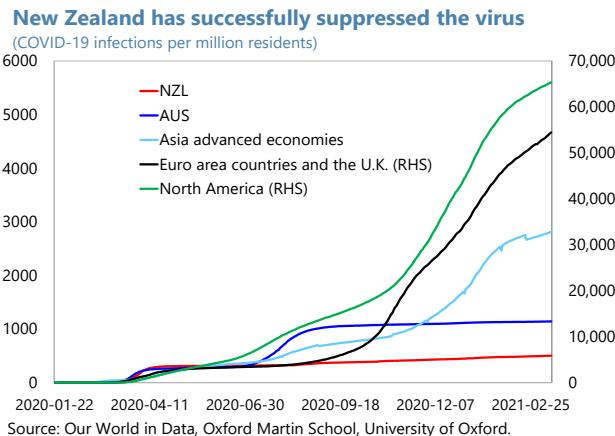
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# A SWIFT BUT STILL UNEVEN RECOVERY AMID HEIGHTENED UNCERTAINTY

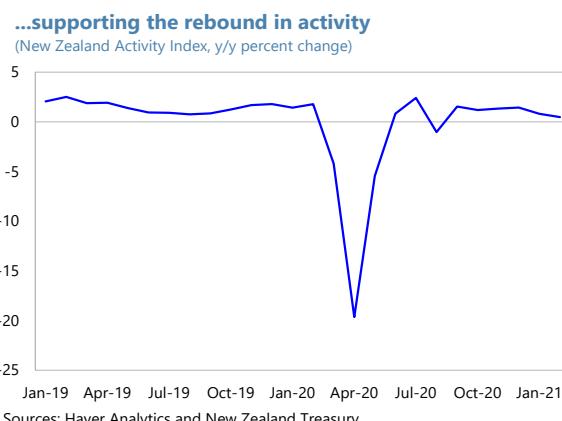
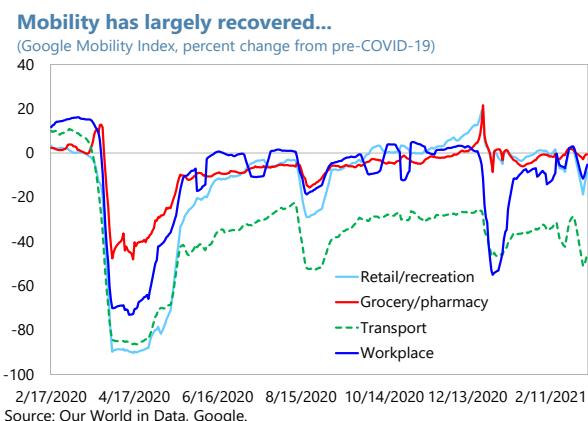
## A. Context and Recent Developments

### 1. New Zealand's management of the COVID-19 health crisis has been successful.

Following an initial wave in March/April 2020, infection rates were brought under control quickly through strict, managed quarantine requirements; strong focus on testing, contract tracing, and social distancing; a hard lockdown in 2020Q2; and ongoing strict travel restrictions (Box 1). Despite intermittent small regional clusters, the number of cases has stayed exceptionally low, with only 26 deaths to date.



**2. Economic activity fell sharply initially but recovered faster than expected.** While the pandemic and hard lockdown led to an unprecedented decline in activity in the first half of 2020, activity, measured by production GDP, rebounded strongly in the second half, temporarily surpassing pre-COVID levels in 2020Q3 before moderating in 2020Q4. While most COVID-related restrictions have been removed, with ongoing travel restrictions, tourism and education exports lag other sectors in the recovery. By contrast, low interest rates together with a structural housing supply shortage have fueled housing demand and construction. Real GDP declined by 2.9 percent in 2020, much less than feared initially. As in most advanced economies, inflation has remained subdued, at 1.4 percent y/y in 2020Q4.



**3. Employment and labor incomes have held up better than expected, but the impact has been uneven.** After reaching 5.3 percent in 2020Q3, the unemployment rate declined to 4.9 percent by end-2020, helped by the fiscal support package. Hourly wages grew by one percent q/q in

2020Q4. Job losses have been unevenly distributed, concentrated in contact-intensive service sectors, disproportionately impacting youth, women, and some ethnic groups.

**4. Despite a marked decline in external demand, the current account deficit narrowed significantly in 2020** (Figure 4). The deficit (0.8 percent of GDP) was driven by a stronger contraction in import volumes (-16.3 percent, due to weaker domestic demand and lower tourism outflows) than export volumes (-12.1 percent). The terms of trade improved by one percent on stronger food export prices, including for dairy products.

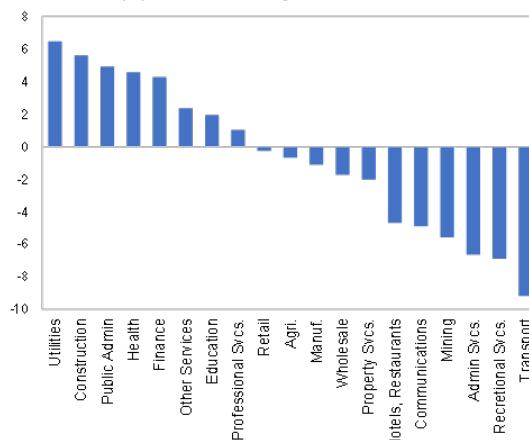
**5. The external position in 2020 was broadly in line with fundamentals and desired policy settings.** With a narrower current account deficit and a real exchange rate depreciation of 1.7 percent from end-2019, the external sector assessment has changed from the 2019 Article IV consultation, when it had been assessed as weaker than implied by fundamentals and desired policy settings. The main current account model under the Fund's external balance assessment suggests that the real exchange rate is overvalued by about 1.4 percent, while the results from the other methodologies fall along a large range around a mid-point of an undervaluation of about 0.3 percent (Annex I). The assessment is subject to exceptionally high uncertainty given the large, temporary impact of COVID-19.

**6. New Zealand is among the signatories of the Regional Comprehensive Economic Partnership (RCEP).** The RCEP strengthens commitments among some of New Zealand's existing trade partners in addressing non-tariff barriers, and is expected to boost regional trade. New Zealand also concluded negotiations on upgrades to the existing bilateral free trade agreement (FTA) with China, adding new chapters on the environment, competition policy, government procurement and e-commerce, and modernizing rules and procedures.

**7. The financial system remains resilient.** Banks remain well-capitalized and liquid. The RBNZ's liquidity provision has been instrumental in reducing banks' funding costs and wholesale funding requirements. Banks offered mortgage payment deferral, with usage already declining from 8 to 0.8 percent of total mortgage loans over May–December 2020. The banks' non-performing loan ratio remained low at 0.6 percent in December 2020. Banks' lending portfolio changed, with a large drop in business loans, driven by declines in

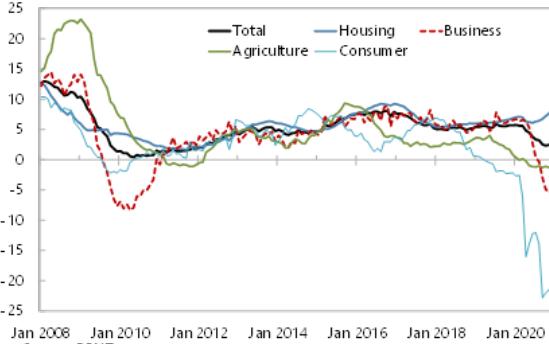
**Uneven sectoral distribution of employment**

(Dec. 2020, y/y percent change)

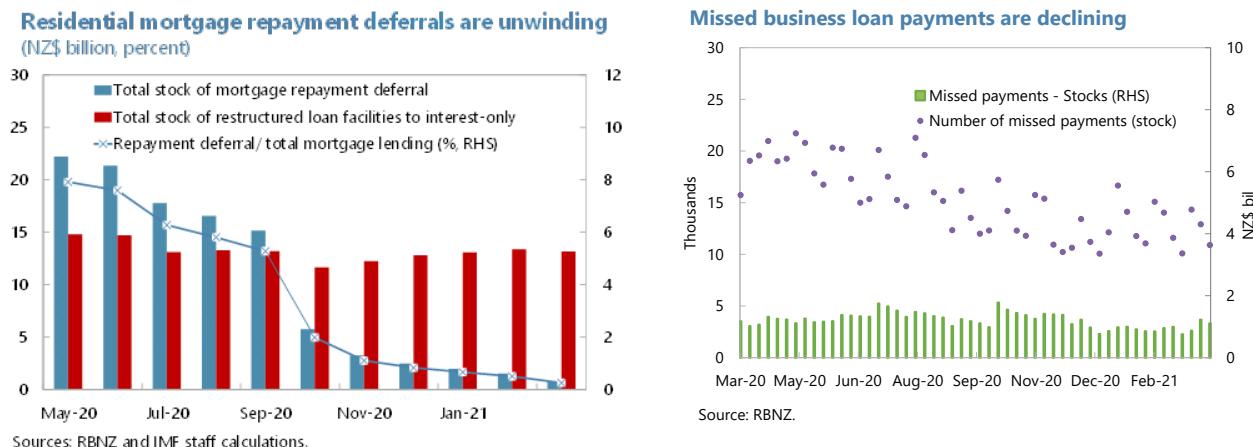


Sources: New Zealand authorities and IMF staff calculations.

**Business and consumer lending declined sharply**  
(Bank lending, y/y percent change)



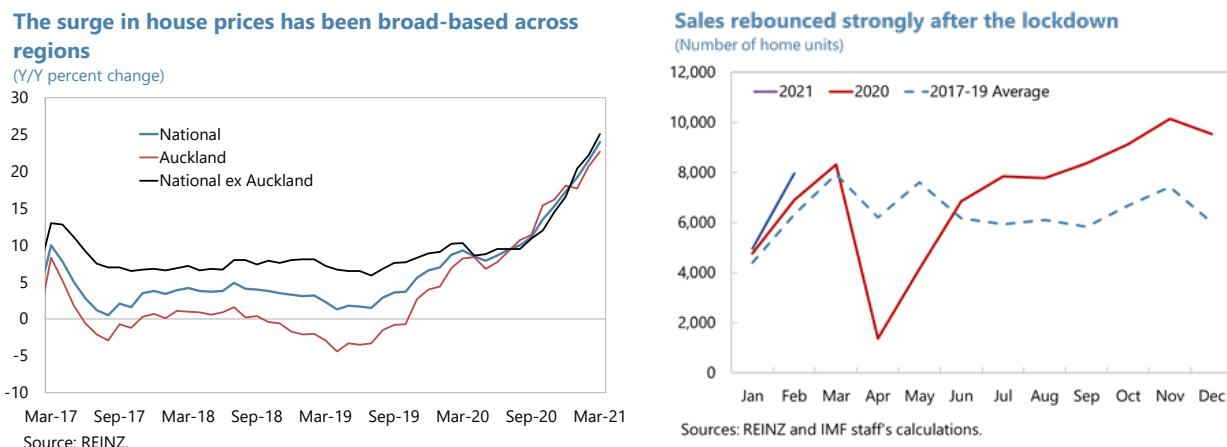
commercial real estate, agriculture, and consumer loans.<sup>1</sup> By contrast, housing loans have grown, supported by the temporary removal of loan-to-value ratio (LVR) restrictions (Figure 8).



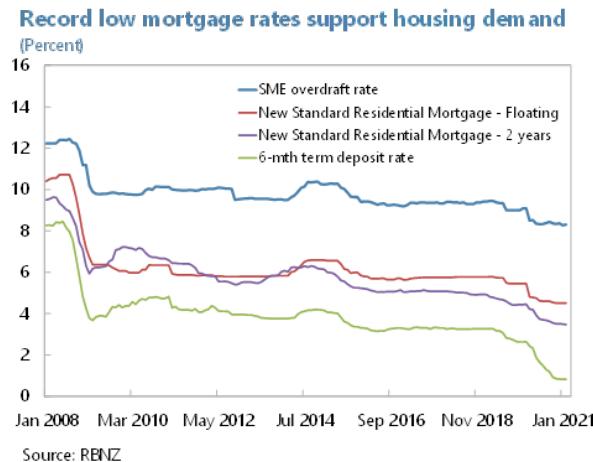
**8. Surging house prices amplify affordability concerns and can add to potential financial stability risks.** National house prices rose by 24 percent y/y in March 2021, driven by low interest rates and temporary removal of LVR restrictions amid ongoing supply-demand imbalances. House price-to-rent ratios have increased rapidly and rents also rebounded after an initial decline. Surging house prices have supported household balance sheets but amplify potential financial stability risks. Reduced affordability, especially among first home buyers facing high and rising debt-to-income levels, has become a key concern (Figures 6-7).

	House Price to Rent Ratio 1/				
	Sep-19	Jan-20	Sep-20	Dec-20	Jan-21
New Zealand	25.8	26.2	29.4	29.8	29.9
Auckland	30.0	31.2	33.7	34.7	34.0

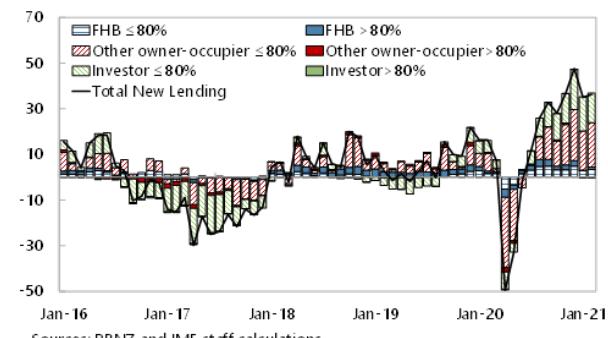
Sources: REINZ; Department of Housing and Building; and Interest.co.nz.  
1/ Median house price to the annual house rent.



<sup>1</sup> Commercial real estate, accounting for about 8 percent of bank lending, has largely withstood the downturn.



**New residential mortgage lending growth led by investors (Percent y/y, contribution by borrower type and LVR ratio 1/)**



## B. Outlook

**9. The economy is expected to continue recovering in the near term.** Despite expected near-term sluggish growth on account of the missed tourist season, real GDP is projected to grow by 4 percent in 2021, driven by domestic demand. However, the ongoing global pandemic and travel restrictions will continue to depress migration and tourism flows.<sup>2</sup> Net migration, which had been cushioned initially by returning New Zealanders and seasonal workers remaining in the country, is expected to gradually normalize once the border reopens. Unemployment is expected to peak at around 5.1 percent, while wage growth should remain modest. Inflation could experience a temporary lift in the near term, driven by higher commodity prices and temporary increases in shipping costs, but is expected to durably reach the two-percent midpoint of the RBNZ's target range only from 2024.

**10. Macrofinancial vulnerabilities and stress in business and household balance sheets are expected to increase with the expiry of COVID-19 support.** Household and non-financial corporate balance sheets have held up relatively well during the crisis, helped by government support and rising house prices. However, business insolvency, especially in disproportionately affected sectors, will likely increase with the expiry of COVID-19 support (Annex II).<sup>3</sup>

**11. The pandemic is likely to have medium-term effects on potential output.** Despite the quick recovery, experience from past recessions suggests there will likely be longer-lasting impacts. Lower labor supply due to muted migration flows, weak capital accumulation, and slowing productivity growth are expected to adversely affect potential output by about 3¾ percent in the medium-term relative to pre-COVID projections.

<sup>2</sup> A travel bubble with Australia started on April 19, 2021. The border closure for visitors from other countries is expected to be gradually lifted starting toward the end of 2021.

<sup>3</sup> See the accompanying Selected Issues Paper: "The Pandemic's Impact on New Zealand's Household and Non-Financial Corporate Balance Sheets."

## C. Risks

**12. Despite the improved economic outlook, significant risks remain.** Key near-term risks relate to the domestic and global paths of the COVID-19 pandemic. Renewed domestic outbreaks and the potential for health risks to delay the opening of the international borders constitute important downside risks to growth, as does COVID-19's impact on New Zealand's trading partners and its export commodity prices. By contrast, faster-than-expected vaccine rollout could prompt a faster border reopening, jumpstarting tourism and international education, thus leading to a more rapid recovery. Rising demand for housing amid low-for-long interest rates and structural housing supply shortages may have amplified the housing cycle, heightening financial stability and affordability concerns. Unsustainable house prices, a tightening of credit standards, or a sharp rise in mortgage rates could trigger a pronounced correction (Box 2). Other risks relate to the impact of geopolitical tensions on trade and commodity prices, cyber-attacks, and New Zealand's exposure to natural disasters (Annex III).

## D. Authorities' Views

**13. The authorities agreed with staff's assessment and emphasized that despite the strong growth so far, the economy had not yet recovered fully from the crisis.** They also concurred with staff that the bands of uncertainty around the near-term outlook remain exceptionally large, and resurgence of the pandemic and an extended border closure, among other risks, have the potential to set back the recovery. The authorities stressed that the rapid rise in house prices was of concern—reducing housing affordability and raising macrofinancial risks—and highlighted that implementation of a comprehensive set of demand and supply measures is an important step to address the problem. They took note of staff's external sector assessment and agreed that the movements in the New Zealand dollar were justified by trade and financial flows, along with commodity price developments.

# SUPPORTING A DURABLE HANDOFF FROM PUBLIC TO PRIVATE DEMAND

**14. The size and scope of economic policy support in response to the pandemic has been unprecedented.** Making use of the substantial fiscal space, the government put in train large-scale fiscal measures of 19.3 percent of GDP (above the line) through FY2024/25, including wage subsidies, infrastructure investment, and tax measures to support businesses and investment.<sup>4</sup> Monetary policy has been very accommodative, with a policy rate cut, quantitative easing, and the Funding for Lending Program (FLP) to support businesses and households (Figures 1, 2, 3 and 5).

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<sup>4</sup> New Zealand's fiscal year runs from July to June.

**15. The large-scale fiscal support measures have helped avert a much larger decline in economic activity and employment.**<sup>5</sup> While the wage subsidy scheme, instituted in March 2020 to bridge over lock-down-related disruptions, has expired, several measures, such as business tax relief and infrastructure spending, continue supporting the recovery. With some COVID-related fiscal support measures expiring, a moderate tightening of the structural fiscal balance is expected to start from FY2021/22. That said, the authorities can react nimbly should downside risks materialize. They have maintained part of the approved COVID-19 Response and Recovery Fund as an unallocated reserve that can be deployed quickly, and put in place a resurgence package, including support payments for businesses, short-term absence and leave support for workers, and wage subsidies, that are contingent on pre-defined triggers in case of renewed COVID lockdown measures.

<b>Discretionary Fiscal Responses to COVID-19</b>	
<b>Expenditure and forgone revenue</b>	<b>NZ\$ 62.1 billion (19.3 percent of GDP)</b>
Labor market	<ul style="list-style-type: none"> <li>• Wage subsidies (NZ\$ 14.8 bn)</li> <li>• Expansion of Flexi-wage subsidies (NZ\$ 0.3 bn)</li> <li>• Targeted training and apprenticeship fund (NZ\$ 0.3 bn)</li> </ul>
Household support measures	<ul style="list-style-type: none"> <li>• Permanent increase in social benefits (NZ\$ 2.4 bn)</li> <li>• Income Relief Payment (NZ\$ 0.6 bn)</li> <li>• Increase in Winter Energy Payment (NZ\$ 0.5 bn)</li> </ul>
Business support measures	<ul style="list-style-type: none"> <li>• Business tax loss carry-back scheme (NZ\$ 3.1 bn)</li> <li>• Permanent change in business tax (NZ\$ 2.8 bn)</li> <li>• Support for the aviation sector (NZ\$ 0.6 bn)</li> <li>• Tourism recovery package (NZ\$ 0.4 bn)</li> </ul>
Infrastructure projects	<ul style="list-style-type: none"> <li>• Infrastructure package (NZ\$ 3.0 bn)</li> <li>• Water infrastructure project (NZ\$ 0.8 bn)</li> <li>• Support for transport projects (NZ\$ 0.6 bn)</li> </ul>
Other measures	<ul style="list-style-type: none"> <li>• Vaccines, isolation, and other health costs (NZ\$ 3.9 bn)</li> <li>• Government housing program (NZ\$ 0.7 bn)</li> <li>• Government R&amp;D (NZ\$ 0.2 bn)</li> <li>• Unallocated (NZ\$ 10.3 bn)</li> <li>• Others (NZ\$ 16.8 bn)</li> </ul>
<b>Other measures</b>	<b>NZ\$ 9.5 billion (2.9 percent of GDP)</b>
	<ul style="list-style-type: none"> <li>• Business Finance Guarantee Scheme (NZ\$ 6.3 bn)</li> <li>• Small Business Cashflow Scheme (NZ\$ 1.6 bn)</li> <li>• Convertible debt agreement with Air NZ (NZ\$ 1.5 bn)</li> <li>• R&amp;D Loan Scheme (NZ\$ 0.2 bn)</li> </ul>

<sup>5</sup> The authorities are committed to maintaining transparency in procurement and issued guidance to government agencies to this end.

### Contingency Measures to Manage COVID-19 Resurgence Events

Resurgence support payment	<ul style="list-style-type: none"> <li>• The payment will include a core per business rate of NZ\$1,500 plus NZ\$400 per employee up to a total of 50 employees (max NZ\$21,500). Firms that have experienced 30 percent drop in revenue over a 7-day period due to an Alert Level escalation will be eligible.</li> </ul>
Wage subsidy scheme	<ul style="list-style-type: none"> <li>• Two-week wage subsidies will be available nationally when there is a regional or national move to Alert Levels 3 or 4 for seven days at the rates of NZ\$585.8 for each employee working 20 hours or more a week and NZ\$350 for each employee working less than 20 hours a week. Firms that have experienced or are expected to experience a 40 percent drop in revenue over a consecutive 14-day period will be eligible, but they cannot get other support (short term absence payment and leave support scheme) for the same employee.</li> </ul>
Short term absence payment	<ul style="list-style-type: none"> <li>• One-off payment of NZ\$350 for employers to pay workers who need to isolate while they (or a dependent) await COVID test results.</li> </ul>
Leave support scheme	<ul style="list-style-type: none"> <li>• Support for businesses to pay workers (including self-employed) during COVID-related self-isolation, covering two weeks per eligible employee at the same rates as the wage subsidy.</li> </ul>

**16. Monetary easing and additional liquidity provision have supported demand and the functioning of the financial markets.** The RBNZ cut the cash rate by 75 basis points to 0.25 percent in March 2020. Quantitative easing was introduced through a large-scale asset purchase program (LSAP) to lower long-term interest rates and the FLP, providing low-cost term funding to banks to facilitate lending to the private sector. The RBNZ also introduced term funding facilities to provide additional liquidity to the banking system. With the improvement in financial market conditions following an initial, brief period of dislocation in March 2020, some of the temporary liquidity facilities with low usage have now been removed. In its public communications, the RBNZ has indicated that it will maintain its current stimulatory monetary settings for a considerable time, that it is prepared to provide additional monetary stimulus if necessary, and that the banking system is operationally ready for negative interest rates.

**17. With the surge in house prices and increased affordability concerns, the RBNZ is required to assess the effect of its monetary policy decisions on the government's housing objectives.** The updated remit by the Minister of Finance to the monetary policy committee (MPC), effective from March 2021, requires the MPC to assess the effects of its decisions on the government's policy relating to sustainable house prices. The monetary policy objectives, with a focus on keeping inflation near the two percent mid-point and supporting maximum sustainable employment, remain unchanged.

### RBNZ's Key Monetary and Liquidity Facilities Under COVID-19

Facility	Objective	Terms and Duration
Funding for Lending Programme (FLP)	Provide term funding, collateralized against approved Tier 1 collateral or RMBS, to lower the cost of borrowing for businesses and households.	Up to NZ\$28 billion of three-year funding priced at 0.25 percent, until December 2022.
Large Scale Asset Purchases (LSAP)	Outright purchases of nominal and inflation-indexed New Zealand Government bonds in the secondary market to lower term interest rates and support market functioning.	Up to NZ\$100 billion, by June 2022. Nominal bonds cap of 60% of total issuance and Inflation-indexed bonds cap of 30% of total issuance.
Large Scale Asset Purchases - LGFA (LSAP LGFA)	Outright purchases of nominal Local Government Funding Agency (LGFA) bonds in the secondary market to lower term interest rates and support market functioning.	Program size is limited to 30% of overall LGFA bond issuance.
Term Auction Facility (TAF)	Provide term funding collateralized against approved Tier 1 and 2 collateral.	3, 6 and 12 months. TAF was removed after March 16, 2021.
Term Lending Facility (TLF)	Provide term funding collateralized against approved Tier 1 collateral or RMBS to support the government's Business Finance Guarantee Scheme (BFGS). <sup>1/</sup>	5 years maturity; facility up to February 1, 2021.
FX Swaps (incl. Cross Currency basis swaps)	The sale of NZD, purchase USD or vice versa for a pre-agreed term for liquidity management and market functioning.	Unlimited; 1 day to 6 months.
Corporate Open Market Operations (COMO)	Provide short-term funding collateralized against approved Tier 3 collateral.	500 million per auction; 1 day to 3 months. COMO was removed after March 16, 2021

Sources: RBNZ and Treasury.

1/ Under a NZ\$6.25 billion Business Finance Guarantee Scheme (BFGS), the government covers up to 80 percent of the loan's default risk, eligible firms can borrow up to a maximum of NZ\$5 million from a bank or NZ\$3 million from a non-bank for five years. Its availability has been extended to June 30, 2021.

## Staff Views

**18. The fiscal and monetary policy mix should remain appropriately accommodative.** The current policy mix, with unprecedented fiscal and monetary support, is adequate. While additional stimulus is currently not needed, fiscal and monetary support should not be withdrawn prematurely as the recovery is still uneven and uncertain. Additional fiscal and monetary support should be deployed if downside risks materialize. Fiscal policy should play a primary role to address the distributional impact of the pandemic and pre-existing structural issues.

**19. Fiscal policy should remain sufficiently accommodative in the near term to ensure a successful transition from public to private demand and limit scarring.** The pace of fiscal normalization needs to be carefully calibrated to support employment and minimize bankruptcies of distressed but viable firms. The authorities should stand ready to deploy additional fiscal support if the recovery falters, including additional public investment, and targeted income and liquidity support measures. In this regard, the introduction of contingency measures to manage resurgence events is welcome and helps mitigate uncertainty for businesses and workers.

**20. The shift from job retention to active labor market policies is appropriate.** While the wage subsidy program played a central role during the acute phase of the crisis, moving to active labor market policies (ALMPs), including free training programs and the expansion of hiring subsidies ("Flexi-wage" subsidies), will facilitate labor reallocation. Given New Zealand's low spending on ALMPs in international comparison, a further expansion of such policies should be considered, with focus on targeting workers disproportionately affected by the pandemic, including

youth, low-skilled workers, women, and some ethnic groups. The permanent increase in unemployment benefits from a relatively low level is welcome and will strengthen automatic stabilizers. The recent increase in the top income tax rate from 33 to 39 percent will help finance the permanent increase in unemployment benefits and mitigate growing inequality.

**21. New Zealand's debt trajectory remains sustainable.** New Zealand's public debt has remained low compared to advanced economy peers, with net government debt projected to peak at 29 percent of GDP in FY2023/24. The Debt Sustainability Assessment suggests that New Zealand's debt trajectory will remain sustainable under stress scenarios (Annex IV), and substantial fiscal space will remain available to address future economic shocks. Staff supports the suspension of the authorities' debt target, which provides additional flexibility to respond to the economic impact of the pandemic.<sup>6</sup> Once the pandemic-related uncertainty subsides, there will be an opportunity to review and update New Zealand's fiscal medium-term targets.

**22. Monetary policy should remain accommodative for an extended period.** Premature tightening should be avoided given remaining slack in the economy and muted inflation and wage pressures. The RBNZ has scope for additional easing, potentially including moderately negative interest rates, if downside risks materialize. Conversely, should the recovery proceed at a stronger-than-expected pace, an earlier-than-planned tapering of bond purchases could be considered.

**23. Monetary policy should remain strictly focused on its existing inflation and employment objectives.** It is important to avoid the perception of overloading monetary policy with potentially conflicting objectives, including housing affordability. Financial stability risks from surging house prices should be addressed primarily through macroprudential measures, while affordability should be supported by fiscal and structural measures.

### Authorities' Views

**24. The authorities assessed the current policy mix as adequate.** While there was a broadly shared expectation that private demand would recover sufficiently for a gradual hand-off from public demand, the authorities agreed that additional withdrawal of stimulus would seem premature given elevated uncertainty.

**25. The authorities emphasized that they continue to stand ready to deploy additional fiscal measures if needed.** While they did not see a case for additional fiscal stimulus at the current juncture, the authorities emphasized that maintaining adequate flexibility was particularly important to address downside risks. They highlighted that the unallocated portion of the COVID-19 Response and Recovery Fund could be used to manage downside risks, and that the announced contingency measures for a possible resurgence of the pandemic would play a central role in mitigating economic effects of any further pandemic-related shocks.

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<sup>6</sup> The authorities had operated with a, now suspended, target on net core crown debt of 15-25 percent of GDP.

**26. Like staff, the authorities judged that public debt remains sustainable.** While supporting the economic recovery remained their clear near-term priority, the authorities indicated their commitment to maintain debt at prudent levels. The authorities intend to stabilize net debt as a percent of GDP by the mid-2020s and then reduce it as conditions permit. They expect to review the public debt anchor once the pandemic-related economic uncertainty subsides. They agreed that public debt remains sustainable, with substantial remaining fiscal space that can be deployed in case of future shocks.

**27. The authorities agreed that monetary policy should remain accommodative.** The RBNZ stressed that, in line with its least regrets approach, the monetary policy stance would remain unchanged until it had confidence that it is sustainably achieving its inflation and employment objectives. While it currently saw no need for additional policy easing, the RBNZ indicated that it was prepared to provide additional stimulus if needed. In this context, it indicated that, with operational preparations completed, a negative policy rate was now among its options. Conversely, if economic conditions improved sufficiently, the RBNZ would be prepared to begin carefully withdrawing its stimulus. However, the RBNZ considered that such a scenario would be unlikely for a considerable time.

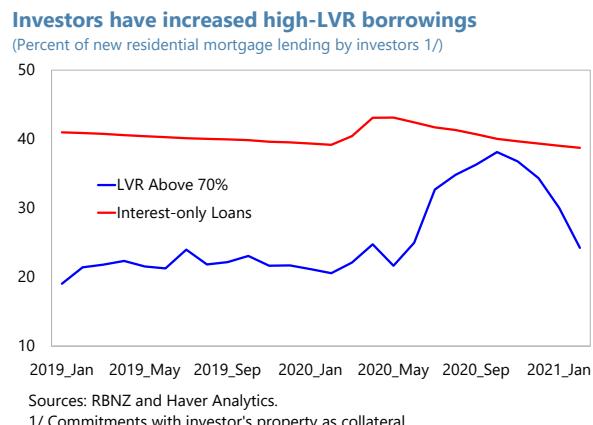
**28. The authorities underscored that the monetary policy objectives remain unchanged.** They highlighted that the focus of monetary policy will remain on meeting its existing inflation and employment objectives, and that the updated MPC remit only requires the RBNZ to assess and communicate the impact of its decisions on the government's policy to support more sustainable house prices. They also emphasized the importance of the MPC's full operational independence.

## STRENGTHENING FINANCIAL SECTOR RESILIENCE

### 29. The rapid increase in riskier housing loans could point to rising financial

**vulnerabilities.** Improvements in past years in reducing the underwriting of riskier home loans have started to reverse with the temporary removal of LVR restrictions under the COVID-19 response effective in May 2020. As investor lending picked up, high-LVR loans increased rapidly, while the share of interest-only loans to investors remained high at around 40 percent.

The RBNZ re-imposed LVR restrictions from March 2021 at pre-pandemic levels, with a further tightening of investors' LVR restrictions from May 2021.<sup>7</sup>



<sup>7</sup> The RBNZ re-imposed limits of a maximum of 20 percent of new lending to owner-occupiers at LVRs above 80 percent, and 5 percent of new lending to investors at LVRs above 70 percent (reduced to 60 percent from May 2021).

**30. The planned rise in bank capital requirements has been postponed in the context of the COVID-19 shock.** The 2019 Capital Review required banks to raise their minimum capitalization from 10.5 to 16 percent of risk-weighted assets (18 percent for the four large banks) over seven years, starting from July 2020. In the context of the COVID-19 response, the starting date has been postponed to July 2022. In the interim, recent RBNZ stress tests suggest that banks' existing capital positions would withstand severe but plausible economic shocks.

**31. The RBNZ is required to have regard to government policy on housing in relation to its financial stability policy.** In February 2021, the Minister of Finance issued a direction to the RBNZ to this end, requiring the RBNZ to have regard to the impact of its actions on the Government's policy of supporting more sustainable house prices, including by dampening investor demand for existing housing, which would improve affordability for first-home buyers.

**32. The Phase 2 Review of the RBNZ Act is under way.** Following the completion in 2018 of Phase 1, which established the MPC and added maximum sustainable employment to the RBNZ's objectives, Phase 2 aims at modernizing the RBNZ's governance and accountability structure, harmonizing the prudential regulatory regime between banks and non-bank deposit takers, strengthening the RBNZ's supervision and enforcement tools, clarifying the crisis resolution framework, and introducing a deposit insurance scheme. A draft RBNZ Bill has been introduced in 2020, to be followed by a new Deposit Takers Bill later this year.

### **Staff Views**

**33. Financial sector policies should maintain resilience against financial risks.** While the banking system has remained resilient, financial risks may increase from the potential deterioration of loan portfolios with the unwinding of relief measures, amid structural financial vulnerabilities from banks' concentrated exposure to residential mortgage lending and elevated household debt. The RBNZ should continue to maintain ample liquidity in the financial system to ensure its smooth functioning and adequate credit provision until the economic recovery takes strong hold. The increased resource allocation for the RBNZ to strengthen its supervisory and regulatory functions is welcome. The extension of the implementation of the 2019 Capital Review to commence in July 2022 mitigates risks of a premature tightening of lending conditions while maintaining the commitment to further increase banks' capital buffers over the medium term.

**34. Macroprudential tools should be readily available to address housing-related macrofinancial risks.** The reinstatement of LVR restrictions in March and further tightening for investors from May 2021 will help mitigate stability risks. Additional tools, including debt-to-income (DTI) ratio limits, caps on interest-only loans, and higher bank capital risk weights on mortgage lending, could play a useful role in addressing housing-related risks when deemed necessary. Any adverse distributional consequences of macroprudential policies should be addressed through fiscal and structural policies.

**35. The ongoing Phase 2 Review of the RBNZ Act is an opportunity to further strengthen governance and operational autonomy.** The draft RBNZ Bill aims to strengthen governance and

accountability of the monetary and financial stability framework. It offers an opportunity to ensure that the RBNZ has adequate operational autonomy and a sufficient degree of flexibility to respond to financial stability risks by having the full macroprudential policy toolkit at its disposal (Annex V). The planned introduction of the deposit insurance scheme under the forthcoming Deposit Takers Bill is welcome, and staff highlighted the scope for reconsidering the relatively low coverage at NZ\$50,000 per depositor per institution. Staff welcomed the ongoing progress in implementing the 2017 FSAP recommendations, of which a significant part is integrated in the Phase 2 Review (Annex VI).

### **Authorities' Views**

**36. The authorities concurred with staff's assessment that the overall financial system remains resilient and stressed their focus on mitigating macrofinancial vulnerabilities.** The RBNZ emphasized that the Minister of Finance's direction to have regard to government policy to support more sustainable house prices, including by dampening investor demand for existing housing stock to help improve affordability for first-home buyers under its financial stability mandate, is welcome. More active intervention through macroprudential policy could be required, focusing on the appropriate level of leverage and interaction with sustainable house prices. The authorities noted that further work was under way assessing tools to address financial risks from high debt-to-income ratios and interest-only mortgages. The authorities stressed the importance of the ongoing Phase 2 review of the RBNZ Act in clarifying the RBNZ's operating powers and objectives and modernizing the monetary and financial stability framework. They appreciated technical comments received from staff and indicated that they were considering possible refinements following the public consultation.

## **ADDRESSING HOUSING SECTOR IMBALANCES**

**37. Structural imbalances in the housing market from insufficient supply accumulated over past decades have come to the fore during the COVID-19 crisis.** Record-low mortgage rates and the temporary removal of LVR restrictions led to a surge in housing demand, which, against a tight housing inventory, has pushed up house prices. Housing affordability has become central to the policy debate, with high house prices and rents affecting especially low-income households and first-time homebuyers (Box 3).

**38. A comprehensive policy approach to address housing imbalances is under way.** Key ongoing focuses include developing the agenda of the newly established urban development authority, Kāinga Ora, to acquire land to fast track housing development; easing developers' access to finance via the Residential Development Response Fund; delivering an extra 8,000 public houses and transitional housing space; undertaking rental housing reforms to support low-income households; and improving the market response to supplying affordable housing. The authorities are also continuing the Urban Growth Agenda to address the fundamentals of land supply for cities, enabling infrastructure and housing development. Further, they are embarking on the reform of the

Resource Management Act (RMA) to increase speed and efficiency in planning and improve environment impact management.

**39. In late March, the government released a housing package aimed at curbing investors' demand and increasing housing supply.** While some details and impact assessments of the proposed plans are still to be fleshed out, changes include removing the tax deductibility for mortgage interest of property investors,<sup>8</sup> extending the minimum holding period to exempt capital gains on investment properties from income tax,<sup>9</sup> and increasing government support for first-home buyers.<sup>10</sup> In addition, the government will provide a NZ\$3.8 billion Housing Acceleration Fund to help fund critical infrastructure needed for housing developments, accelerate the development of publicly-owned land, support delivery of ownership and rental housing for low-to-moderate income households, and support Kāinga Ora to borrow an additional NZ\$2 billion for strategic land purchases.

### Staff Views

**40. Tackling housing imbalances requires a comprehensive approach.** Achieving long-term housing affordability depends critically on freeing up land supply, improving planning and zoning, and fostering infrastructure investments to enable fast-track housing developments and lower construction costs. Increasing the stock of social housing also remains important. In parallel, mitigating investors' demand for existing housing will help moderate near-term price pressures. Staff also noted that the 2018 ban on the purchase of residential property by nonresidents only curbed demand in a small part of the market and does not appear to have materially affected overall house prices.

**41. The newly announced housing package will help address New Zealand's housing imbalances.** The demand-side measures, particularly the change in deductibility of mortgage interest, can make a material difference for the attractiveness of property investment and improve affordability for owner-occupiers. A fuller assessment of the expected market impact, including on house prices and rents, will be needed as remaining parameters are decided and the reform is legislated. In parallel, the added support for first-home buyers will be helpful in promoting affordability.

**42. The new package adds to existing initiatives to boost housing supply.** The new supply-side measures, including the Housing Acceleration Fund, can be supportive in unlocking housing supply, and quick and efficient implementation of the Fund's activities will be important. Providing

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<sup>8</sup> Tax deductibility will cease at the end of September 2021 for newly purchased investment properties (except for newly built properties), while being phased out over four years for properties bought before March 27, 2021. Owner occupiers are not affected by this change. Under New Zealand's tax system, they could not deduct mortgage interest already prior to the new policy.

<sup>9</sup> The minimum holding period will be extended from five to ten years for newly-acquired properties (except newly built homes and owner-occupier homes).

<sup>10</sup> Income and property price caps are revised upward under the existing First Home Grant and First Home Loan schemes.

financing and improving incentives for local councils to increase the supply of land and infrastructure will be helpful in this regard. The reform of the RMA is expected to reduce current complexities and contribute to efficiency in strategic planning. Plans to deliver additional public houses and transitional housing space, and rental housing reforms to provide assistance to low-income households, are welcome.

### **Authorities' Views**

**43. The authorities stressed that addressing housing imbalances and affordability was an important priority.** They emphasized that a comprehensive approach was required, addressing both the supply and demand sides. They underscored that the housing policy package announced in March 2021 was an important step in this regard, reducing the attractiveness for investors of the existing housing stock and enabling faster provision of new housing supply. At the same time, the additional support for first home buyers would help mitigate affordability concerns. The authorities noted that it was crucial to reform the approach to land use planning and address constraints to land supply.

## **PROMOTING DURABLE AND INCLUSIVE GROWTH**

**44. New Zealand has been facing long-standing structural issues, including weak productivity growth.** Connectivity with global markets has been relatively weak, in part due to the country's geographical remoteness, and inward foreign direct investment (FDI) has remained low compared to peers. Relatively strong growth before the pandemic was driven by strong population growth boosted by migration. Capital deepening had been weak, with a persistent infrastructure gap remaining in some areas.

**45. The uneven impact of the pandemic on the labor market has aggravated already relatively high inequality and may hinder long-term human capital accumulation.** Historically, there has been large dispersion of labor market conditions among worker groups, and the disproportionate impact of the pandemic on some ethnic groups may aggravate inequality. Youth employment has seen the largest adjustment, which could lead to scarring in the labor market and adversely affect long-term human capital accumulation.

### **Staff Views**

**46. Structural policies should aim at fostering durable, inclusive, and green growth.** The pandemic has made pre-existing deficiencies more acute (Annex VII and Figure 9).<sup>11</sup> Reforms need to be designed with a view to ensuring that productivity gains are broadly shared, given the extent of scarring and the pandemic's disproportionate impact on vulnerable groups (Annex VIII).<sup>12</sup>

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<sup>11</sup> See accompanying Selected Issues Paper: "How Fast Can New Zealand Grow after the Pandemic? Challenges and Opportunities."

<sup>12</sup> See accompanying Selected Issues Paper: "The Uneven Impact of the Pandemic on New Zealand's Labor Market."

- The authorities should address weak productivity performance by scaling up innovative investment and R&D spending. The recently introduced R&D tax credits can support private innovative investment. New Zealand can scale up government spending on R&D and expand innovative capacities of Crown Research Institutes.
- Reducing entry barriers and simplifying administrative processes will strengthen competitive forces in the economy. Efforts to improve the performance of state-owned enterprises are needed to yield productivity gains. Pro-competitive reforms would encourage firms' innovations and investment over the medium term.
- The government should upgrade infrastructure and step up green investment. "Shovel-ready" projects can make a meaningful contribution to narrowing infrastructure gaps. Steps taken to support local councils' infrastructure funding and financing would facilitate more timely supply of land and infrastructure provision. The reform of the RMA is expected to reduce current complexities in land use that restrict infrastructure development. The post-COVID-19 recovery also offers opportunities for directing investment towards low-emissions infrastructure and technology (Annex IX).
- To facilitate reallocation of workers from severely affected sectors and limit scarring, labor market policies should focus on support to displaced workers that would foster employability. While some active labor market policies have been announced already, there is scope for broadening the coverage of training programs, which should reflect industry needs. The ongoing Reform of Vocational Education is an opportunity to enhance effectiveness of training programs. Large dispersion in education achievement among ethnic groups should be addressed to render growth more inclusive.
- The ongoing reform of the Overseas Investment Act is an opportunity to attract more high-quality FDI. The reform should focus on streamlining the FDI approval process to increase the attractiveness of FDI and thereby deepen connectivity with global markets. In this context, the government's intention to use the newly introduced national interest test sparingly is welcome.<sup>13</sup>

### **Authorities' Views**

**47. The authorities concurred that structural policies are central for lifting medium-term growth.** They saw weak productivity performance as an important issue that required a multifaceted approach. They stressed that R&D tax credits had recently been strengthened and pointed to ongoing efforts to improve the quality of government R&D spending. The authorities agreed with staff's views on labor market policies and highlighted that the recently introduced active labor market policies are an important step to support displaced workers. While higher infrastructure spending will help reduce the existing infrastructure gap, the authorities saw limited scope in the near term for scaling up green investments, as projects are still in early planning stages. The authorities also expressed the intention to use the new national interest test for FDI sparingly and

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<sup>13</sup> Under the phase two reforms of the Overseas Investment Act (OIA), the May 2020 Urgent Measures Bill introduced a national interest assessment to the FDI approvals process, aimed to ensure that overseas investments in sensitive and high-risk assets are not contrary to New Zealand's national interests.

pointed out that no proposed project had been rejected since introduction of the test in May 2020. They noted that simplification of the FDI approval process has been implemented with the adoption in 2020 of the Urgent Measures Bill, and significant additional steps to this end were planned in the context of the ongoing reform of the Overseas Investment Act.

## STAFF APPRAISAL

**48. New Zealand weathered the COVID-19 pandemic shock well.** Public health measures were successful in suppressing the virus, and the authorities appropriately made use of their ample policy space to counter the macroeconomic and financial effects of the pandemic. The policy response cushioned the impact on affected households and firms, limited market volatility, and sustained financial stability. As a result, New Zealand was able to stage a fast recovery from the pandemic after the initial, stringent domestic public health measures were lifted.

**49. Notwithstanding this success, the recovery remains uneven, and uncertainty remains exceptionally high.** Activity in high-contact services such as hospitality and retail—which disproportionately employ the young, women, some ethnic groups and lower skilled workers—continues to lag other sectors because of the pandemic and the fall in international tourism. Together with the fast rise in house prices, this exacerbates inequality. Uncertainty around the near-term outlook remains high given the uncertain trajectory of the virus, domestically and abroad.

**50. The need for additional stimulus has waned under the baseline, but a premature withdrawal of support should be avoided.** The policy mix should remain accommodative, and fiscal and monetary policy measures should not be withdrawn in the near term. The pace of normalization should be state-contingent and calibrated to economic and financial developments.

**51. Fiscal policy should remain sufficiently accommodative in the near term to ensure a successful transition from public to private demand and limit scarring.** The expiry of some COVID-related fiscal support measures implies a moderate tightening of the structural fiscal balance from FY2021/22. While current plans are adequate considering New Zealand's faster-than-expected economic recovery, the authorities should stand ready to deploy additional fiscal support should the recovery falter. New Zealand's debt trajectory is expected to remain sustainable, with substantial remaining fiscal space that can be deployed in case of future shocks.

**52. Monetary policy should remain accommodative for an extended period.** While the current monetary policy stance is adequate, it should remain data dependent. The RBNZ could implement further monetary stimulus, potentially including negative interest rates, in case downside risks materialize. Conversely, should the recovery proceed at a stronger-than-expected pace, an earlier-than-planned tapering of bond purchases could be considered.

**53. Financial sector policies should maintain resilience against financial risks.** While the banking system has remained well-capitalized and liquid, financial risks may increase from the potential deterioration of loan portfolios as relief measures are unwound, against the backdrop of banks' concentrated exposure to residential mortgage lending and elevated household debt. Macroprudential tools should be readily available to address housing-related macrofinancial risks.

The ongoing Phase 2 Review of the RBNZ Act aims to further strengthen governance and operational autonomy. It offers an opportunity to ensure that the RBNZ has adequate operational autonomy and a sufficient degree of flexibility to respond to financial stability risks by having the full macroprudential policy toolkit at its disposal.

**54. Staff supports a comprehensive approach to tackling housing imbalances.** Mitigating housing demand, particularly from investors, will help moderate price pressures and address affordability concerns. Achieving long-term housing affordability also depends critically on freeing up land supply, improving planning and zoning, and fostering infrastructure investments to enable fast-track housing developments.

**55. The external position is broadly consistent with economic fundamentals and desired policy settings.** The narrowing of the current account deficit and the depreciation of the real exchange rate since 2017 supports staff's assessment.

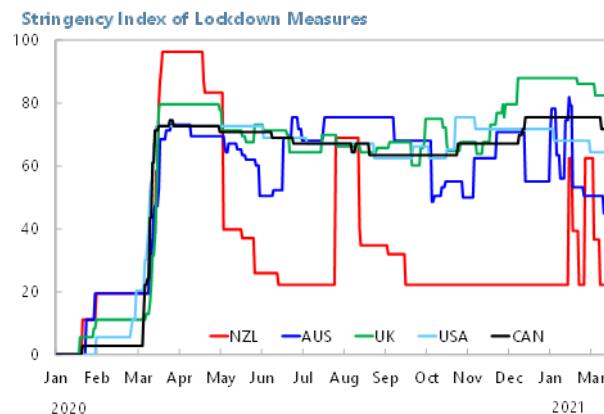
**56. Structural policies should aim at fostering durable, inclusive, and green growth.** Expanding R&D spending and product market reforms can help accelerate productivity growth. The ongoing reform of the Overseas Investment Act is an opportunity to streamline the foreign direct investment approval process and deepen connectivity with global markets. Infrastructure spending should aim at reducing the existing infrastructure gap, and the recovery offers opportunities for orienting investment towards low-emissions infrastructure and technology. Active labor market policies should focus on supporting displaced workers and disadvantaged groups, while promoting reallocation of resources and long-term human capital accumulation.

**57. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.**

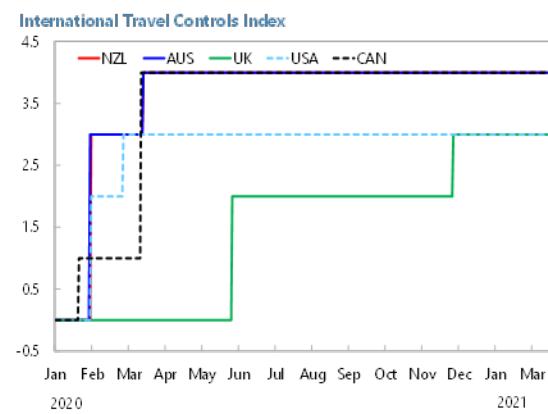
### Box 1. New Zealand's Success in Fighting the COVID-19 Battle

Shortly after the first COVID-19 case, New Zealand introduced a four-level alert system, declared a state of emergency, and moved to the most restrictive Alert Level 4 lockdown.<sup>1</sup> The country's strategy focused on speedy testing, contact tracing, and isolation, rigorously adhering to public health guidance. Local transmission was eliminated by June 2020. By that time, New Zealand carried out 10,000 tests per day, and contact tracers alerted anyone who had close interactions if a case was confirmed.

The World Health Organization praised New Zealand for acting quickly. The authorities implemented strong containment measures earlier in the infection curve than most other countries, including closing non-essential businesses, cancelling events and gatherings, closing education institutions, and closing the border to non-residents, with returning residents required to enter into two-week supervised quarantine from April 2020.

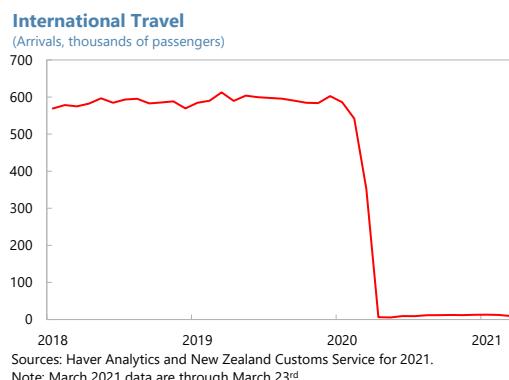


Source: Covid-19 Government Response Tracker, Oxford University.



Source: Covid-19 Government Response Tracker, Oxford University.

After local transmission had been suppressed, New Zealand moved to Alert Level 1 in June 2020, lifting restrictions on personal movements, gathering, workplaces, and services. Strict travel restrictions and quarantine requirements remain in place. The country faced two episodes of localized resurgence, prompting temporary lockdowns in Auckland.



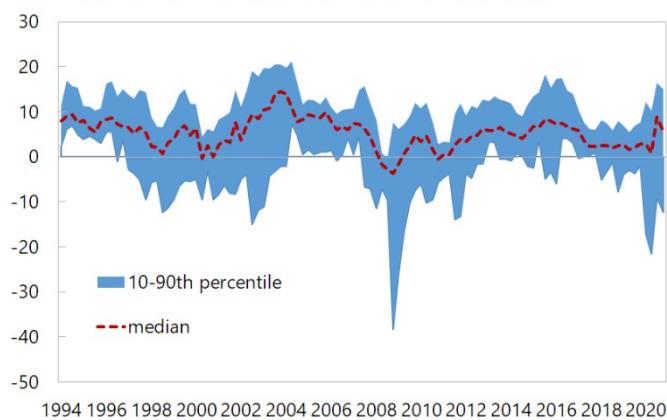
<sup>1</sup> New Zealand has a 4-level Alert system: <https://covid19.govt.nz/alert-system/>.

### Box 2. House-Prices-at-Risk in New Zealand

**House prices surged in New Zealand despite the COVID-19 shock.** Since the onset of the pandemic, house prices in New Zealand have increased sharply, with 12 percent y/y nominal increase in 2020Q4 under a low-interest-rate environment and continued supply-demand imbalances, warranting careful monitoring of risks.

**Staff estimates point to some downside risks to New Zealand's house prices.** House-price-at-risk (HaR)<sup>1</sup> has deteriorated in previous recessions in New Zealand. In 2020Q2, downside risks increased sharply amid the severe lockdown and sizable economic slowdown. Despite the economic rebound in the second half of 2020, downside risks remain in the housing market, while some upside risks are also emerging. Conditional on 2020Q4 economic conditions, real house prices in New Zealand would fall by 12 percent over the next four quarters with a 10-percent likelihood.<sup>2</sup>

**Sizable Downside Risks Remain in the Housing Market**  
(House-Price-at-Risk in New Zealand, 4 quarter change, percent)



Sources: IMF staff estimates

<sup>1</sup> See October 2019 GFSR (Chapter 2) for methodology and discussion.

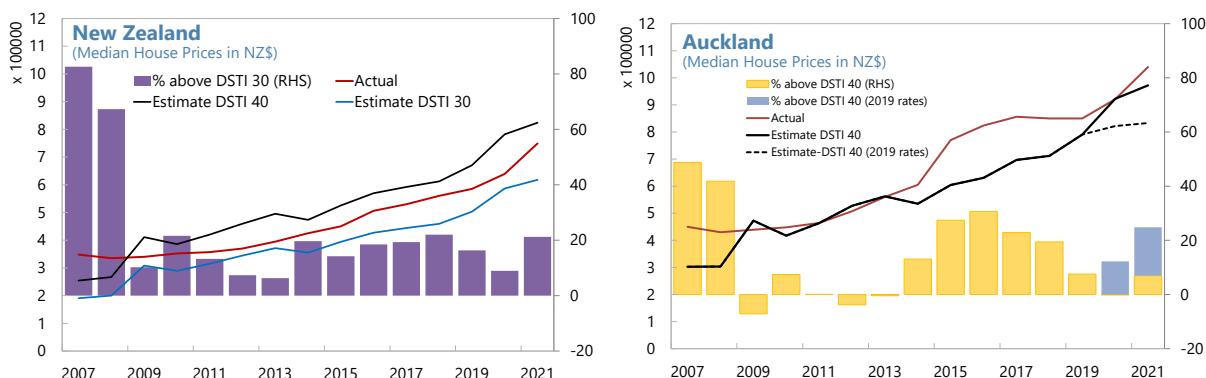
<sup>2</sup> This estimation does not incorporate possible impacts of the housing measures announced in March 2021.

### Box 3. New Zealand House Prices and Affordability

**Housing affordability can be approximated by an attainable housing price indicator that reflects financial fundamentals of the home buyer.** This borrowing capacity approach is based on the maximum size of a mortgage loan attainable by a household to finance a home purchase given its income, the prevailing mortgage rate, and leverage requirements.<sup>1</sup>

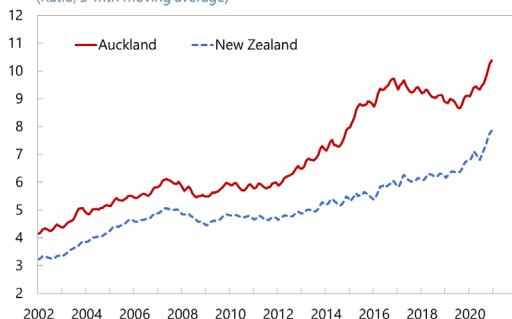
**Actual median house prices in New Zealand were about 22 percent higher than house prices attainable under a 30-percent debt-service-to-income ratio (DSTI) in December 2020.** The surge in house prices in H2 2020 has further widened the affordability gap despite a significant decline in mortgage rates (127 bps for one-year fixed rate since mid-2019).

**In Auckland, where median house prices are close to 40 percent higher than the national average, median house prices were 11 percent higher than attainable house prices under a DSTI of 40 percent in December 2020.** Without the cut in interest rates, the affordability gap would have been even higher at about 30 percent in Auckland (including the blue bars).



**Housing affordability is becoming an increasing concern amid rising house prices.** The rapid rise in the house price-to-income ratio risks putting home ownership out of reach for many, and it will take significantly longer for a first-time home buyer to save for a 20 percent cash deposit against rising house prices and low deposit rates.

#### House Price-to-Income Ratios (Ratio, 3-mth moving average)

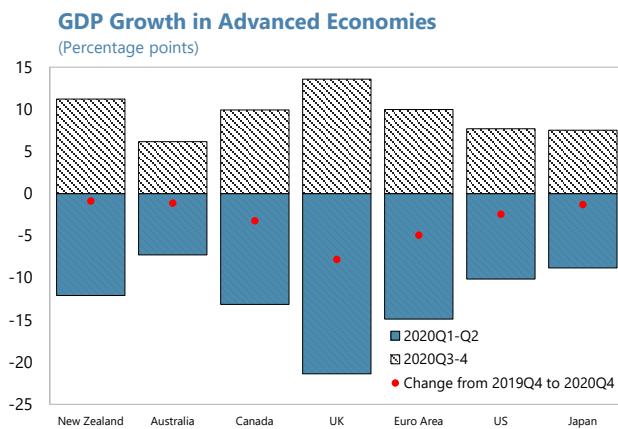


Sources: REINZ; NZ Stat; and Interest.co.nz.

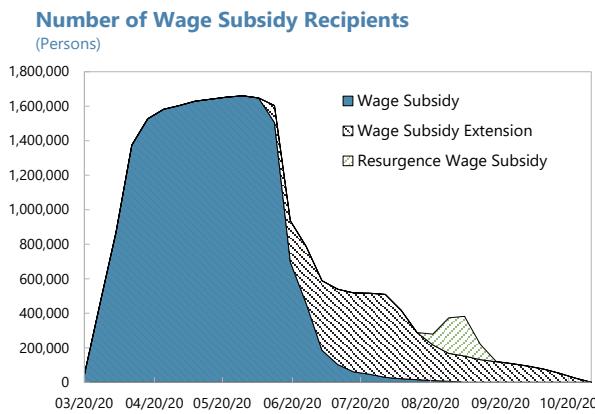
<sup>1</sup> Attainable house prices are estimated by using average annual household disposable income by fiscal year end (end-June). Affordable housing cost is assumed to be in the conventional range of a debt service to household income ratio (DSTI) of 25 to 40 percent. The mortgage rate is the 1-year fixed average residential mortgage rate (monthly), applying to a principal and interest loan of 30-year maturity. The mortgage is to finance up to a loan-to-value ratio of 80 percent with a down payment of 20 percent. Actual house prices are median value of dwellings in June of each year reported by RBNZ. For "2021", estimates are based on December 2020 house prices and interest rates, and projected average household disposable income (increased by 1.5 percent y/y).

### Figure 1. Strong Policy Response to the COVID-19 Pandemic

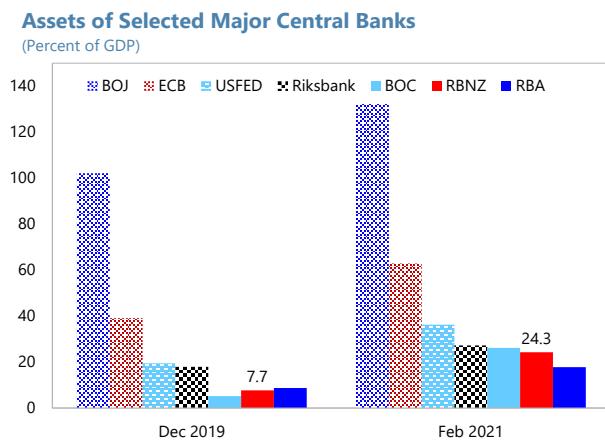
New Zealand has shown a strong rebound after the lockdown.



...featuring wage subsidies which covered more than 60 percent of workers...

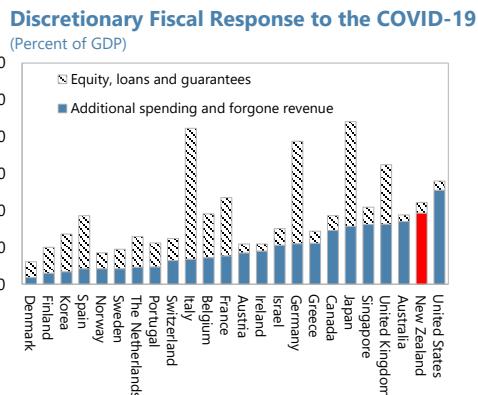


The RBNZ's balance sheet has expanded ...



Sources: Reserve Bank of New Zealand; Statistics New Zealand; Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.

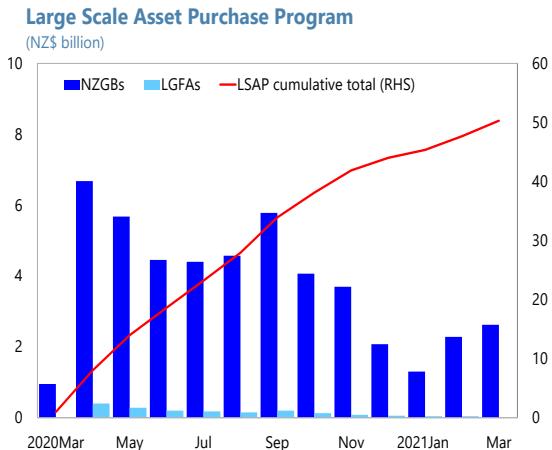
With ample fiscal space, the government has put in train a large fiscal response ...



...and a credit guarantee scheme to help SMEs access credit.



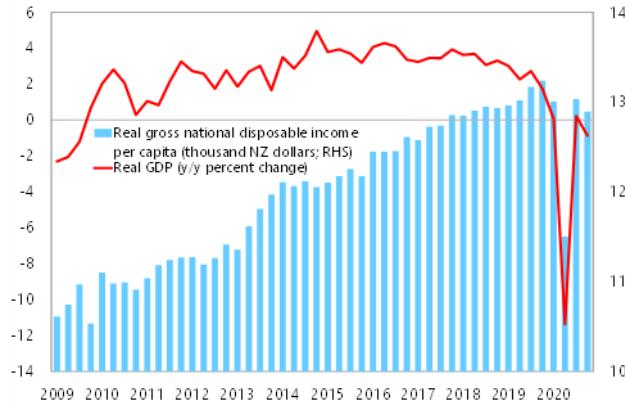
...with significant quantitative easing.



## Figure 2. Rapid Recovery After the Pandemic's Initial Impact

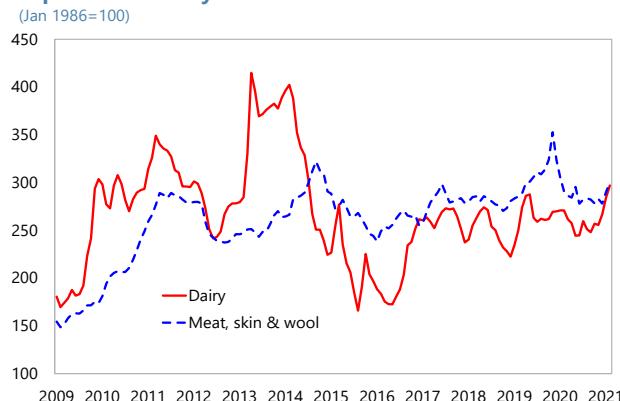
*Real GDP growth bounced back rapidly after the initial pandemic impact, though real disposable incomes remain well below pre-crisis levels.*

### Growth Performance



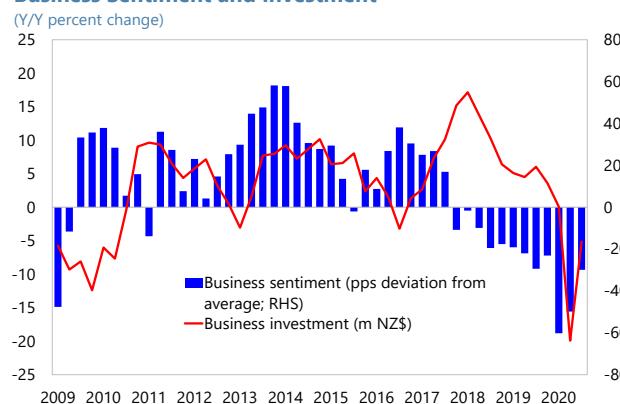
*Export prices for major commodities held steady.*

### Export Commodity Price Indices



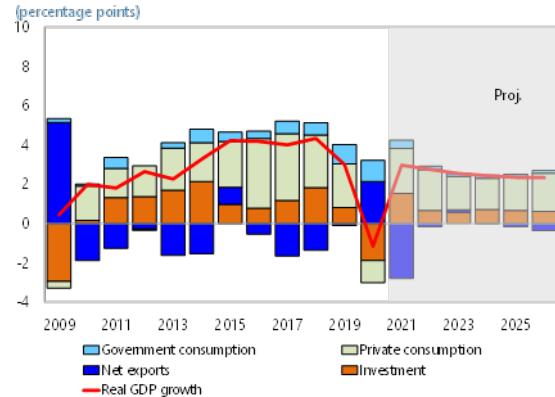
*Business sentiment and investment declined sharply and have not yet fully recovered.*

### Business Sentiment and Investment



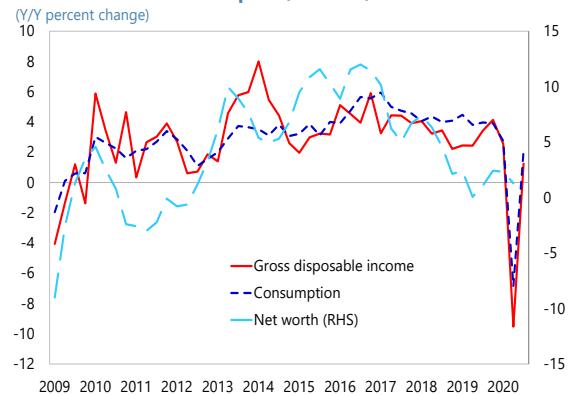
*Government consumption, net exports and a relatively contained downturn in private consumption cushioned activity.*

### Contribution to Growth (percentage points)



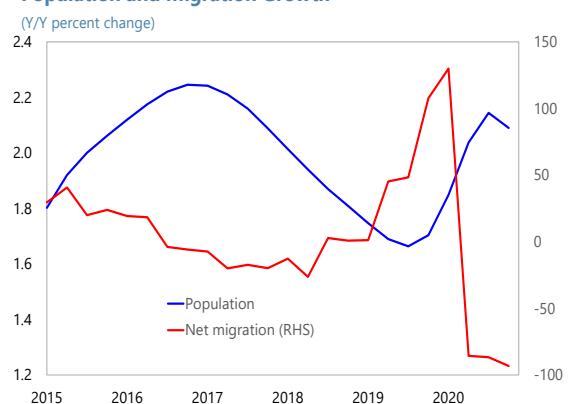
*Rising house prices prevented impairments to household balance sheets even as income declined.*

### Real Household Consumption, Income, and Wealth



*Migration flows have been weak due to border restrictions.*

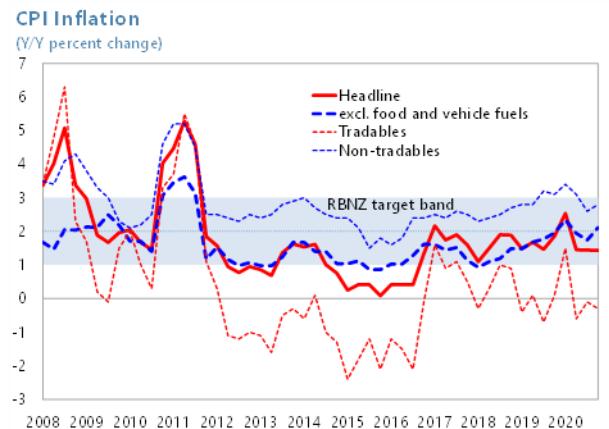
### Population and Migration Growth



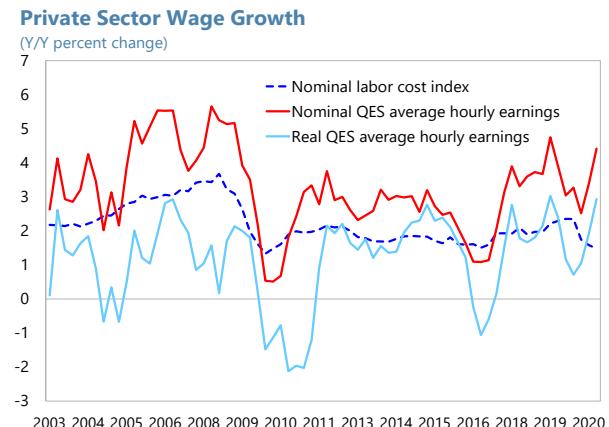
Sources: Statistics New Zealand; Haver Analytics; and IMF staff calculations.

### Figure 3. Significant Monetary Stimulus

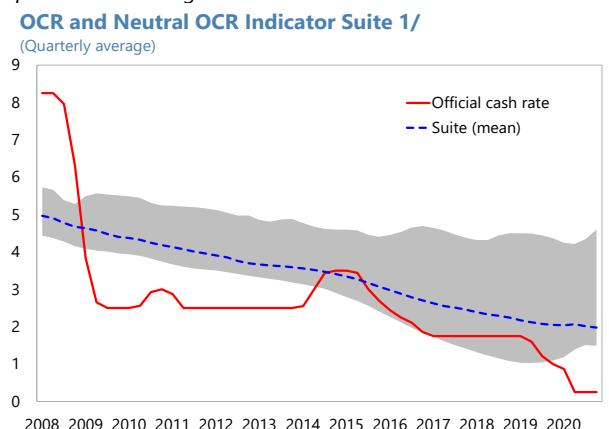
*Headline inflation has declined to the lower half of the target band...*



*Hourly earnings rebounded recently.*



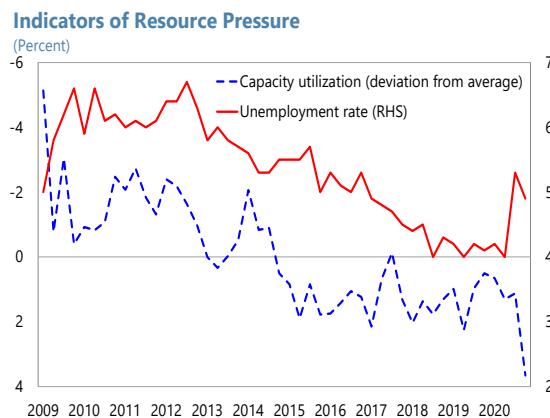
*The official cash rate was cut at the onset of COVID-19 and quantitative easing was introduced...*



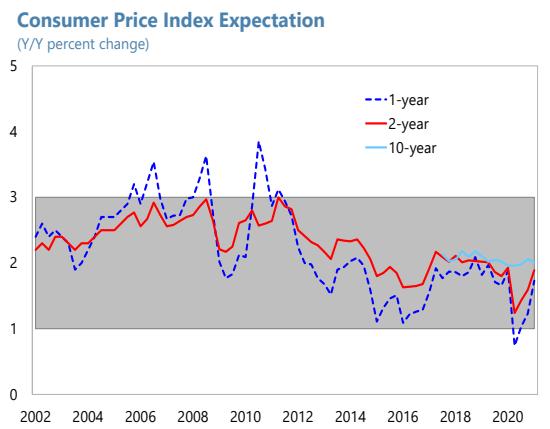
Sources: Reserve Bank of New Zealand; Haver Analytics; and IMF staff calculations.

1/ Shaded area indicates the range between the maximum and minimum values from a suite of neutral OCR indicators.

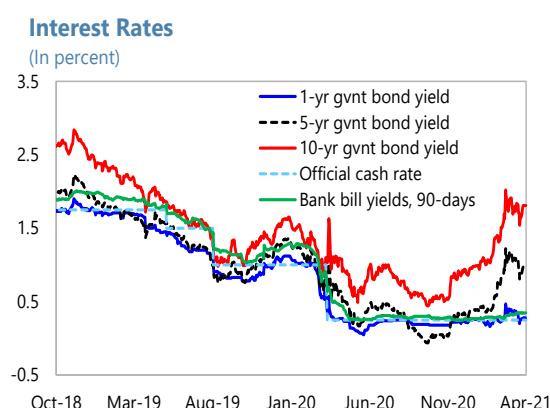
*...with a rise in unemployment.*



*Inflation expectations have recovered following the initial COVID-19 shock.*



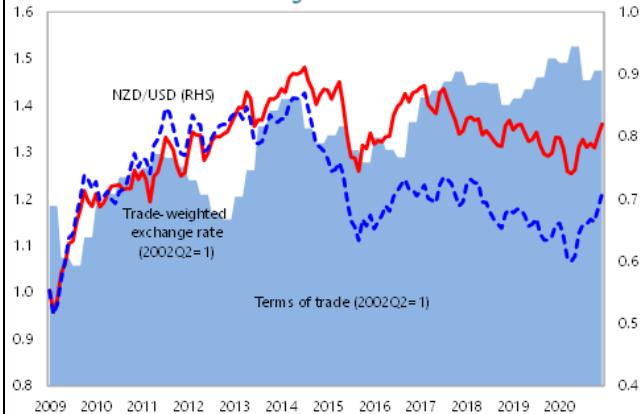
*...with the yield curve steepening again after the lockdowns.*



### Figure 4. The External Sector Has Remained Stable

*The nominal exchange rate depreciated sharply in Q2 2020 and rebounded strongly in Q3, mirroring domestic activity...*

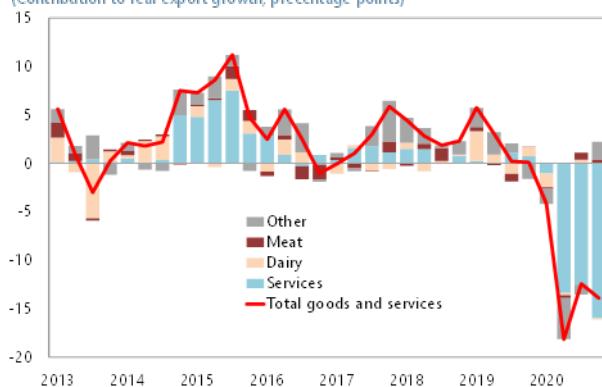
#### Terms of Trade and Exchange Rates



*Services exports (tourism and education) drove the decline in overall exports.*

#### Export Composition

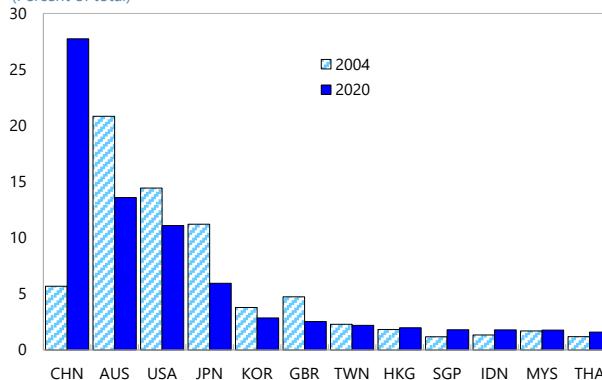
(Contribution to real export growth, percentage points)



*China remains the most important export market.*

#### Exports by Destination

(Percent of total)

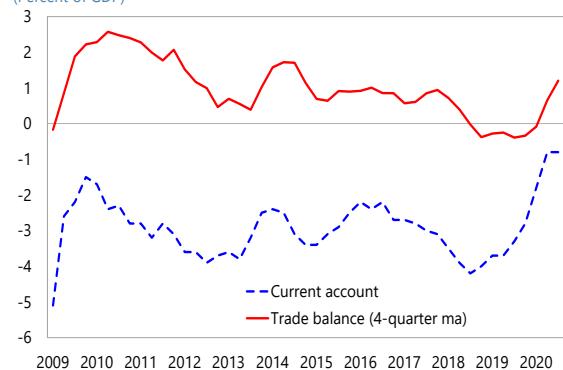


Sources: Reserve Bank of New Zealand; Haver Analytics; World Travel & Tourism Council; and IMF staff calculations.

*... while the current account deficit narrowed sharply due to weaker investment demand.*

#### Current Account

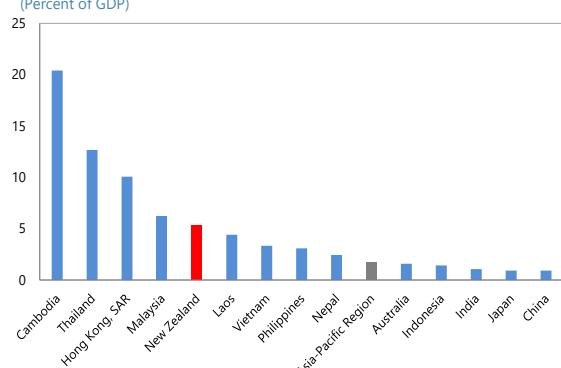
(Percent of GDP)



*With relatively high exposure to international tourism, services exports will lag until borders reopen.*

#### International Visitor Spend in 2019

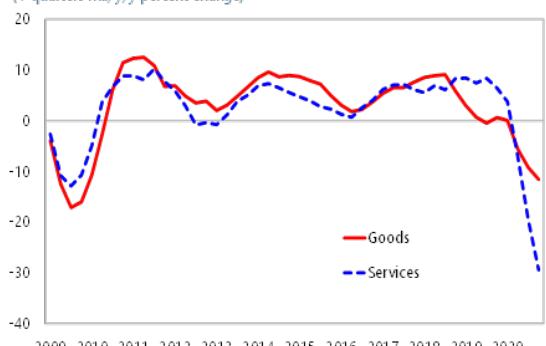
(Percent of GDP)



*The decline in import volumes has been primarily driven by sharply lower imports of services.*

#### Import Volume

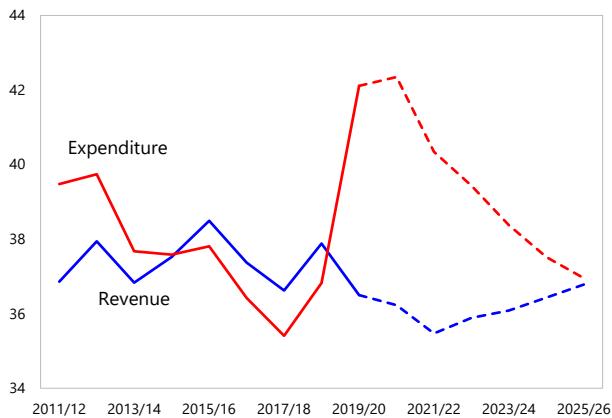
(4-quarters ma; y/y percent change)



### Figure 5. The Fiscal Position Remains Strong, Notwithstanding Higher Spending

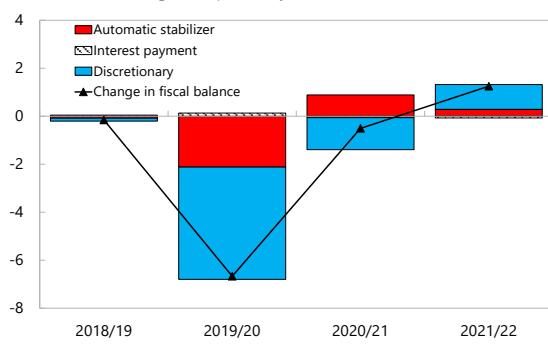
*With ample fiscal space, the government has boosted expenditure to support affected firms and households...*

**General Government Revenue and Expenditure**  
(Percent of GDP)



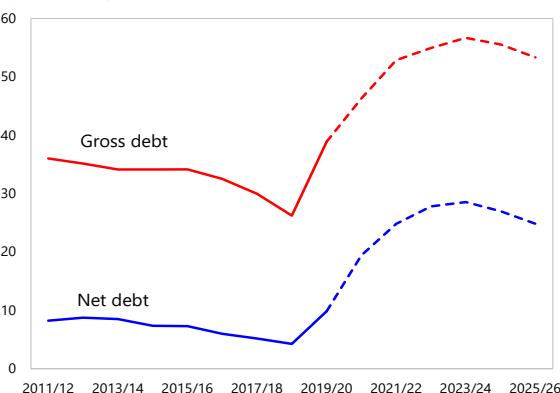
*The fiscal deficit is driven by discretionary policy responses and the economic recession.*

**Drivers of Changes in Fiscal Balances**  
(Percent of GDP, change from previous year)



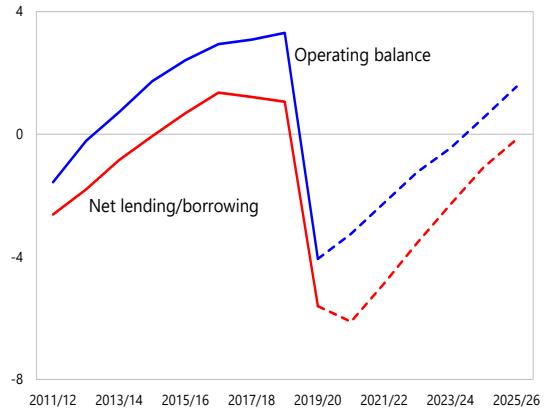
*Government debt is projected to increase as a result of the large fiscal response....*

**General Government Debt**  
(Percent of GDP)



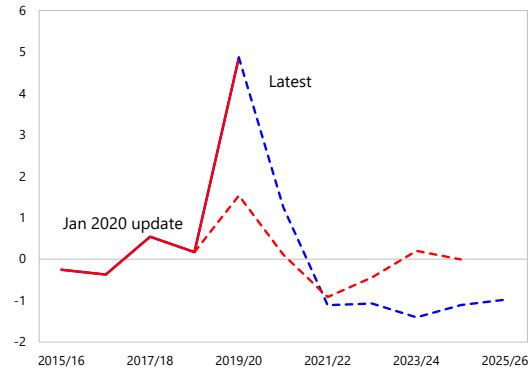
*...which has led to a deterioration of the fiscal balance.*

**Overall and Operating Balance**  
(Percent of GDP)



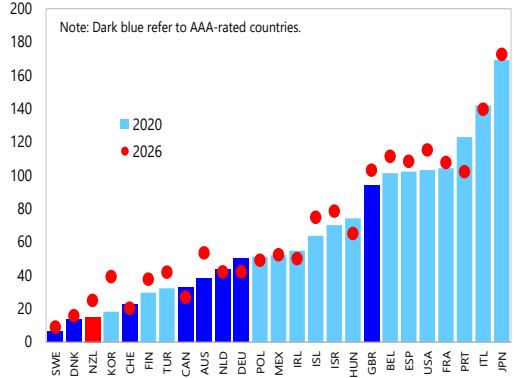
*The large fiscal response is expected to unwind gradually over the medium-term.*

**Fiscal Impulse**  
(Percent of nominal potential GDP)



*....but is expected to remain relatively low compared to other advanced economies.*

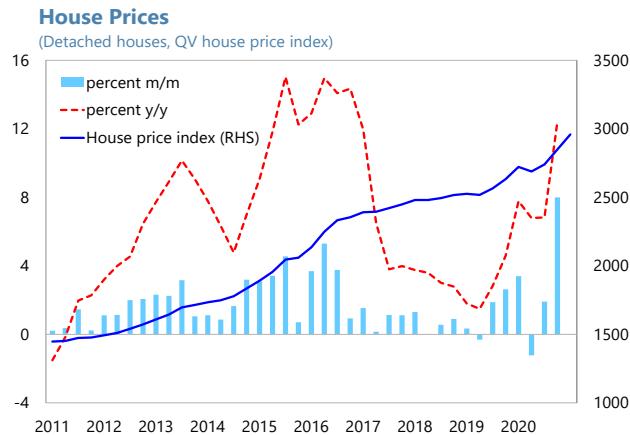
**Net Public Debt**  
(Percent of GDP)



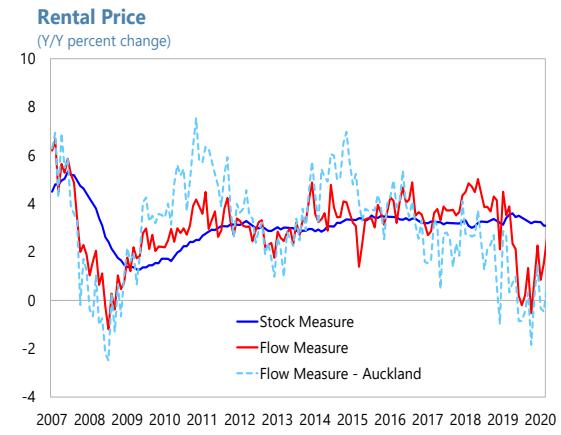
Sources: The Treasury New Zealand, *Budget 2020* and *2020 Half-Year Economic and Fiscal Update*; and IMF staff calculations.

### Figure 6. The Housing Market Rebounded Strongly

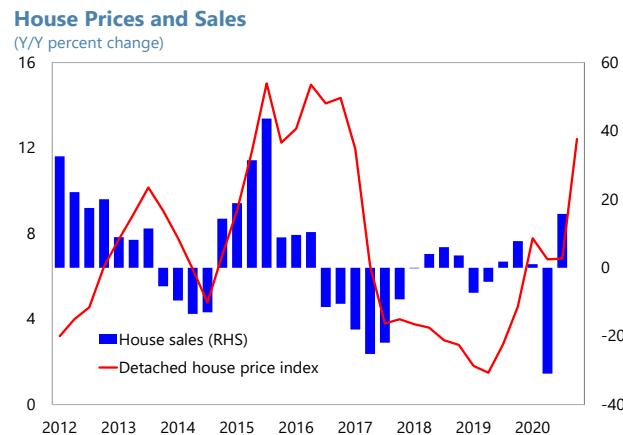
*House price inflation accelerated despite the downturn...*



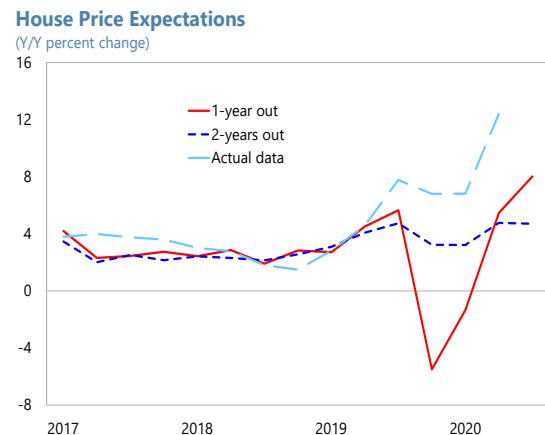
*...and rents also rebounded after an initial decline.*



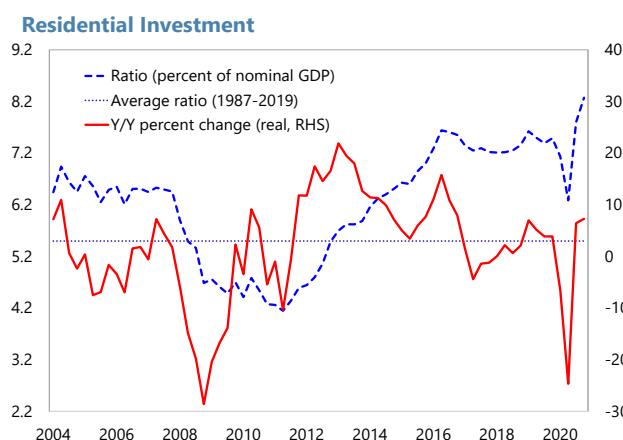
*Sales surged after the lockdown...*



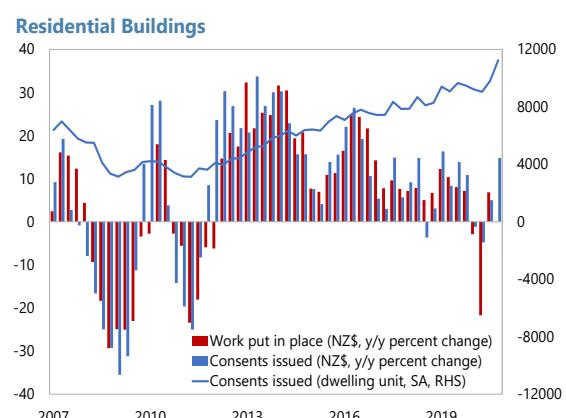
*...amid rising expected house price increases.*



*Residential investment has picked up strongly...*



*...amid a strong increase in building consents issued.*



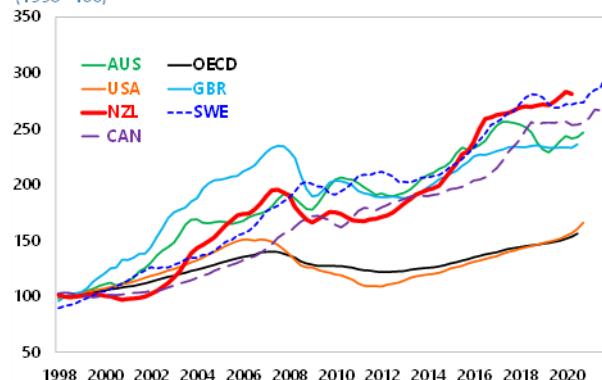
Sources: Reserve Bank of New Zealand; Haver Analytics; and IMF staff calculations.

### Figure 7. Household Debt and Balance Sheet Risks Are Elevated

*House prices have increased strongly by international comparison...*

#### Real House Prices vs OECD

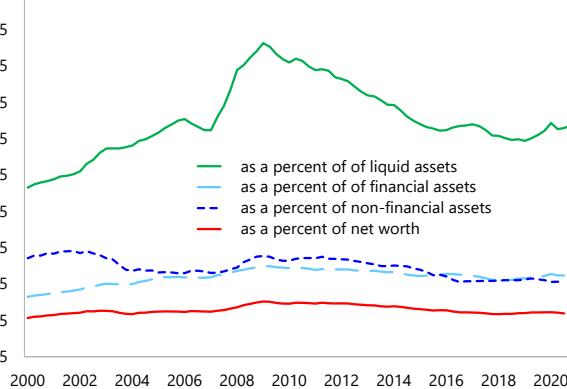
(1998=100)



*Household debt as a percentage of liquid assets has edged up again.....*

#### Household Debt

105

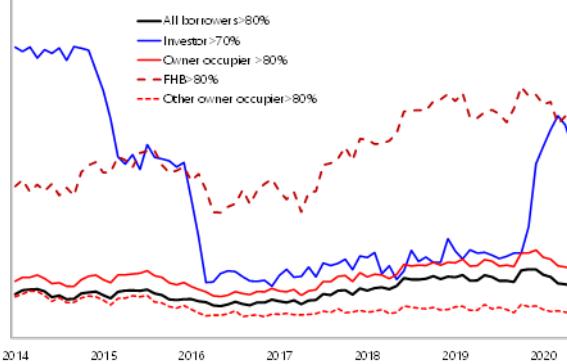


*High loan-to-value ratio lending to investors has risen sharply...*

#### New Residential Mortgage Lending by High LVR

(Percent share of new lending by borrower)

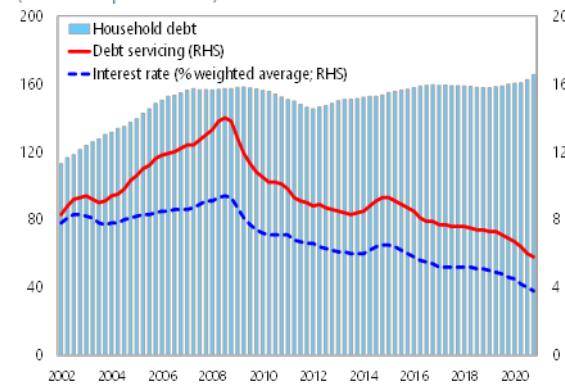
60



*...with household debt remaining elevated despite a reduction in the debt servicing ratio.*

#### Household Debt

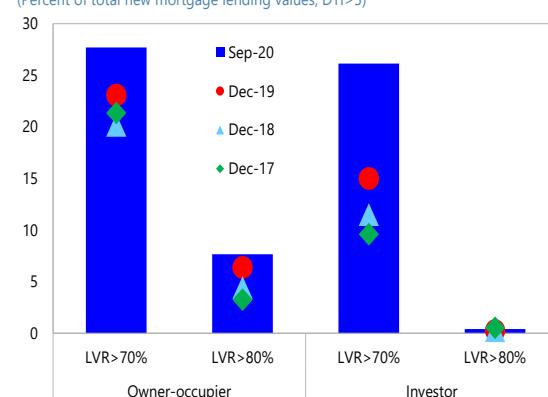
(% nominal disposable income)



*...with a rising share of high debt-to-income lending.*

#### Share of High DTI Loans

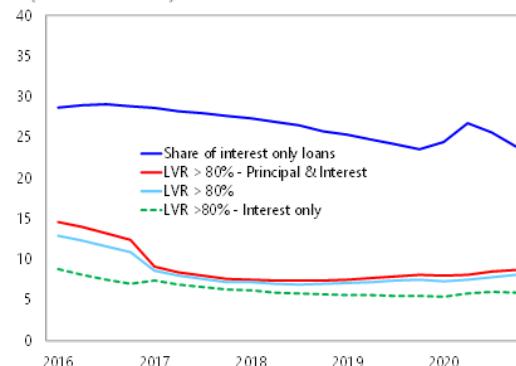
(Percent of total new mortgage lending values; DTI>5)



*... and the share of outstanding interest-only loans has picked up following loan deferral.*

#### Existing Residential Mortgage Lending

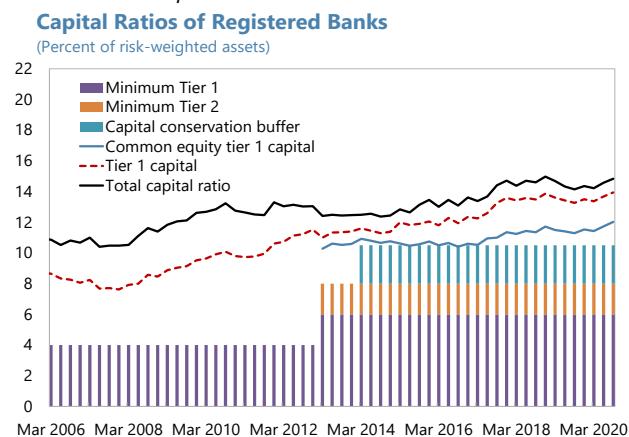
(Percent share of total)



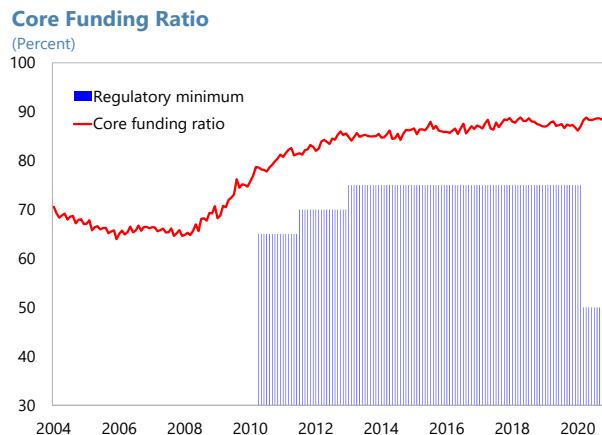
Sources: Reserve Bank of New Zealand; Statistics New Zealand; and Haver Analytics.

### Figure 8. The Banking Sector Has Weathered the COVID-19 Crisis Well So Far

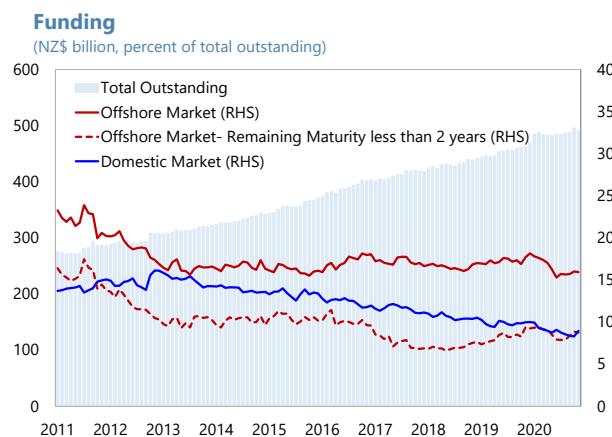
Banks are well capitalized...



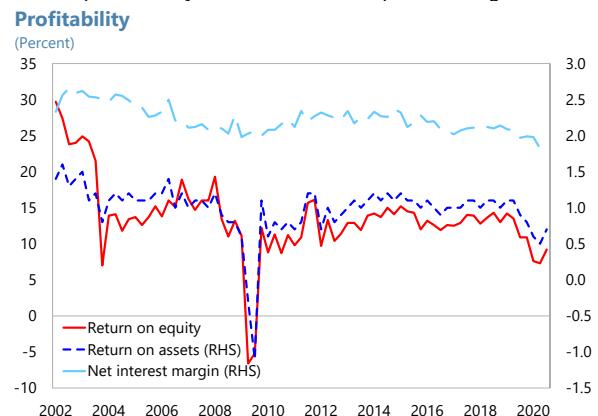
The core funding ratio is well above the regulatory minimum.



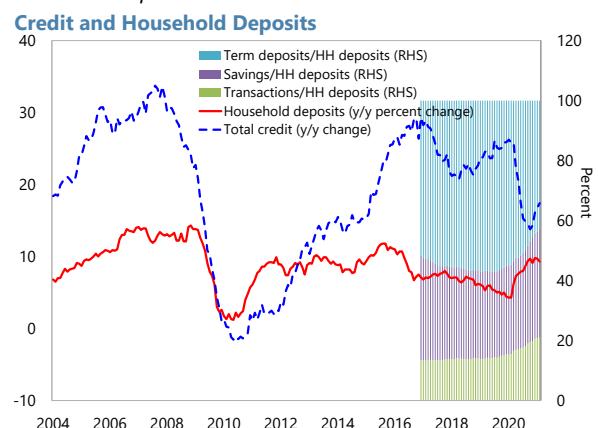
Low credit growth and high deposit growth reduced banks' wholesale funding needs.



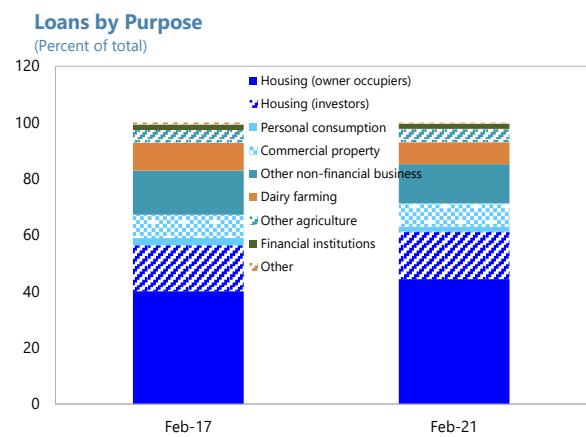
...while profitability has declined from previous high levels.



Credit growth has slowed while fiscal support has increased household deposits.



Banks' exposure to the housing sector continued to increase.



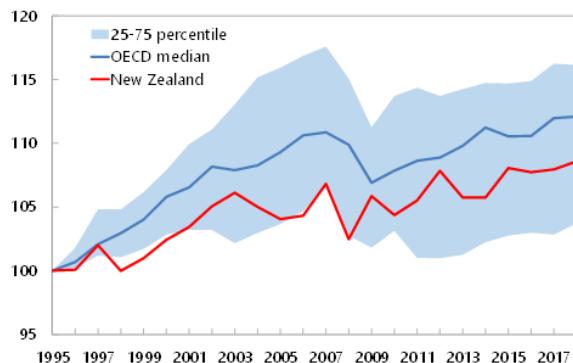
Source: Reserve Bank of New Zealand.

### Figure 9. Macro-Structural Opportunities

*Weak productivity has been a long-standing issue.*

#### Multifactor Productivity Growth

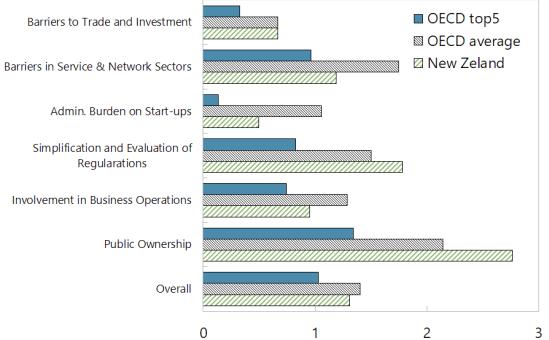
(1995=100)



*Medium-term growth and productivity can be lifted by improving product market regulations.*

#### OECD Product Market Regulations

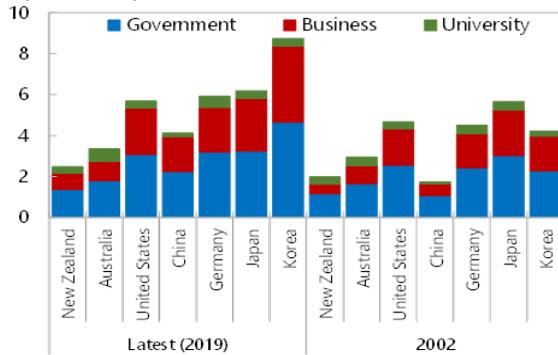
(Indicator; 0 to 3; 0 is best; as of 2018)



*There is a scope for expanding innovative investment.*

#### R&D Expenditures

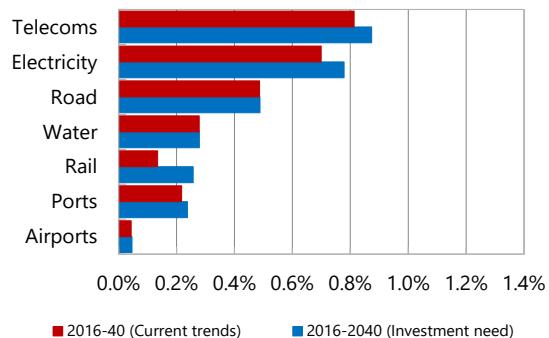
(Percent of GDP)



*Medium-term growth can be augmented by closing infrastructure investment gaps.*

#### Infrastructure Investment Gaps

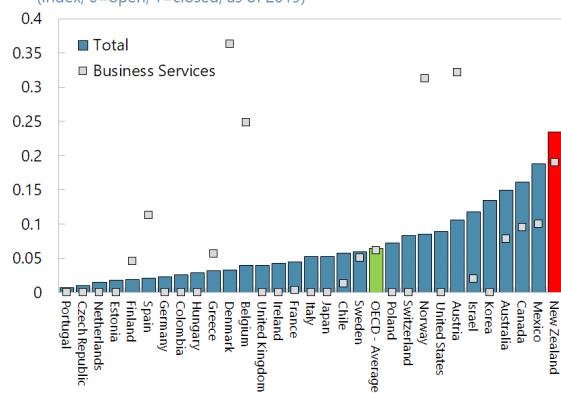
(Percent of GDP)



*The FDI regime is restrictive compared to peer advanced economies.*

#### FDI Restrictiveness

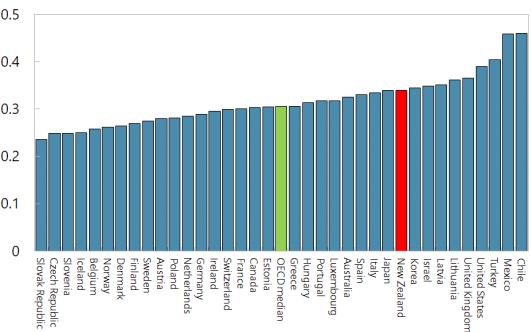
(Index, 0=open, 1=closed, as of 2019)



*The uneven impact of the pandemic is likely to aggravate already relatively elevated inequality.*

#### Gini Coefficient

(latest available data, 2017-2019)



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

**Table 1. New Zealand: Main Economic Indicators, 2016–2026**  
 (Annual percent change, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Projections										
<b>NATIONAL ACCOUNTS</b>											
Real GDP (production)	3.9	3.5	3.4	2.4	-2.9	4.0	3.2	2.6	2.5	2.4	2.5
Real GDP (expenditure)	4.2	4.0	4.3	3.0	-1.1	3.0	2.8	2.5	2.4	2.4	2.3
Domestic demand	4.6	5.3	5.3	2.9	-2.5	5.4	2.7	2.3	2.3	2.4	2.6
Private consumption	5.9	5.6	4.4	3.6	-1.8	3.7	3.4	2.7	2.5	2.8	3.1
Public consumption	2.0	3.4	3.4	5.4	5.8	2.2	0.9	0.8	0.9	0.6	0.8
Investment	3.5	5.7	9.0	0.3	-10.3	9.5	2.7	2.3	2.9	2.7	2.5
Public	-1.1	7.1	3.8	-0.6	-4.8	5.6	0.6	-0.6	2.1	1.8	1.8
Private	4.6	4.2	8.5	4.3	-8.3	6.5	3.3	3.1	3.1	3.0	2.7
Private business	1.3	7.3	12.3	4.1	-10.1	3.1	3.2	2.8	3.2	3.1	2.7
Dwelling	11.4	-1.5	1.2	5.0	-4.4	13.4	3.5	3.8	3.0	2.7	2.7
Inventories (contribution to growth, percent)	0.1	0.2	0.4	-0.7	-0.7	0.6	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	-0.5	-1.7	-1.4	-0.1	2.1	-2.8	-0.2	0.1	0.0	-0.2	-0.4
Real gross domestic income	4.6	5.4	3.7	3.0	-0.9	3.6	2.6	2.1	2.1	2.5	2.4
Investment (percent of GDP)	23.1	23.5	24.6	24.0	21.7	23.3	23.3	23.3	23.5	23.6	23.6
Public	5.3	5.4	5.4	5.3	5.0	5.1	5.1	4.9	4.9	4.9	4.8
Private	17.8	18.0	19.2	18.7	16.6	18.1	18.2	18.4	18.6	18.7	18.7
Savings (gross, percent of GDP)	20.9	20.5	20.4	20.7	20.9	21.2	21.2	20.9	20.8	20.8	20.8
Public	1.0	1.3	1.1	-2.3	-5.9	-5.5	-4.2	-2.9	-1.7	-0.6	-0.1
Private	19.9	19.2	19.3	23.0	26.8	26.7	25.4	23.9	22.5	21.4	20.9
Potential output	3.0	2.9	2.9	2.9	1.8	1.5	1.9	2.2	2.3	2.4	2.5
Output gap (percent of potential)	0.0	0.6	1.0	0.6	-4.2	-1.8	-0.6	-0.2	0.0	0.0	0.0
<b>LABOR MARKET</b>											
Employment	4.8	4.2	2.9	1.3	1.4	0.1	1.3	1.3	1.6	1.6	1.4
Unemployment (percent of labor force)	5.2	4.7	4.3	4.1	4.6	5.1	4.9	4.7	4.5	4.4	4.4
Wages (nominal percent change)	1.9	2.1	3.1	3.9	3.6	1.9	2.5	3.1	3.5	3.5	3.7
<b>PRICES</b>											
Terms of trade index (goods, % change)	1.1	7.3	-1.7	0.3	3.0	2.7	-1.1	-1.9	-1.6	-0.1	-0.1
Consumer prices (avg, % change)	0.6	1.9	1.6	1.6	1.7	1.8	1.6	1.7	2.1	2.1	2.2
GDP deflator (avg, % change)	1.8	3.3	1.2	2.2	2.2	1.8	1.5	1.4	1.9	2.2	2.3
<b>MACRO-FINANCIAL</b>											
Official cash rate (policy rate, percent, avg)	2.2	1.8	1.8	1.4	0.4	0.3	0.3	0.3	0.6	1.1	1.6
Credit to the private sector (percent change)	7.0	4.9	5.4	5.6	3.9	5.2	5.0	5.4	5.2	4.5	3.8
Interest payments (percent of disposable income)	8.1	7.7	7.5	7.1	6.2	6.4	6.5	6.6	7.4	8.1	8.6
Household savings (percent of disposable income)	3.2	3.3	3.2	3.4	3.6	3.5	3.2	3.2	3.0	3.0	3.0
Household debt (percent of disposable income)	159	159	158	160	166	167	169	171	172	171	169
<b>GENERAL GOVERNMENT (percent of GDP) 1/</b>											
Revenue	37.5	36.9	37.3	36.5	36.7	36.0	35.7	36.0	36.3	36.6	36.9
Expenditure	36.5	35.6	36.2	38.8	42.7	41.5	39.9	38.9	37.9	37.3	37.0
Net lending/borrowing	1.0	1.3	1.1	-2.3	-5.9	-5.5	-4.2	-2.9	-1.7	-0.6	-0.1
Operating balance	2.6	3.0	3.2	-0.4	-3.7	-2.8	-1.7	-0.8	0.1	1.1	1.6
Cyclically adjusted balance 2/	1.7	1.7	1.4	-1.1	-3.9	-3.9	-2.8	-1.6	-0.3	0.7	1.2
Gross debt	33.4	31.1	28.1	32.1	43.1	49.9	53.9	55.9	56.1	54.4	52.1
Net debt	6.6	5.5	4.7	7.0	14.9	22.3	26.3	28.2	27.7	25.9	23.7
Net worth	85.6	89.5	92.4	86.6	78.5	70.8	66.9	65.4	65.5	65.8	65.6
<b>BALANCE OF PAYMENTS</b>											
Current account (percent of GDP)	-2.2	-3.0	-4.2	-3.3	-0.8	-2.1	-2.1	-2.4	-2.7	-2.8	-2.8
Export volume	2.4	2.5	2.8	2.3	-12.1	-0.5	8.4	5.0	4.6	3.5	3.1
Import volume	3.8	7.3	6.5	2.2	-16.3	9.3	7.2	3.6	3.7	3.4	3.6
Net international investment position (percent of GDP)	-57.4	-52.1	-55.9	-53.7	-55.0	-54.5	-54.4	-54.7	-55.1	-55.4	-55.8
Gross official reserves (bn US\$)	18.2	20.3	17.6	17.0	13.0	...	...	...	...	...	...
<b>MEMORANDUM ITEMS</b>											
Nominal GDP (bn NZ\$)	267	287	303	319	322	337	352	366	382	400	418
Percent change	6.0	7.5	5.6	5.3	1.0	4.8	4.3	3.9	4.3	4.6	4.7
Nominal GDP per capita (US\$)	39,428	42,330	42,803	42,166	41,127	47,499	49,027	50,522	52,329	54,302	56,341
Real gross national disposable income per capita (NZ\$)	50,225	51,374	52,372	53,537	52,499	54,068	55,006	55,304	55,587	55,950	57,807
Percent change	3.0	2.3	1.9	2.2	-1.9	3.0	1.7	0.5	0.5	0.7	3.3
Population (million)	4.7	4.8	4.9	5.0	5.1	5.1	5.2	5.3	5.3	5.4	5.5
US\$/NZ\$ (average level)	0.697	0.711	0.693	0.659	0.650	...	...	...	...	...	...
Nominal effective exchange rate	109.6	111.1	106.8	105.2	103.8	...	...	...	...	...	...
Real effective exchange rate	105.8	107.4	102.9	101.3	100.5	...	...	...	...	...	...

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

1/ Calendar year.

2/ In percent of potential GDP.

**Table 2. New Zealand: Fiscal Accounts, 2015/16-2025/26<sup>1/</sup>**  
 (In percent of GDP, unless otherwise indicated)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Projections										
<b>GENERAL GOVERNMENT 2/</b>											
<b>Revenue</b>	<b>37.5</b>	<b>37.4</b>	<b>36.6</b>	<b>37.9</b>	<b>36.5</b>	<b>36.2</b>	<b>35.5</b>	<b>35.9</b>	<b>36.1</b>	<b>36.4</b>	<b>36.8</b>
Tax revenue	30.8	31.0	30.6	31.7	30.7	31.2	30.7	31.1	31.1	31.3	31.6
Direct taxes	19.7	20.0	19.7	20.5	19.7	19.9	19.7	20.2	20.3	20.5	20.5
Individual and withholding	12.4	12.4	12.2	12.6	12.9	13.1	13.0	12.9	13.0	13.0	13.0
Corporate	5.3	5.6	5.5	5.9	4.8	4.8	4.6	5.2	5.3	5.3	5.3
Property	2.0	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Indirect taxes	11.1	11.0	10.9	11.1	10.9	11.2	11.0	10.9	10.8	10.9	11.1
Of which: GST	7.5	7.5	7.4	7.4	7.3	7.6	7.4	7.4	7.3	7.4	7.5
Non-tax revenue	6.6	6.4	6.1	6.2	5.8	5.0	4.8	4.8	5.0	5.1	5.2
<b>Expenditure</b>	<b>36.8</b>	<b>36.0</b>	<b>35.4</b>	<b>36.8</b>	<b>42.1</b>	<b>42.4</b>	<b>40.3</b>	<b>39.4</b>	<b>38.4</b>	<b>37.5</b>	<b>37.0</b>
Expense	35.1	34.5	33.5	34.6	40.6	39.5	37.7	37.1	36.5	35.9	35.2
Employee expenses	8.7	8.5	8.3	8.6	9.1	9.1	9.2	9.2	9.1	8.9	8.8
Other operating expenses (excl. depreciation)	5.4	5.4	5.2	5.4	5.7	7.8	7.1	6.6	6.0	5.9	5.6
Social benefits	14.0	13.6	13.3	13.8	14.9	15.2	15.0	14.7	14.7	14.5	14.5
Other transfers	3.1	3.2	3.1	3.0	7.3	3.5	2.7	2.6	2.6	2.5	2.6
Interest	1.6	1.5	1.4	1.4	1.3	1.3	1.4	1.6	1.7	1.8	1.8
Other	2.3	2.3	2.2	2.3	2.4	2.6	2.4	2.4	2.4	2.4	2.0
Net acquisition of nonfinancial assets	1.7	1.6	1.9	2.2	1.5	2.9	2.6	2.3	1.8	1.6	1.7
Of which: Gross fixed capital formation	3.8	3.7	3.7	4.0	3.7	4.8	4.1	3.4	2.9	2.6	2.5
Operating balance	2.4	2.9	3.1	3.3	-4.1	-3.3	-2.2	-1.2	-0.5	0.5	1.6
Primary balance	1.3	2.0	1.8	1.7	-5.0	-5.3	-4.0	-2.3	-1.0	0.3	1.2
<b>Net lending (+)/borrowing (-)</b>	<b>0.7</b>	<b>1.3</b>	<b>1.2</b>	<b>1.1</b>	<b>-5.6</b>	<b>-6.1</b>	<b>-4.9</b>	<b>-3.5</b>	<b>-2.3</b>	<b>-1.1</b>	<b>-0.2</b>
<b>GENERAL GOVERNMENT BALANCE SHEET 2/</b>											
<b>Liabilities</b>	<b>63.4</b>	<b>60.7</b>	<b>57.3</b>	<b>57.6</b>	<b>73.9</b>	<b>80.6</b>	<b>86.4</b>	<b>87.3</b>	<b>88.4</b>	<b>85.9</b>	<b>82.4</b>
Gross debt	34.2	32.5	29.9	26.2	38.9	46.3	52.9	54.9	56.7	55.5	53.3
Other liabilities 3/	29.2	28.1	27.3	31.4	35.0	34.3	33.6	32.4	31.7	30.4	29.1
<b>Assets</b>	<b>146.0</b>	<b>148.8</b>	<b>148.5</b>	<b>150.9</b>	<b>156.9</b>	<b>153.4</b>	<b>154.7</b>	<b>152.9</b>	<b>153.6</b>	<b>151.8</b>	<b>148.1</b>
Financial assets	64.1	66.4	65.3	65.4	70.1	68.3	69.5	69.1	70.9	71.3	69.4
Debt relevant	26.9	26.5	24.8	22.0	29.0	26.9	28.0	27.1	28.1	28.6	28.5
Other	37.2	39.9	40.5	43.4	41.1	41.4	41.5	42.0	42.8	42.7	40.9
Nonfinancial assets	81.9	82.4	83.2	85.5	86.7	85.1	85.1	83.8	82.7	80.5	78.7
<b>Net financial worth</b>	<b>0.7</b>	<b>5.8</b>	<b>8.0</b>	<b>7.8</b>	<b>-3.8</b>	<b>-12.3</b>	<b>-16.9</b>	<b>-18.2</b>	<b>-17.5</b>	<b>-14.6</b>	<b>-13.0</b>
<b>Net debt 4/</b>	<b>7.3</b>	<b>6.0</b>	<b>5.2</b>	<b>4.3</b>	<b>9.9</b>	<b>19.4</b>	<b>24.8</b>	<b>27.8</b>	<b>28.5</b>	<b>27.0</b>	<b>24.8</b>
Central government	3.7	2.4	1.9	0.8	5.8	15.5	20.8	23.8	24.4	22.9	20.7
Local government	3.6	3.6	3.3	3.5	4.0	4.0	4.0	4.1	4.1	4.1	4.1
<b>Net worth</b>	<b>82.6</b>	<b>88.1</b>	<b>91.2</b>	<b>93.3</b>	<b>83.0</b>	<b>72.7</b>	<b>68.2</b>	<b>65.6</b>	<b>65.2</b>	<b>65.8</b>	<b>65.7</b>
Central government	38.4	44.5	48.9	50.7	40.7	32.1	28.3	26.9	27.3	29.2	30.1
Local government	44.3	43.6	42.3	42.6	42.3	40.6	39.9	38.7	37.9	36.7	35.6
<b>MEMORANDUM ITEMS</b>											
Cyclically adjusted balance (percent of potential GDP)	0.8	1.3	0.8	0.7	-4.0	-5.3	-4.3	-3.5	-2.2	-1.1	-0.2
Fiscal impulse (change in CAB; in percent of potential GDP)	-0.4	-0.5	0.4	0.1	4.7	1.3	-1.0	-0.8	-1.3	-1.0	-1.0
Change in real revenue (percent)	4.8	4.8	3.6	6.6	-3.5	3.2	-0.9	4.0	2.2	3.7	3.3
Change in real primary expenditure (percent)	3.0	3.1	4.2	7.4	15.5	4.4	-3.9	-0.2	-1.5	0.1	0.7
New Zealand Superannuation Fund											
Budget transfers (+ = receipts)	0.0	0.0	0.2	0.3	0.5	0.6	0.7	0.3	0.4	0.4	0.4
Net assets	11.4	12.5	13.2	13.6	14.0	15.1	16.2	16.7	17.5	18.2	18.3
Contributed capital	5.8	5.4	5.2	5.3	5.6	6.0	6.5	6.5	6.7	6.8	7.0
Central government											
Revenue	34.1	34.0	33.2	34.4	33.0	33.1	32.3	32.7	32.9	33.3	33.6
Expenditure	33.3	32.5	32.0	32.9	38.5	39.0	37.0	36.1	35.0	34.2	33.6
Net lending (+)/borrowing (-)	0.8	1.5	1.3	1.5	-5.6	-5.9	-4.7	-3.4	-2.1	-0.9	0.0
Local government											
Revenue	4.0	3.9	3.9	4.0	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Expenditure	4.1	4.1	4.1	4.5	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Net lending (+)/borrowing (-)	-0.2	-0.2	-0.1	-0.5	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
GDP (in billion NZ\$)	259	276	296	310	317	334	344	360	373	391	409

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

1/ The fiscal year runs from July to June.

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

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

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

**Table 3. New Zealand: Balance of Payments, 2016-2026**  
 (In percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026											
	Projections																					
<b>BALANCE OF PAYMENTS</b>																						
( % GDP )																						
<b>Current account</b>	-2.2	-3.0	-4.2	-3.3	-0.8	-2.1	-2.1	-2.4	-2.7	-2.8	-2.8											
Balance on goods and services	0.9	0.9	-0.4	-0.3	1.3	-0.1	-0.4	-0.6	-0.7	-0.6	-0.8											
Exports of goods and services	26.7	27.2	27.5	27.2	24.2	22.2	23.0	23.0	23.0	23.1	23.1											
Exports of goods	18.1	18.8	19.1	18.9	18.5	18.3	18.9	18.8	18.8	18.9	18.9											
Exports of services	8.5	8.4	8.4	8.3	5.7	3.9	4.1	4.1	4.2	4.2	4.2											
Imports of goods and services	25.8	26.3	27.9	27.5	22.8	22.3	23.4	23.5	23.7	23.7	23.8											
Imports of goods	19.1	19.5	20.8	20.1	17.5	17.3	18.0	18.1	18.2	18.2	18.3											
Imports of services	6.7	6.8	7.1	7.5	5.4	5.0	5.4	5.5	5.6	5.5	5.6											
Primary income, net	-2.9	-3.7	-3.6	-2.7	-1.7	-2.1	-2.1	-2.0	-2.0	-2.1	-1.9											
Inflows	3.1	3.0	2.9	2.9	2.7	3.8	3.8	3.9	3.8	3.8	3.8											
Outflows	6.0	6.7	6.5	5.5	4.5	5.9	5.9	5.9	5.8	6.0	5.7											
Secondary income, net	-0.1	-0.1	-0.1	-0.2	-0.3	0.1	0.3	0.2	0.1	0.0	-0.2											
Inflows	0.8	0.8	0.9	0.8	0.7	0.7	0.9	0.8	0.8	0.8	0.8											
Outflows	0.9	0.9	1.0	1.0	1.0	0.6	0.6	0.6	0.7	0.8	0.9											
<b>Capital and financial account</b>																						
Capital account, net	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0											
Financial account, net	-2.8	-0.7	-1.1	-2.1	-2.1	-2.1	-2.1	-2.4	-2.7	-2.8	-2.8											
Direct investment	-1.4	-1.1	-0.9	-2.1	-1.6	-1.3	-1.2	-1.2	-1.4	-1.4	-1.5											
Equity	-0.9	-1.6	-0.4	-2.7	-1.9	-1.0	-1.0	-1.0	-1.1	-1.1	-1.1											
Debt	-0.5	0.5	-0.6	0.6	0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3											
Portfolio investment	-3.4	0.1	0.0	1.8	4.6	-0.6	-0.6	-0.8	-0.9	-0.9	-0.9											
Equity	1.3	0.7	-0.2	1.2	1.5	0.8	0.6	0.5	0.6	0.6	0.6											
Debt	-4.7	-0.7	0.2	0.6	3.1	-1.3	-1.3	-1.3	-1.5	-1.5	-1.6											
Financial derivatives	-0.1	0.4	1.0	-0.6	-2.4	0.1	0.0	0.0	0.0	0.0	0.0											
Other investment	0.5	-1.0	0.0	-1.0	-0.6	-0.6	-0.5	-0.6	-0.6	-0.7	-0.7											
Reserve assets	1.7	0.9	-1.1	-0.2	-2.1	...	...	...	...	...	...											
<b>Net errors and omissions</b>	-1.3	2.2	3.2	1.2	-1.3	0.0	0.0	0.0	0.0	0.0	0.0											
<b>BALANCE SHEET</b>																						
Net international investment position	-57.4	-52.1	-55.9	-53.7	-55.0	-54.5	-54.4	-54.7	-55.1	-55.4	-55.8											
Equity, net	-3.0	-1.0	-4.6	-6.0	-8.6	-8.5	-8.4	-8.5	-8.7	-8.8	-8.9											
Assets	37.1	40.2	37.7	42.7	46.8	46.8	46.8	46.8	46.8	46.8	46.8											
Liabilities	40.1	41.1	42.3	48.8	55.4	55.3	55.2	55.3	55.5	55.6	55.7											
Debt, net	-64.0	-61.3	-60.0	-55.9	-52.3	-52.0	-51.9	-52.1	-52.4	-52.6	-52.8											
Assets	45.8	39.8	40.0	40.3	45.9	45.9	45.9	45.9	45.9	45.9	45.9											
Liabilities	109.8	101.2	100.0	96.2	98.2	97.9	97.8	98.0	98.3	98.5	98.7											
External assets (gross)	92.4	90.2	86.4	91.3	98.6	98.6	98.6	98.6	98.6	98.6	98.6											
Equity	37.1	40.2	37.7	42.7	46.8	46.8	46.8	46.8	46.8	46.8	46.8											
Debt	45.8	39.8	40.0	40.3	45.9	45.9	45.9	45.9	45.9	45.9	45.9											
External liabilities (gross)	149.9	142.3	142.3	145.0	153.6	153.2	153.0	153.4	153.7	154.1	154.4											
Equity	40.1	41.1	42.3	48.8	55.4	55.3	55.2	55.3	55.5	55.6	55.7											
Debt	109.8	101.2	100.0	96.2	98.2	97.9	97.8	98.0	98.3	98.5	98.7											
Of which: NZ\$ denominated	65.8	56.7	52.2	51.1	51.8	50.4	50.4	50.5	50.6	50.7	50.8											
FX denominated	45.1	44.7	43.9	43.6	53.7	47.5	47.5	47.6	47.7	47.8	47.9											
Short-term	35.4	29.5	34.0	29.5	33.5	33.4	33.3	33.4	33.5	33.5	33.6											
<b>MEMORANDUM ITEMS</b>																						
Gross official reserves (bn NZ\$)	18.2	20.3	17.6	17.0	13.0	...	...	...	...	...	...											
In months of prospective imports	4.1	4.1	3.6	4.3	3.0	...	...	...	...	...	...											
In percent of short-term external debt	27.0	34.4	25.5	28.2	17.7	...	...	...	...	...	...											

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

**Table 4. New Zealand: Monetary and Financial Sector, 2016-2026**  
 (In billions of NZ\$, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Projections											
<b>CENTRAL BANK</b>											
<b>Net foreign assets</b>	22	24	22	19	11	12	12	13	13	14	14
<b>Net domestic assets</b>	-8	-9	-8	-4	27	66	77	71	68	63	64
Net domestic claims	-1	-1	-4	0	31	69	81	75	72	68	69
Claims on Central government (net)	-2	-2	-5	-1	28	67	78	72	69	63	63
Claims on Other Depository Corporations	0	0	0	1	3	3	3	3	3	3	3
Other items net	-6	-8	-3	-4	-4	-4	-4	-4	-4	-4	-5
<b>Monetary base</b>	14	15	15	15	38	77	89	83	81	77	79
<b>DEPOSITORY CORPORATIONS</b>											
<b>Net foreign assets</b>	-80	-76	-80	-91	-100	-105	-109	-114	-119	-124	-129
<b>Net domestic assets</b>	352	369	391	417	466	521	551	563	580	596	619
Net domestic claims	415	436	459	489	544	603	636	651	673	693	719
Claims on Central government (net)	7	7	7	12	48	87	98	92	89	83	83
Claims on State and Local Government	6	6	7	8	10	10	11	11	12	12	13
Claims on Public Nonfinancial Corporations	1	1	1	1	2	2	2	2	2	2	2
Claims on Private Sector	392	412	434	459	473	492	513	534	557	581	606
Claims on Other Financial Corporations	9	9	9	10	12	12	13	13	14	14	15
Other items net	-63	-67	-67	-72	-78	-82	-85	-89	-92	-97	-101
<b>Broad money</b>	273	293	311	326	366	416	442	449	462	473	490
<b>MEMORANDUM ITEMS</b>											
Private sector credit 2/	409	429	452	477	496	518	544	574	604	631	656
Housing loans 1/	229	242	256	274	296	319	343	367	391	412	430
Business loans 1/	97	103	108	115	109	111	113	119	124	129	134
Household deposits	156	167	177	185	203	213	222	231	241	252	264
In percent of GDP											
Private sector credit 2/	153	150	149	150	154	154	155	157	158	158	157
Housing loans 1/	86	84	85	86	92	95	97	100	102	103	103
Business loans 1/	36	36	36	36	34	33	32	32	32	32	32
Household deposits	58	58	59	58	63	63	63	63	63	63	63
Percentage change											
Private sector credit 2/	7.0	4.9	5.4	5.6	3.9	4.6	5.0	5.5	5.2	4.5	3.8
Housing loans 1/	9.2	5.5	5.9	6.9	8.2	7.9	7.3	7.1	6.6	5.2	4.5
Business loans 1/	7.8	6.1	5.0	6.5	-5.3	1.8	2.0	4.5	4.3	4.3	3.8
Household deposits	7.1	7.1	6.2	4.4	9.8	4.8	4.3	3.9	4.3	4.6	4.7

Sources: RBNZ and IMF staff calculations.

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

2/ Depository corporations.

**Table 5. New Zealand: Financial Soundness Indicators, 2016-20**

	2016	2017	2018	2019	2020
<b>Interest rates (percent end-year)</b>					
90-day bank bill rate	2.3	2.0	1.9	1.5	0.5
90-day bank bill rate, real	1.7	0.1	0.3	-0.1	-1.2
<b>Stock market index (percent change, end-year)</b>					
	8.8	22.0	4.9	30.4	13.9
<b>Liquidity and funding (in percent)</b>					
Liquid assets to total assets	13.1	13.3	13.3	13.5	17.0
Liquid assets to short-term liabilities	20.0	20.0	19.8	20.4	25.1
1-month maturity mismatch	6.8	7.4	7.2	6.7	6.8
Core funding ratio	87.2	88.7	87.0	86.8	88.5
<b>Asset composition (percentage share of total)</b>					
Agricultural	14.6	14.1	13.9	13.2	12.7
Business	25.0	25.1	25.0	25.3	23.6
Households	60.4	60.7	61.1	61.5	63.7
Of which: Housing	56.7	56.9	57.3	58.0	60.7
<b>Asset quality (in percent)</b>					
Non-performing loans to total loans	0.5	0.5	0.5	0.6	0.6
Non-performing loans net of provisions to capital	n.a.	n.a.	0.7	2.3	-0.1
Non-performing loans (in millions of NZ\$)	2,183	2,296	3,686	4,483	4,827
<b>Capital adequacy (in percent)</b>					
Regulatory capital to risk-weighted assets	13.7	14.7	15.0	14.4	15.2
Tier I capital to risk-weighted assets	12.4	13.6	13.9	13.5	14.3
Common equity tier 1 to risk-weighted assets	10.7	11.4	11.7	11.5	12.4
Capital to assets	7.2	7.7	7.7	7.7	7.6
<b>Profit Ratios (in percent)</b>					
Return on assets	1.0	1.1	1.0	0.8	0.9
Return on equity	12.6	13.9	13.0	10.9	12.0
Net interest margin	2.1	2.1	2.1	2.0	1.9

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

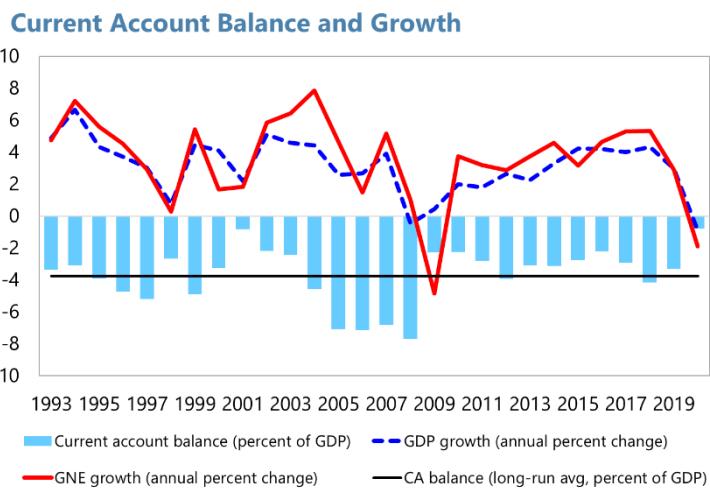
Note: Capital adequacy measures, NPLs net of provisions to capital, liquid assets, 1-month mismatch ratio, core funding ratio, and return on equity are calculated for locally incorporated banks only.

## Annex I. External Sector Assessment

*Based on preliminary estimates, New Zealand's external position in 2020 was broadly in line with fundamentals and desired policy settings. The change from the previous assessment (when it was seen as weaker than implied by fundamentals and desirable policies) stems from the significantly lower current account deficit and the depreciated real exchange rate.*

**1. New Zealand has historically run current account (CA) deficits, averaging close to 4 percent of GDP over the past few decades.** These deficits reflected a long-standing structural savings-investment imbalance and have resulted in a sizable negative net international investment position (NIIP). New Zealand's NIIP narrowed slightly to -53.7 percent of GDP at the end of 2019 but rose again to -55 percent in 2020.

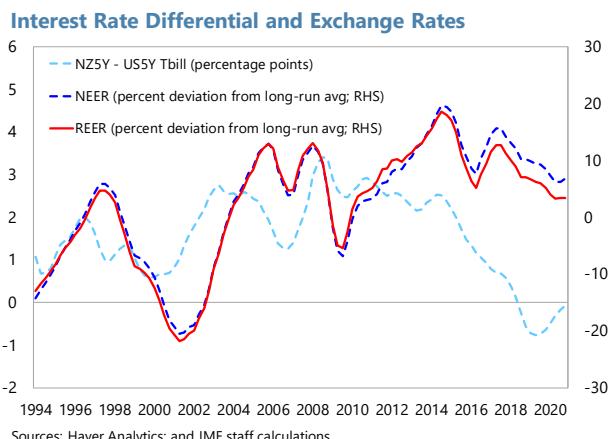
**2. The CA deficit narrowed significantly in 2020.** While both real exports and imports declined during the crisis, the weaker domestic demand conditions had a proportionately larger impact on real imports, while the overall terms of trade improved. The primary income deficit also narrowed as the interest rate on foreign liabilities declined during the year even as portfolio flows increased significantly, drawn by New Zealand's strong performance in the face of the pandemic.



Sources: Haver Analytics; and IMF staff calculations.

### 3. New Zealand's external imbalances have narrowed since 2018.

- New Zealand's REER declined from some 13 percent above its long-term average in 2017 to just over 3 percent by end-2020.** The depreciation mirrors the declining interest differential, which had turned negative in 2018, and also likely reflects the slowing economic activity in 2019. Since 2020Q3, both the real and nominal exchange rate appreciated somewhat, partially reversing some of the depreciation since 2017 with the fast economic recovery and resilient commodity prices.



Sources: Haver Analytics; and IMF staff calculations.

- The EBA current account regression suggests that the current account deficit in 2020 was at about the level implied by fundamentals and desired policy settings.** The estimated cyclically-adjusted CA norm for 2020 was -1.1 percent of GDP, compared to an actual cyclically-

adjusted CA balance of -1.4 percent. This gives an estimated CA gap of -0.3 percent of GDP. Applying the EBA-estimated elasticity of the current-account-to-GDP ratio with respect to the REER of -0.23 to this gap results in an estimated currency overvaluation of around 1.4 percent.

- **The EBA REER level regression suggests the real exchange rate was in line with fundamentals in 2020** (text table). However, the results from the REER index regression deviate significantly from this assessment and the conclusions of the other EBA methodologies.
- **The NIIP level and trajectory are on course to narrow over the medium term.** The External Stability (ES) approach suggests that the NIIP would be stabilized at current levels with a CA deficit of 2.9 percent of GDP, while the cyclically-adjusted CA deficit for 2020 is estimated at 1.4 percent (see above). This implies that the currency is estimated to be undervalued by around 6.4 percent. The structure of New Zealand's external balance sheet reduces the vulnerability associated with its large negative NIIP. Since external NIIP liabilities are mainly in New Zealand dollars and there is a net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector has a net foreign currency liability position, but it is fully hedged. Further, the temporary provision of significant domestic funding to commercial banks from the RBNZ as a response to the pandemic has largely eliminated the need for banks' external financing.

**4. Taken together, the models indicate that the external position is broadly in line with fundamentals and desired policy settings.** The results from the various approaches indicate an average undervaluation of around 0.3 percent, close to the results of the current account model. On balance, the current account model likely provides a reliable assessment of the external position, especially with the use of multilaterally consistent adjustors to account for the temporary but extraordinary impact of the pandemic.

**5. There is an unusually high level of uncertainty surrounding the current assessment.** In particular, it is possible that the compression of the current account in 2020 may have had a larger transitory component than implied by the cyclical adjustment applied in the analysis, which could thus be revised as more information becomes available.

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

EBA Real Exchange Rate Assessments			
	2018	2019 1/	2020
REER index regression	1.1	8.2	6.5
REER level regression	3.0	0.3	-2.8
Current account regression 2/	0.9	9.0 <sup>3/</sup>	1.4 <sup>3/</sup>
External sustainability 2/	2.0	1.9 <sup>3/</sup>	-6.4 <sup>3/</sup>
<b>Summary</b>			
Mean	1.8	4.9	-0.3
Median	1.6	5.1	-0.7

Note: figures show percent deviation from level implied by fundamentals and desired policy settings. +ve sign indicates actual REER is stronger than the predicated level.

1/ Based on estimates prepared in February 2020.

2/ The underlying current account balance was also lowered by 0.7 percent to account for the temporary impact of the COVID-19 pandemic, largely reflecting the sharp decline in oil imports (-0.9 percent), partly offset by the transitory impact of lower tourism inflows (0.2 percent) and an increase in imports of tradeables due to a change in expenditure patterns (0.1 percent).

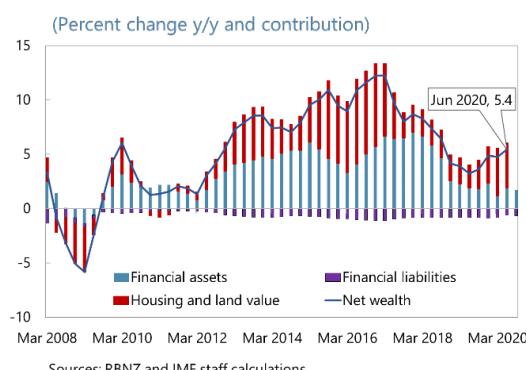
3/ CA/GDP to REER elasticity is estimated to be -0.23.

## Annex II. Impact of COVID-19 on Household and Nonfinancial Corporate Balance Sheets<sup>1</sup>

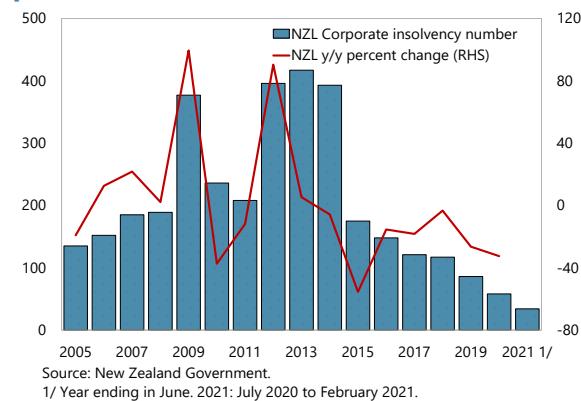
**1. New Zealand's households and nonfinancial corporates (NFCs) have so far weathered the impact of the COVID-19 shock relatively well.** Initial strength of the balance sheets, strong cash flow support, and loan deferrals have cushioned households and NFCs from the initial brunt of adverse impact.

**2. Household net worth continued to increase, boosted by rising housing prices, while increasing housing costs have a larger adverse impact on lower-income households.** Balance sheet strength and wealth effects from rising house prices are likely to have supported households' consumption, contributing to both macroeconomic and financial stability in the wake of the COVID-19 shock. However, the surge in house prices has increased leverage levels and vulnerabilities to interest rate shocks for many home buyers and households. The impact of high house prices on rents and the higher debt-to-income burden for first-home buyers are more likely to affect lower-income households.

### Household net worth continued to increase, boosted by rising housing and land value



### Business bankruptcies declined amidst the pandemic



**3. Before the pandemic, leverage levels of NFCs were relatively low and stable, albeit with moderate liquidity ratios.** Cash and deposits, at about 12 percent of financial assets, were relatively low, largely reflecting smaller firm sizes. Firm-level data suggests that about one quarter of firms had a liquidity ratio (cash cover of short-term borrowing) of less than one.

**4. The full effect of the COVID-19 shock on private balance sheets will only be known when temporary supports end.** Corporate bankruptcies are expected to rise with the phasing out of support measures and delayed administrative processes. Firms in contact-intensive service industries, especially tourism, tend to be more vulnerable than others to liquidity shortfalls and insolvency.

<sup>1</sup> Prepared by Yu Ching Wong (APD) based on an accompanying Selected Issues Paper.

**5. The phasing out of policy support would need to be well-timed, with appropriate refocusing on viable loans and solvent firms.** Macroprudential policy could be more actively used to preserve the health of household balance sheets by limiting debt to income exposure and securing serviceability buffers. While a blanket approach to providing emergency cashflow relief worked well at the depth of the pandemic, the next phase would warrant a more targeted approach to firms that are viable. A greater reliance on the bank lending channel, supplemented with targeted credit guarantee scheme, would help ensure that credits go to viable projects that generate adequate investment return.

### Annex III. Risk Assessment Matrix<sup>1</sup>

	Source of risks	Likelihood	Time horizon	Impact	Policies to reduce impact
	COVID-Related Risks				
	Unexpected shift in the COVID-19 pandemic Downside: Asynchronous progress globally, or prolonged pandemic with renewed domestic infections	<b>M</b>	Short to medium term	<b>H</b> Setbacks to the recovery from economic disruptions related to domestic lockdown measures or from a longer-than-expected border closure affecting tourism and education exports and migration flows.	In addition to using available policy space to deliver monetary and fiscal relief, calibrate reopening strategy in light of international developments; consider more aggressive steps to acquire and distribute vaccines to prevent more infections virus strains from taking root.
	Unexpected shift in the COVID-19 pandemic Upside: Faster global containment	<b>M</b>	Short to medium term	<b>M</b> Early resumption of tourism and migration will further boost growth.	Speed up unwinding of stimulus.
<b>Other Risks: Domestic</b>					
	Unsustainable growth in the housing market	<b>M</b>	Short to medium term	<b>M</b> A further amplification of the cycle could lead to a faster build-up of financial vulnerabilities that would have more severe effects on growth, residential investment, private consumption, and households' and banks' balance sheets in the event of a downturn.	Macroprudential policy tightening; policies to unlock housing supply and discourage speculative investment; address affordability issues. Accommodative macroeconomic and macroprudential policies in case of a pronounced downturn.
	Cyber-attacks on critical infrastructure, institutions, and financial systems	<b>M</b>	Short to medium term	<b>M</b> An escalation of attacks could destabilize banks and affect critical facilities, slowing the recovery and disrupting financial markets.	Preventative investment in strengthening critical infrastructure; fast liquidity provision in case of financial market disruptions.
	Higher frequency and severity of natural disasters	<b>M/L</b>	Medium term	<b>H</b> Stronger and more frequent economic disruptions. Larger fiscal costs related to disaster recovery and adaptation.	Combined monetary, fiscal policy easing; review medium-term fiscal framework to explicitly build in buffers for this risk going forward.
<b>Other Risks: External</b>					
	Oversupply and volatility in the oil market	<b>M</b>	Short to medium term	<b>L</b> New Zealand benefits from lower oil prices as an importer, but volatility could increase uncertainty and impact the business environment	Accelerate shift toward renewables to reduce long-term dependence on imported oil and hydrocarbons.
	Accelerating de-globalization, leading to an increase in tensions and less trade	<b>M</b>	Short to medium term	<b>M</b> Geopolitical tensions could impact New Zealand's export performance, impacting growth.	Combined monetary, fiscal policy easing.

<sup>1</sup> Based on the January 2021 Global Risk Assessment Matrix (G-RAM).

## Annex IV. Public Debt Sustainability Analysis

*The unprecedented fiscal policy response and sharp contraction of the economy in light of the COVID-19 pandemic have led to a large increase of the fiscal deficit and public debt. Under the baseline scenario, the public debt ratio is projected to increase by 24 percentage points from its pre-COVID level but to drift lower in the medium-term, maintaining a sustainable debt trajectory. Gross financing needs are expected to be larger than before the pandemic due to the fiscal deficit and scheduled government bond redemptions but are projected to remain at a manageable level. A negative growth shock, a combined macrofiscal shock, and a natural disaster shock represent the largest risks to the debt outlook. However, even in these cases, the debt trajectory and gross financing needs are expected to remain sustainable.*

### A. Baseline and Alternative Scenarios

1. **Macroeconomic assumptions.** Real GDP growth (expenditure side) is projected to rebound by 3.0 percent in 2021, after a decline of 1.2 percent in 2020. Growth is expected to converge to its potential level over the medium run, and inflation—measured by the GDP deflator—will reach around 2.0 percent. Average interest rates of public debt are expected to decline to 2.8 percent in 2023, from 3.7 percent in 2021.
2. **Baseline.** Under the baseline scenario, public gross debt is projected to rise, reflecting scheduled discretionary COVID-related fiscal measures, partially offset by the economic recovery. Public debt is expected to remain below the indicative threshold for high scrutiny (60 percent of GDP) and the benchmark DSA threshold (85 percent of GDP). In the medium term, public gross debt is projected to decline to 51 percent of GDP in 2026, from a peak at 56 percent of GDP in 2023, reflecting fiscal consolidation and economic growth at around potential.
3. **Alternative scenarios.** The constant primary balance scenario, under which the large-scale, temporary COVID-19 support implemented in 2021 is assumed not to be withdrawn, would put debt on a rising trajectory, though remaining below the benchmark threshold. Gross financing needs would also increase but exceed the threshold only temporarily in 2025. Public debt and gross financing needs will remain below the baseline under the historical scenario, which does not consider scarring of the pandemic and assumes higher GDP growth.
4. **Realism.** The maximum 3-year adjustment of the cyclically adjusted primary balance (CAPB) lies in the top quartile of historical and cross-country experience. However, this adjustment is mainly driven by the withdrawal of the sizable and temporary fiscal measures adopted in response to the pandemic.

### B. Shocks and Stress Tests Through the Medium Term

5. **Growth shock.** Under this scenario, real output growth rates are assumed to be lower than in the baseline by one (10-year historical) standard deviation for two consecutive years, in 2022–23, i.e., by 1.7 percentage points. Under this adverse scenario, inflation will be lower by 0.4 percent and the primary balance will weaken (by 1.2 percent of GDP per year, on average) in the shock years, and

the interest rate will increase modestly in response to deterioration in the primary balance. Debt will peak at 60 percent of GDP in 2024 and gross financing needs will increase temporarily to 16 percent of GDP in 2023 under this case but they will remain below the benchmark thresholds.

**6. Primary balance shock.** This scenario examines the effect of lower revenues, leading to a cumulative 2.9 percent deterioration in the primary balance in percent of GDP. Interest rate will increase modestly in response to larger primary balance deficit. The shock would result in a modest deterioration of debt dynamics.

**7. Interest rate shock.** This scenario assumes an increase in interest rate of 480 basis points throughout the forecast horizon, mimicking the historical maximum interest rate experienced since 2010. The effect on public debt and gross financing needs would also be relatively modest.

**8. Additional stress test: combined macro-fiscal shock.** This test combines shocks to growth, the interest rate, and the primary balance; while avoiding double-counting the effects of individual shocks. The impact on debt dynamics is slightly worse than that of a growth shock, but the debt level and gross financing needs remain sustainable.

**9. Additional stress test: disaster shock.** This scenario assumes a cumulative 12 percent of GDP additional fiscal cost over 2022–23 due to a natural disaster such as a large-scale earthquake. Under this scenario, expenditure will peak at 45 percent of GDP in 2022, near the level recorded in FY2010/11, when the 2010-11 Canterbury Earthquake sequence hit New Zealand. GDP growth will be 5 percentage points below the baseline in 2022, before recovering in the medium-term. Debt will peak at 70 percent of GDP and gross financing needs will increase temporarily to near 20 percent of GDP in 2023 under this scenario, but they will remain below the benchmark thresholds.

**10. Additional stress test: resurgence of COVID-19.** Under this scenario, due to a resurgence of COVID-19, growth is assumed to be 3 percentage points below the baseline in 2021, before recovering in the medium term. The scenario assumes fiscal costs amounting to 8 percent of GDP related to the lockdown and other health responses. The debt level will peak at 63 percent of GDP under this scenario but will remain sustainable.

## C. Heatmap and Stochastic Simulations

**11. Heatmap.** Risks from the debt level are deemed low, as the level of debt will remain well below the benchmark of 85 percent of GDP for advanced economies under the baseline and stress scenarios. Gross financing needs also will not exceed the benchmark of 20 percent of GDP.

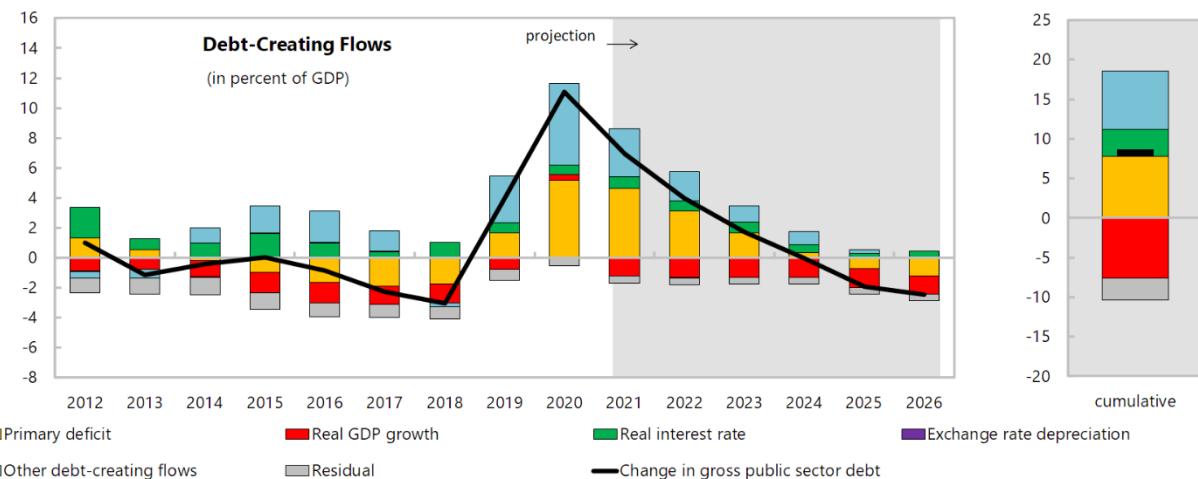
**12. Stochastic simulations.** The fan charts illustrate the possible evolution of the debt ratio over the medium term under symmetric and asymmetric distributions of risk based on historical outturns. Debt levels will remain below the benchmark threshold under both distributions.

**Figure 1. New Zealand: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario**  
(In percent of GDP unless otherwise indicated)

	Debt, Economic and Market Indicators <sup>1/</sup>										As of March 24, 2021		
	Actual			Projections							Sovereign Spreads	Bond Spread (bp) <sup>3/</sup>	30
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026				
Nominal gross public debt	32.9	32.1	43.1	50.0	54.0	55.7	55.7	53.8	51.3				
Public gross financing needs	1.3	2.4	6.1	9.5	7.5	13.2	8.9	12.9	6.4	5Y CDS (bp)			16
Net public debt	6.5	7.0	14.9	22.4	26.4	28.1	27.4	25.2	22.8				
Real GDP growth (in percent)	3.2	3.0	-1.2	3.0	2.8	2.5	2.4	2.4	2.3	Ratings			
Inflation (GDP deflator, in percent)	2.0	2.2	2.2	1.8	1.5	1.4	1.9	2.2	2.3	Moody's	Aaa	Aaa	
Nominal GDP growth (in percent)	5.2	5.3	1.0	4.8	4.3	3.9	4.3	4.6	4.7	S&Ps	AA+	AA+	
Effective interest rate (in percent) <sup>4/</sup>	5.6	4.9	4.1	3.7	3.0	2.8	2.9	2.9	3.2	Fitch	AA	AA+	

	Contribution to Changes in Public Debt												
	Actual			Projections									
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance <sup>9/</sup>		
Change in gross public sector debt	0.4	4.0	11.1	6.9	4.0	1.7	0.0	-1.9	-2.5	8.2			
Identified debt-creating flows	1.4	4.7	11.6	7.4	4.4	2.2	0.4	-1.5	-2.0	10.9			
Primary deficit	0.5	1.6	5.2	4.6	3.1	1.7	0.3	-0.7	-1.2	7.8			
Primary (noninterest) revenue and grants	36.4	35.9	36.2	35.6	35.2	35.6	35.8	36.2	36.4	214.8			
Primary (noninterest) expenditure	36.9	37.5	41.4	40.2	38.4	37.2	36.2	35.4	35.2	222.6			
Automatic debt dynamics <sup>5/</sup>	0.1	-0.1	1.0	-0.4	-0.6	-0.6	-0.8	-0.9	-0.8	-4.2			
Interest rate/growth differential <sup>6/</sup>	0.1	-0.1	1.0	-0.4	-0.6	-0.6	-0.8	-0.9	-0.8	-4.2			
Of which: real interest rate	1.1	0.7	0.6	0.8	0.7	0.7	0.5	0.3	0.4	3.4			
Of which: real GDP growth	-1.0	-0.8	0.4	-1.2	-1.3	-1.3	-1.3	-1.3	-1.2	-7.6			
Exchange rate depreciation <sup>7/</sup>	0.0	0.0	0.0	...	...	...	...	...	...	...			
Other identified debt-creating flows	0.8	3.1	5.4	3.2	1.9	1.1	0.9	0.2	0.0	7.3			
Residual, including asset changes <sup>8/</sup>	-1.0	-0.7	-0.5	-0.5	-0.4	-0.4	-0.4	-0.5	-0.5	-2.7			



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

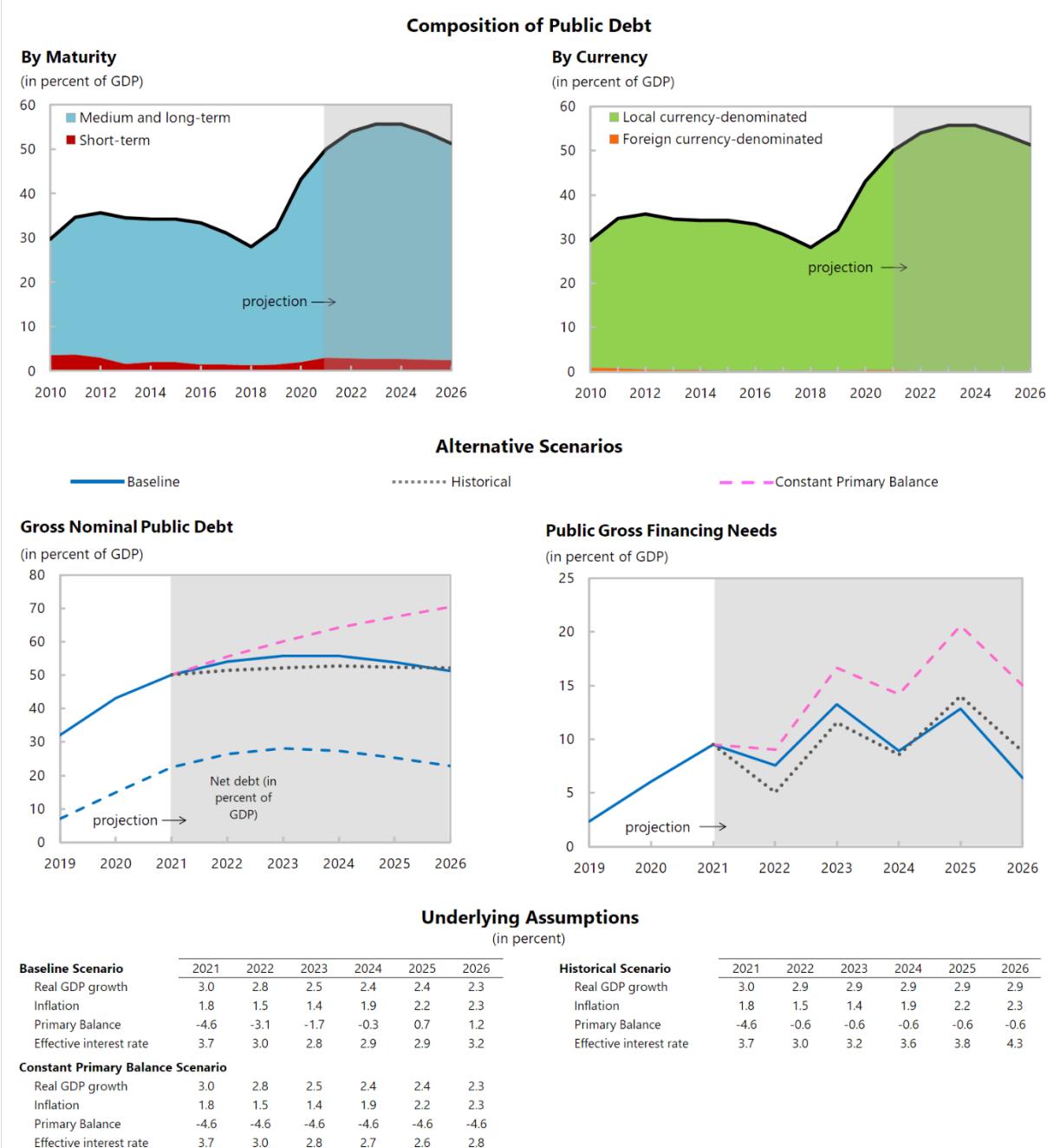
3/ Long-term bond spread over U.S. bonds (bp).

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

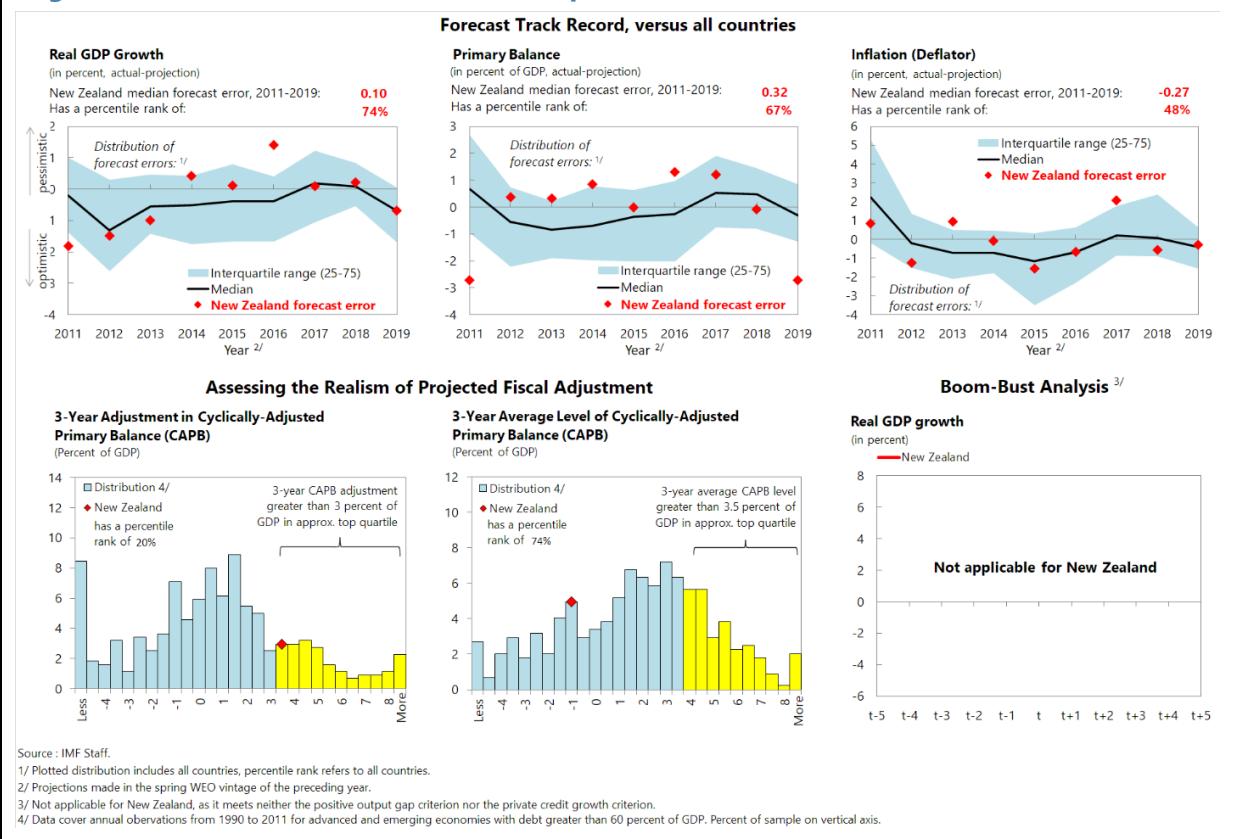
5/ Derived as  $[r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+gt)$  times previous period debt ratio, with  $r$  = effective nominal interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $a$  = share of foreign-currency denominated debt; and  $e$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .7/ The exchange rate contribution is derived from the numerator in footnote 5 as  $ae(1+r)$ .

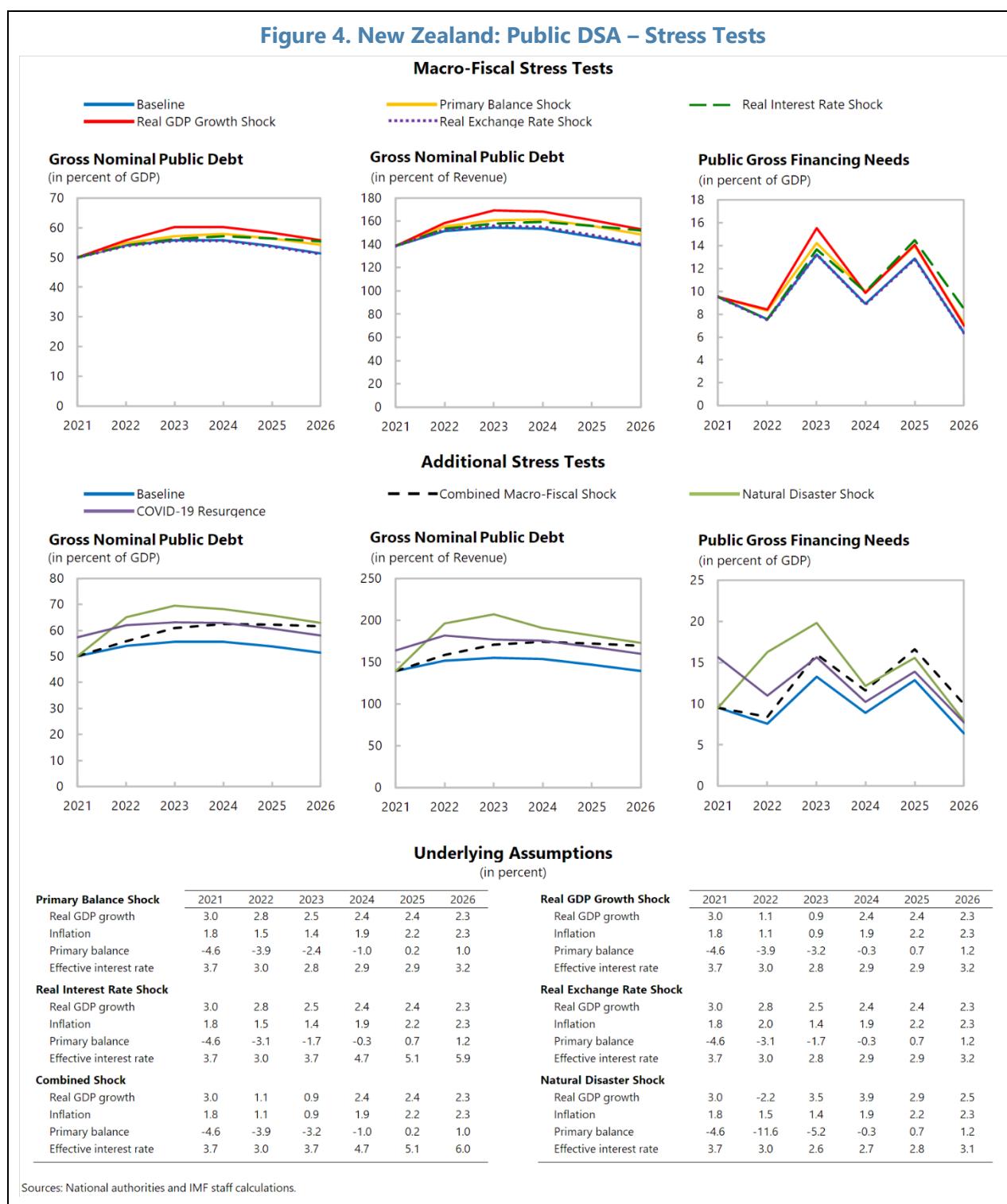
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

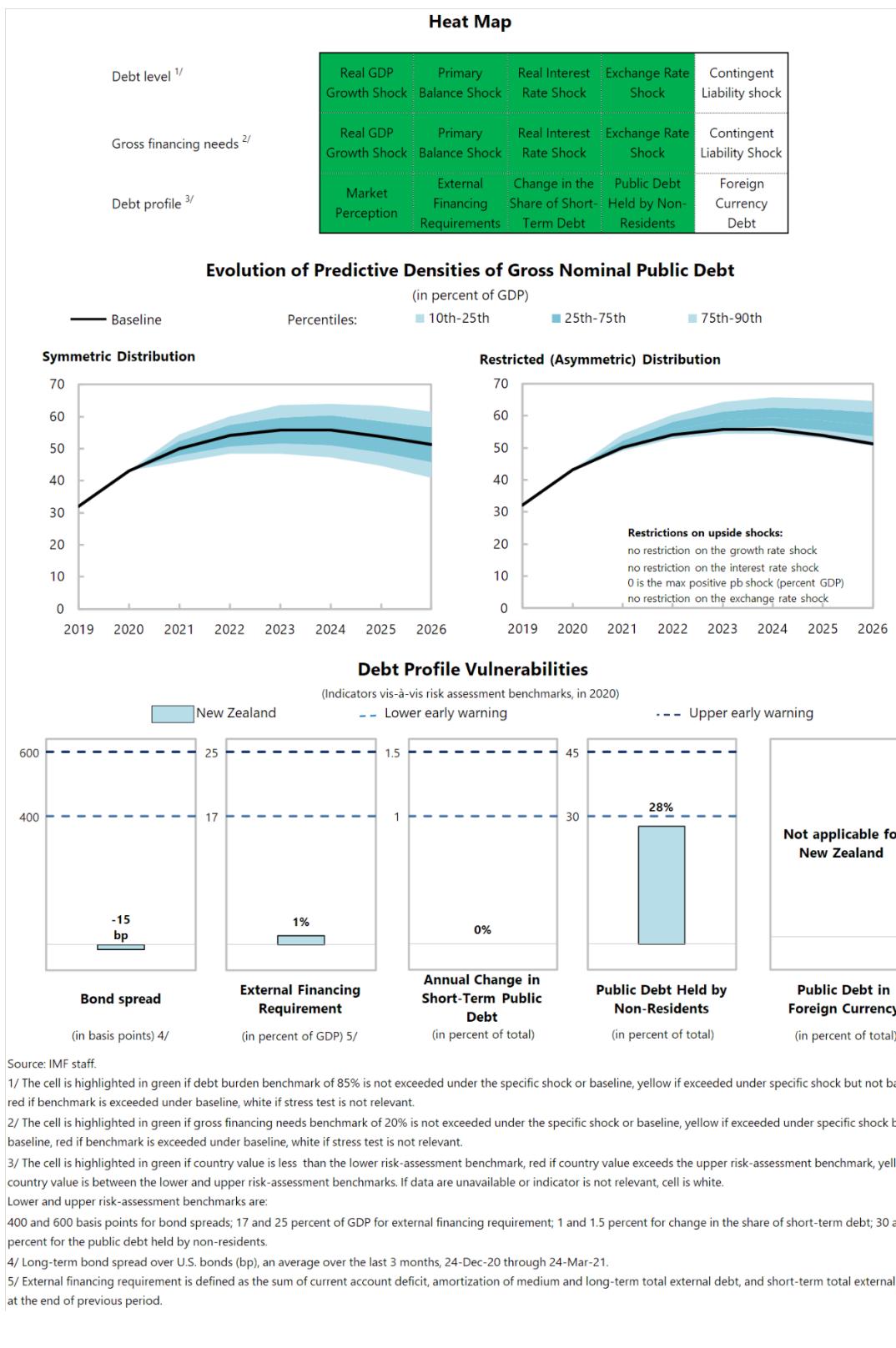
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

**Figure 2. New Zealand: Public DSA – Composition of Public Debt and Alternative Scenarios**

Sources: National authorities and IMF staff calculations.

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

**Figure 4. New Zealand: Public DSA – Stress Tests**

**Figure 5. New Zealand: Public DSA Risk Assessment**

## Annex V. Reform of the Reserve Bank of New Zealand Act<sup>1</sup>

**1. The Phase 2 Review of the Reserve Bank of New Zealand Act 1989 (Reserve Bank Act) is underway.** The RBNZ Bill, introduced to Parliament in July 2020, is expected to pass into law in late 2021. The bill is currently being considered by a Parliamentary select committee, which may recommend amendments. The bill sets out the RBNZ's prospective institutional and governance arrangements. No changes are made to the objectives of monetary policy introduced under Phase 1 of the Review completed in 2018. The prudential framework for deposit takers will be covered in an upcoming Deposit Takers Bill to be introduced later this year.

**2. The reform aims to strengthen governance and accountability of the monetary and financial stability framework.** The RBNZ Bill will add an overarching financial stability objective. A Financial Policy Remit, issued by the Minister of Finance, sets out matters the Board must have regard to when making decisions in relation to financial stability and prudential standards (replaces the current direction under section 68B of the Reserve Bank Act). It intends to more effectively balance operational autonomy of the Reserve Bank with appropriate accountability and democratic oversight. Decision-making will move from a single decision-maker model centered on the Governor to a new Board, comprised of all non-executives, which will be responsible for all oversight, policy-making, and regulatory decisions, except for monetary policy, which remains reserved for the Monetary Policy Committee (MPC) with executives in majority. Changes to the funding model would allow for appropriate recovery of costs on financial regulatory functions through industry levies and fees. The RBNZ's accountability and reporting frameworks will be changed to align more closely with those of Independent Crown Entities. The Council of Financial Regulators is provided with a statutory basis to facilitate cooperation and coordination in financial sector regulation between council members. The Bill also provides increased accountability and transparency of the Reserve Bank's financial risk management and use of foreign reserves.

**3. The reform provides an opportunity to further strengthen the RBNZ's governance framework and autonomy.** A revision of the Board structure in the bill is advisable for better coordination between monetary policy and financial policies, and to help the management of trade-offs. A transparent Financial Policy Remit is likely to have net benefits and could help strengthen the macroprudential framework. To enhance the proposed safeguards and minimize risks to supervisory autonomy adequately, the Bill could clarify that matters included in a remit are for the RBNZ's own understanding of its financial stability objective and provide the RBNZ an explicit opportunity to disclose to the public how it intends to react to the remit. For instance, the U.K. experience with the financial policy committee remit has supported the effectiveness of macroprudential policy. Despite some improvements, the RBNZ Bill also carries over a range of provisions that can impact on the functional, institutional, and personal autonomy of the RBNZ. The current reform provides an opportunity to review these in view of their links to objectives, governance, and remit powers in order to further enhance the RBNZ's operational autonomy.

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<sup>1</sup> Prepared with inputs from MCM and LEG.

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

Recommendation	Time Frame	Update and Implementation
<b>Financial Stability and Financial Sector Resilience</b>		
Increase RBNZ resources for the supervision and regulation of banks, insurance companies, and FMIs.	ST	<b>Completed.</b> A new funding agreement signed in June 2020 provides the RBNZ with an average of NZ\$115 million a year (up about \$35 million) for its operations over five years from July 2020, to support a more intensive supervisory model.
Strengthen cooperation and collaboration arrangements with Australian authorities.	ST	<b>In process.</b> With ongoing interaction, completed a hypothetical bank crisis simulation exercise in September 2017, follow-up exercise on communications coordination is being planned. The RBNZ Bill contains a new cooperation function for the RBNZ that includes 'overseas central banks and relevant international institutions'. The trans-Tasman cooperation provision in the current Act (s.68A) will be carried across to the deposit takers sectoral legislation under the forthcoming Deposit Takers Act (DTA).
Clarify responsibilities of the Treasury and RBNZ on financial sector issues to reinforce the role of RBNZ as prudential regulator and supervisor.	ST	<b>In process.</b> Governance and prudential regulation options are examined in Phase 2 Review of the RBNZ Act. A new financial stability objective for the RBNZ is introduced in the RBNZ Bill. A Financial Policy Remit to be issued by the Minister of Finance will outline matters that the RBNZ will have to have regard to in pursuing its financial stability objectives, prudential standards and its implementation. The RBNZ Bill will designate Treasury as the formal monitor of the RBNZ on behalf of the Minister of Finance (replacing the role played by the current board) The DTA will further clarify the role of the Minister in the prudential framework (e.g., role in the crisis management framework).
Issue enforceable standards on key risks, governance, risk management, and controls to make RBNZ's supervisory expectations more transparent and support supervisory preventive action.	ST	<b>In process.</b> As part of the Phase 2 Review of the RBNZ Act, the Cabinet has agreed that prudential requirements for deposit takers will be set through 'standards' as a secondary legislative instrument. The DTA will clearly set out the areas where the RBNZ can set standards. The scope of standard-setting will broadly align with those areas expected by the Basel Core Principles (BCPs). Within the scope permitted by legislation, the RBNZ will still choose in what areas to set standards, supported by guidance where appropriate.
Review and extend the enforcement regime to promote preventive action and enhance sanctions powers, including by eliminating ministerial consent for directions, and making compliance with RBNZ policy documents evidence of prudent practice.	MT	<b>In process.</b> Phase 2 Review of the RBNZ Act examines options on supervision and enforcement. The Cabinet has made an in-principle decision to widen the current enforcement toolkit and to remove the requirement for Ministerial consent to issue directions, thereby removing the current high threshold for using this tool to take corrective action.
Initiate on-site programs to test the foundation of the three-pillar	ST	<b>In process.</b> A team has been formed to undertake cross-cutting review. As part of the Phase 2 Review, the Cabinet has

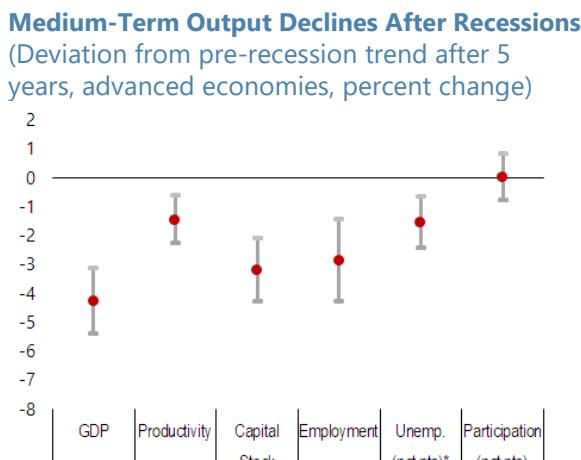
Recommendation	Time Frame	Update and Implementation
approach and directors' attestations and increase supervisory engagement with institutions in order to require appropriate action.		made an in-principle decision that the RBNZ be empowered to undertake on-site inspections of deposit takers and insurers. How this power is operationalized will be a matter for the RBNZ (e.g., frequency and scope of inspections across large and small deposit takers).
Refine Financial Markets Authority (FMA) supervision by <ul style="list-style-type: none"> <li>a) direct monitoring of aspects of asset management relevant to financial stability;</li> <li>b) ensuring quality of Financial Markets Supervisors; and</li> <li>c) enhancing insurance intermediary and conduct regulation and supervision.</li> </ul>	I	<p><b>In process.</b> The FMA has completed the first stage of redemption/liquidity stress testing of fund managers in 2020 and information is currently being analysed. The second stage will take place later in 2021, subject to the need to manage regulatory burden to assist the economic recovery from COVID-19.</p> <p><b>In process.</b> The FMA continues to have extensive ongoing engagement with the five licensed supervisors. The FMA conducted a thematic review of supervisory processes in 2018.</p> <p><b>In process.</b> A new financial advice conduct regime went live on March 15, 2021 (delayed from June 2020 due to COVID-19). Financial advisers currently operate under a transitional license issued by the FMA. A full license issued by the FMA will be required from March 2023. This regime expands conduct regulation to a large, previously unregulated population. A bill to expand conduct regulation for retail banks, insurers and non-bank deposit takers is currently before the Parliament. Implementation and formal FMA oversight is currently expected to begin around 2023. The FMA and RBNZ continued to engage with banks and life insurers following the conduct and culture review into banks and life insurers which took place in 2018. Changes to insurance contract law were consulted in 2019 and the Government has committed to making changes to allow consumers to more easily understand insurance policies. The next step in the process is the release of an exposure draft of legislation.</p>
Expand the FMA's regulatory perimeter to include licensing and supervision of custodians and appropriate oversight of wholesale asset managers.	ST	<b>In process.</b> The FMA has received its outsourced thematic on custodial arrangements and is progressing work to consider whether there is a case for recommending the establishment of a regulatory regime for custodians.
Adopt and implement proposed Financial Market Infrastructures (FMI) legislation on regulation, oversight, and enforcement powers.	I	<b>In process.</b> In April 2017, the Government agreed to adopt an enhanced legislative framework for the regulation of FMIs. The FMI Bill is currently before the Parliament awaiting the Committee of the Whole House stage.
Adopt the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMI) through detailed requirements in secondary legislation; change the frequency of FMI self-assessments in the proposed regime from three to two years; and enhance compliance of	ST	<b>In process.</b> The FMI Bill will provide the ability for the PFMI to be implemented via standards prescribed in secondary legislation. The frequency of FMI self-assessments is intended to be changed from three to two years once the FMI Bill is in force.

Recommendation	Time Frame	Update and Implementation
the designated FMs with PFMI requirements.		
Ensure that designated nonfinancial businesses and professions are subject to AML/CFT requirements, particularly company service providers, lawyers, and accountants.	MT	<b>Completed.</b> The <i>AML/CFT Amendment Act 2017</i> , which extends the coverage of the AML/CFT laws, has come fully into effect. The legislation now covers lawyers, conveyancers and businesses that provide trust and company services (from July 1, 2018); accountants (from October 1, 2018); and real estate agents (from January 1, 2019).
Expand data collection and modeling efforts to develop structural models for credit risk in commercial real estate (CRE) and corporate portfolios.	MT	<b>In process.</b> Current focus is on embedding stress testing within the prudential framework. Consideration of enhancements will follow.
<b>Macroprudential Framework</b>		
Strengthen arrangements for macroprudential policy by increasing communication efforts; by increasing the transparency of the process to adjust the framework; and by maintaining an accountability framework that does not jeopardize the integrity and independence of the macroprudential decision-making process.	C	<p><b>In process.</b> The RBNZ has published a review of experience with its loan-to-value ratio policy and provided more clarity on the purpose and strategy for using macroprudential tools. The Financial Policy Remit (see above) will enable the Minister to articulate government's policy priorities that are relevant to how the RBNZ goes about addressing systemic risk (i.e., macro-prudential policy).</p> <p>The Phase 2 Review of the RBNZ Act proposed that macroprudential powers should be subject to the same general framework as other standard-setting powers, and empower lending-standard tools in relation to property lending (e.g. LVRs and DTIs).</p> <p>The current Macro-Prudential Policy MoU will be superseded in the new prudential framework by the role played by the Financial Policy Remit, and the process around the setting of standards (including lending standards).</p>
Introduce DTI measures in the macroprudential toolkit.	I	<p><b>In process.</b> The RBNZ conducted a public consultation in June-August 2017 on the possible addition of serviceability restrictions to the macroprudential toolkit. The role of DTI measures is included in Phase 2 Review of the RBNZ Act (see above). The Minister of Finance has recently requested further advice from the RBNZ on DTI restrictions, including the potential impact on first-home buyers. The RBNZ will report to the Minister in May on DTI restrictions, along with a range of other policy measures that could be used to address housing-related macrofinancial risks and/or support the Government's objective of more sustainable house prices.</p>
Implement DTI measures if the changes to the LVR do not reduce the risks in the housing sector.	I	<p><b>In process.</b> The Finance Minister has requested the RBNZ for more information and analysis on DTI ratios against the backdrop of the current surge in house prices. If DTI measures are introduced in the macroprudential toolkit, the RBNZ will review whether they are needed to address housing-related macrofinancial risks and/or support the Government's objective of more sustainable house prices.</p>

Recommendation	Time Frame	Update and Implementation
Increase capital buffer requirements to reflect the concentration of the financial sector in four banks.	I	<b>Completed.</b> The 2019 Capital Review, required banks to raise their minimum capitalization from 10.5 percent of risk-weighted assets to 18 percent for the four large banks and 16 percent for the remaining smaller banks in seven years, starting from July 2020. In the context of the COVID-19 response, the target date has been extended to July 2022.
<b>Crisis Readiness, Management, and Resolution</b>		
Strengthen domestic crisis management arrangements by reaching ex ante agreement on roles, responsibilities, and processes; prepositioning, mobilization, logistics, and communications plans; and testing through simulation exercises.	MT	<b>In process.</b> Phase 2 Review of the RBNZ Act examines options to enhance the crisis management regime, most of which have been developed with reference to the 2017 FSAP recommendations. The Phase 2 Review has designated the RBNZ as the Resolution Authority, with a broader range of powers. A Deposit Insurance Scheme (DIS) will be introduced. The DTA will also clarify the role of the Minister in the crisis management framework. An amendment to the Public Finance Act 1989 will be introduced in order to address a gap in the current arrangements, enabling the Government to act quickly and use public funds in a financial crisis.
Reconsider the merits of deposit insurance, or in the absence of policy support, introduce a limited depositor preference to provide legal certainty for the <i>de minimis</i> exemption in OBR.	MT	<b>Partially done.</b> Key decisions adopted as a part of the Phase 2 Review of the RBNZ Act, include to introduce a deposit insurance with a \$50,000 limit per person per institution, and to be funded by a levy on deposit takers, with a Government backstop.
Revise the RBNZ Act to provide greater clarity and certainty in resolution, by inserting objectives in resolution including protection of depositors and the public interest and requiring accountability reporting against these objectives; by clarifying that the RBNZ is the sole resolution authority and inserting an express requirement for ministerial consent for resolutions with fiscal or systemic implications only.	MT	<b>In process.</b> Phase 2 Review of the RBNZ Act examines options to enhance the crisis management regime, most of which have been developed with reference to the 2017 FSAP recommendations. In-principle decision adopted include the RBNZ will be resolution authority, with clear objectives and functions; to widen resolution powers (e.g. statutory bail-in powers); and “no creditor worse off” provisions.
C = continuous; I (immediate) = within one year; ST (short-term) = 1–3 years; MT (medium-term) = 3–5 years.		
Sources: IMF (2017), <i>New Zealand, Financial Sector Assessment Program—Financial System Stability Assessment</i> ; and New Zealand authorities.		

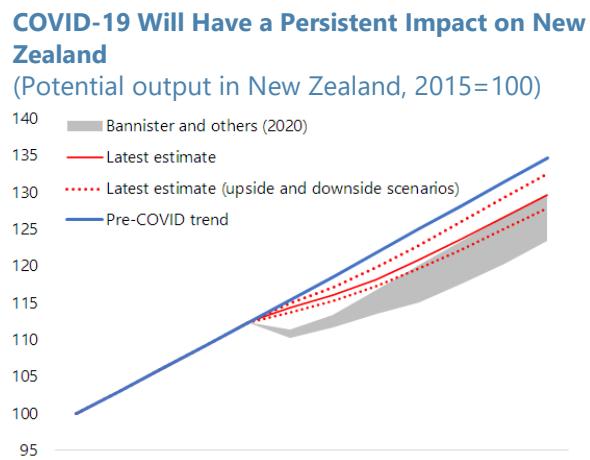
## Annex VII. Impact of the Pandemic on New Zealand's Medium-Term Potential Output<sup>1</sup>

- 1. The pandemic is expected to have a sizable impact on medium-term growth.** Although GDP rebounded strongly in the second half of 2020 after a sharp decline in 2020Q2, supported by strong pent-up demand, the pandemic and continued border restrictions are expected to have a medium-term impact on trend growth.
- 2. Past recessions in advanced economies point to long-lasting effects.** An event study of previous recessions suggests that recessions have persistent effects on medium-term output, driven by a productivity slowdown and reduced capital stock and labor input. On average, medium-term output remains 4½ percent below pre-recession after the crisis, and effects are stronger in large recessions.
- 3. In this crisis, lower labor input, weaker capital accumulation, and a productivity slowdown are expected to adversely affect potential output in New Zealand.** Net migration, a key driver of growth before the pandemic, is expected to remain low while travel restrictions remain in place. Shortage of skilled labor due to reduced migration is likely to adversely affect productivity, despite some offset from labor shifting to more productive sectors. Heightened uncertainty, reduced labor input, and productivity slowdown are expected to adversely affect capital accumulation. Although the impact on medium-term potential output may be somewhat milder than previously estimated, the pandemic is expected to have scarring effects, with a 3¾ percent loss of potential output in the medium-term.<sup>2</sup>
- 4. Efforts are needed to limit scarring and lift potential output.** To address the medium-term fallout from the pandemic, the authorities should address pre-existing structural issues, including weak productivity performance, the infrastructure gap,<sup>3</sup> and product market regulations.



Source: Bannister and others (2020).

Note: Bands show 90 percentile confidence interval.



Source: IMF staff calculations and Bannister and others (2020).

<sup>1</sup> Prepared by Yosuke Kido (APD) based on an accompanying Selected Issues Paper.

<sup>2</sup> Uncertainty around this baseline is high, with both upside and downside risks. For previous estimates, see G. Bannister, H. Finger, Y. Kido, S. Kothari and E. Loukoianova, 2020, "Addressing the Pandemic's Medium-term Fallout in Australia and New Zealand," IMF Working Paper, WP/20/272.

<sup>3</sup> The infrastructure spending gap is estimated to be between 8 and 23 percent of GDP.

## Annex VIII. The Uneven Impact of the Pandemic on New Zealand's Labor Market<sup>1</sup>

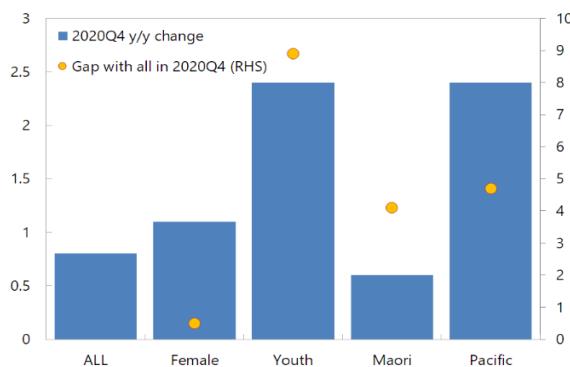
**1. The labor market has deteriorated somewhat due to the pandemic.** Despite the large swing in economic activity, the impact on broader labor market aggregates has been relatively small so far due to large-scale wage subsidies. The unemployment rate has increased modestly to 4.9 percent in 2020Q4 from 4.1 percent in 2019Q4, while the underutilization rate increased more sharply from 10.1 percent in 2019Q4 to 11.9 percent in 2020Q4.

**2. The impact of the pandemic has been uneven, with a more severe impact on young workers, female workers, some ethnic groups, and low-skilled workers.** Youth employment has seen the largest adjustment so far, with a 2.4 percentage point y/y increase in the youth unemployment rate. Job losses have been concentrated in service sectors, and this has resulted in a sharp increase in female unemployment and underutilization. Some ethnic groups have been more affected.

**3. Uneven labor market adjustment would lead to scarring and aggravate already relatively high inequality.** International experience suggests that youth unemployment could lead to scarring in the labor market, with a persistent increase in unemployment, which may also undermine long-term human capital accumulation. A more severe impact on some ethnic groups and low-skilled workers would aggravate inequality, which was relatively high even before the pandemic.

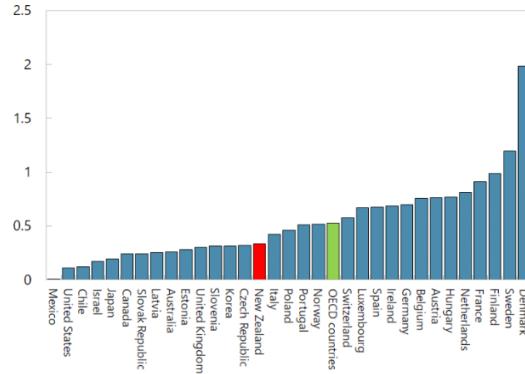
**4. Active labor market policies should be deployed to address emerging labor market issues.** The authorities should focus on policies to support displaced workers and facilitate sectoral labor reallocation, including targeted hiring subsidies, training, and job search assistance. Government spending on active labor market policies has been relatively small compared to other advanced economies, indicating scope for scaling up spending to address emerging labor market issues.<sup>2</sup> The government has already appropriately started expanding support, including Flexi-wage subsidies, providing free access to training courses, and reform of the training systems.

**Some Worker Groups Have Been Affected More Severely**  
(Unemployment rate, percentage points)



Source: Stats NZ.

**There Is Scope for Scaling Up ALMP Spending**  
(Spending on active labor market policies, percent of GDP, average of 2010-18)



Source: OECD.

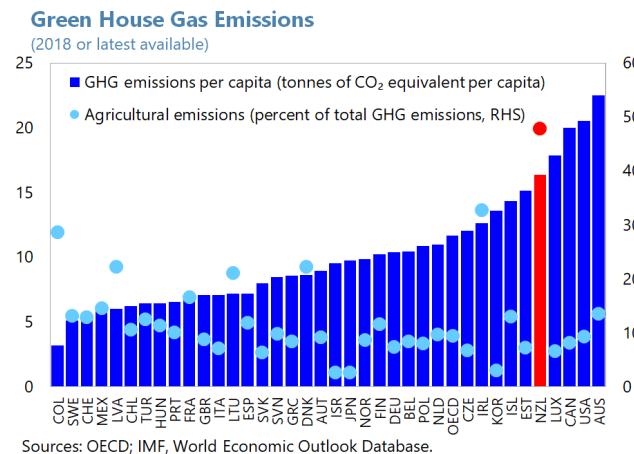
<sup>1</sup> Prepared by Yosuke Kido and Siddharth Kothari (both APD) based on an accompanying Selected Issues Paper.

<sup>2</sup> It should be noted that low spending is driven partly by relatively low unemployment rate in recent years.

## Annex IX. Transformation to a Green and Digital Economy

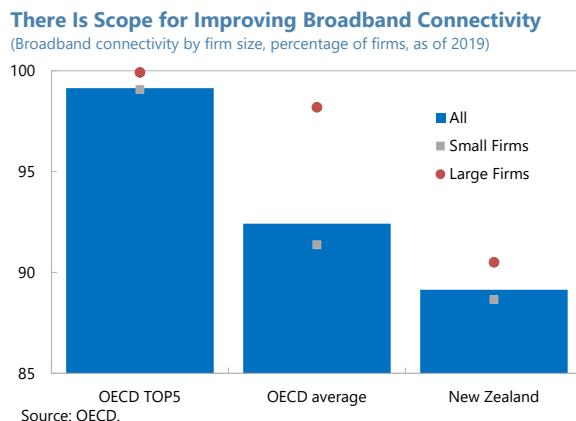
*The COVID recovery provides an immediate opportunity for government policies to build a low-emissions and more digitalized economy that supports sustainable and durable economic growth.*

- 1. Green recovery.** New Zealand ranks high among advanced economies on greenhouse gas (GHG) emissions, with the highest share (50 percent) of emissions from agriculture (largely from short-lived methane). New Zealand has a strong institutional framework to address climate change, including through the Climate Change Response Act 2019 and the Emission Trading Scheme. Decisive policy actions would help to close the large gap that exists between projected emissions and a trajectory consistent with meeting New Zealand's 2050 net zero carbon target and international targets under the Paris agreement.



- The broad green strategy requires a transition from fossil fuels to electricity, substantial afforestation, and changes to the structure and methods of pastoral farming.<sup>1</sup> The release of the Climate Change Commission draft advice in February 2021 and the preparation of New Zealand's first Emissions Budgets (mid-2021), the Emissions Reduction Plan (late 2021), and the National Adaption Plan (late 2022) by the Climate Change Commission are intended to ensure consistency with commitments and set clear signals for the transition to a low-emission economy. Further, the post-COVID-19 recovery offers opportunities for a re-orientation of both public and private investment towards low-emissions infrastructure and technology that can be undertaken in the context of the government's efforts to step up public investment.<sup>2</sup>

- 3. Digitalization.** The pandemic has accelerated internet-based and bandwidth-intensive activities, which require high-quality connectivity and stronger cyber security. New



<sup>1</sup> New Zealand Productivity Commission, 2018, *Low-emission Economy*, Final Report, August 2018. The report also recommended putting biogenic methane within either a dual-cap NZ ETS or an alternative methane quota system, to incentivize reductions of biogenic methane in recognition of its nature as a short-lived GHG.

<sup>2</sup> The public sector is required to achieve carbon neutrality by 2025. A NZ\$200 million State Sector Decarbonization Fund will finance the replacement of public sector coal boilers and support the government to switch to electric or hybrid vehicles in its fleet. The Auckland Transport Alignment Project 2021-31 package will reduce transport emissions in Auckland.

Zealand has expanded digital infrastructure under the Ultra-Fast Broadband Programme and the Rural Broadband Initiative, with 83 percent of the population to date covered by fibre-to-the-home networks. Despite recent progress, a gap to the international frontier remains. To facilitate the digital transition, thereby improving global competitiveness, policies should focus on fostering digital skills, enhancing the digital infrastructure and its safety, and promoting the broader uptake of technology across the economy.<sup>3</sup> The authorities should address growing cyber threats amid continued digitalization, highlighted by recent cyberattacks affecting the RBNZ and New Zealand's stock exchange.

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<sup>3</sup> In this respect, the recent introduction of the Small Business Digital Boost is welcome, promoting the digital transformation of SMEs.



# NEW ZEALAND

April 20, 2021

## STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department  
(In consultation with other departments)

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# FUND RELATIONS

(As of March 31, 2021)

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

**General Resources Account:**

	SDR Million	Percent Quota
Quota	1,252.10	100.00
Fund Holdings of Currency	935.93	74.75
Reserve position in Fund	317.26	25.34
Lending to the Fund		
New Arrangements to Borrow	10.71	

**SDR Department:**

	SDR Million	Percent Allocation
Net cumulative allocation	853.76	100.00
Holdings	867.63	101.62

**Outstanding Purchases and Loans:** None

**Financial Arrangements:** None

**Projected Payments to Fund (SDR Million; based on existing use of resources and present holdings of SDRs) <sup>1/</sup>**

	Forthcoming				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.01	0.01	0.01	0.01	0.01
<b>Total</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>

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

**Exchange Arrangement:**

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

**Article IV Consultation:**

New Zealand is on the 12-month consultation cycle. The 2019 Article IV consultation was concluded by the Executive Board on September 20, 2019.

**FSAP Participation and ROSCs:**

New Zealand has participated in two FSAPs to date.

- The FSSA from the 2003 FSAP mission and the Detailed Assessments of Observance of IOSCO Objectives and Principles of Securities Regulation and FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism were published under Country Reports No. 04/126, No. 04/417, and No. 05/284, respectively.
- New Zealand participated again in 2016, with one FSAP mission in August 2016 and another FSAP mission in November 2017. The FSSA was discussed by the Executive Board at the time of the discussion of the Staff Report for the 2017 Article IV Consultation with New Zealand.

**Technical Assistance:**

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

# STATISTICAL ISSUES

(As of April 20, 2021)

<b>I. Assessment of Data Adequacy for Surveillance</b>
<p><b>General.</b> Data provision is adequate for surveillance. The authorities are continuing to enhance data quality and expand the range of data available, and are making progress towards subscribing to the IMF's Special Data Dissemination Standard (SDDS).</p>
<p><b>Real Sector.</b> Annual estimates of GDP are compiled for production, expenditure and income, in nominal and chained volume terms. Estimates are fully reconciled via supply and use tables and make use of annual enterprise and household surveys to update benchmarks. The authorities compile quarterly estimates of GDP for both production and expenditure, based on appropriate indicators. Quarterly production GDP is compiled only on a chained volume basis while quarterly expenditure GDP is compiled on both nominal and chained volume terms. National accounts data are released around 11 weeks after the close of the reference quarter. New Zealand only produces a quarterly rather than monthly consumer price index (CPI), which has national coverage and a contemporary weight reference period (2018/2019). CPI data is released three weeks after the close of the reference quarter. Data collection methods are appropriate, and include web-scraping and the use of scanner data.</p>
<p><b>Fiscal Sector.</b> Stats NZ provides annual data (operating statement, balance sheet, government expenses by function, taxation revenue and non-financial assets reconciliation) on the general government and its central and local government subsectors following the Government Finance Statistics Manual 2014 (GFSM 2014) recommendations for data beginning from 2009 on a fiscal year (July-June) basis. It is published roughly five months following the fiscal year end, preceded by data on a provisional basis at the time of the budget (usually in May). It replaced the publication of data only on the central and local government subsectors on December 5, 2016. The authorities also report detailed central government debt data to the IMF / World Bank Quarterly Public Sector Debt Database.</p> <p>The Treasury also provides data on a timely basis for the central government that complies with New Zealand equivalents of the GAAP Public Sector Public Benefit Entity (PBE) Standards from 2005 onwards. They are provided on a monthly basis (with a one-month lag), with an annual statement published within 4 months of the fiscal year end. The impact of moving from NZ IFRS (International Financial Reporting Standards) to PBE Standards on July 1, 2014 was not significant, due to a strong degree of convergence between the two suites of standards.</p> <p>The provided data enable adequate assessment of the impact of fiscal policy measures on New Zealand's economic performance.</p>

**Monetary and Financial Sectors.** The Reserve Bank of New Zealand (RBNZ) publishes monthly and quarterly data on a broad range of monetary and financial variables. Monetary statistics compiled by the RBNZ are consistent with the methodology of the *2016 Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG)*. New Zealand reports high quality monetary statistics regularly to STA for publication in *International Financial Statistics*. There is room for improving the timeliness of the data for other financial corporations.

RBNZ also reports some data and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

**Financial Sector Surveillance:** New Zealand currently does not report Financial Soundness Indicators (FSIs) for dissemination on the Fund website. The authorities should develop an action plan to submit the FSI data and metadata to the IMF for posting.

**External Sector.** Stats NZ provides timely information on the balance of payments and the international investment position (IIP) on a quarterly frequency since 2000. The data are released around 11 weeks after the close of the reference quarter. An expanded lending and debt statistic was introduced in 2012. The new series complements the existing IIP and international financial assets and liabilities measures of New Zealand's international balance sheet position, with a time series of external lending and debt in total and by sector, and the ownership relationship between the New Zealand-resident party and the non-resident counterparty of external lending and debt positions. This follows the IMF's external debt methodology in excluding values for financial derivative asset and liability positions. RBNZ provides monthly data on official international reserves. New Zealand's reporting of international reserves has been modified for March 2000 data onwards to conform to the standards required by the IMF for the purpose of subscription to the SDDS. Stats NZ also participates in the Coordinated Direct Investment and Portfolio Investment Surveys conducted by the IMF's Statistics Department.

<b>New Zealand: Table of Common Indicators Required for Surveillance</b> <i>(As of April 20, 2021)</i>					
	Date of latest observation	Date received	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of Publication <sup>6</sup>
Exchange Rates	4/16/21	4/16/21	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	2/21	3/29/21	M	M	M
Reserve/Base Money	1/21	3/19/21	M	M	M
Broad Money	1/21	3/19/21	M	M	M
Central Bank Balance Sheet	2/21	3/12/21	M	M	M
Consolidated Balance Sheet of the Banking System	1/21	3/19/21	M	M	M
Interest Rates <sup>2</sup>	4/16/21	4/16/21	D	D	D
Consumer Price Index	Q4 2020	1/22/21	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	2019/20	12/10/20	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt <sup>4</sup>	2019/20	12/10/20	A	A	A
External Current Account Balance	Q4 2020	3/17/2021	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2020	3/17/2021	Q	Q	Q
GDP/GNP	Q4 2020	3/18/2021	Q	Q	Q
Gross External Debt	Q4 2020	3/17/2021	Q	Q	Q
International Investment Position <sup>5</sup>	Q4 2020	3/17/2021	Q	Q	Q

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

**Statement by the Staff Representative on New Zealand**  
**May 5, 2021**

**1.** This statement contains information that has become available since the staff report was circulated to the Executive Board on April 21, 2021. This information does not alter the thrust of the staff appraisal.

**2. The Cabinet has agreed on measures to update the prudential policy framework and raise the coverage limit of the prospective deposit insurance scheme.** As part of the Phase 2 Review of the Reserve Bank of New Zealand (RBNZ) Act (see Annex VI of the staff report on earlier in-principle decisions), the Cabinet has adopted decisions on policy measures for the forthcoming Deposit Takers Act, including a new prudential framework, a crisis resolution regime, and a deposit insurance scheme. The planned deposit insurance coverage limit will be raised to NZ\$100,000 per depositor per eligible institution, from NZ\$50,000 in the original proposal. This is expected to fully protect 93 percent of depositors and is in line with staff's recommendation to raise the limit. Other measures include empowering the RBNZ to undertake on-site inspections of deposit-takers and insurers, widening the enforcement toolkit, and removing the requirement for ministerial consent to issue directions. Further, the new Act will grant the RBNZ the operational independence to implement macroprudential policies, including instrument choice, within types of lending prescribed by the Minister of Finance.

**3. New Zealand is taking action to become the first country to mandate climate-related disclosure for financial entities.** The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill has been introduced to Parliament, which would make climate-related disclosure mandatory for around 200 entities. The aim is to ensure that businesses routinely consider the effects of climate change in their business decisions and demonstrate responsibility and foresight in their consideration of climate issues. Reporting standards are expected to be prepared in line with the Task Force on Climate-Related Financial Disclosures (TCFD) framework.

**4. The RBNZ published guidance on cyber resilience.** The new guidance aims to promote the cyber resilience of the financial sector and will apply to all entities that the RBNZ regulates. It provides high-level principle-based recommendations and serves as an overarching framework for the governance and management of cyber risk, which entities can tailor to their own specific needs and technologies.

**5. Consumer price inflation rose to 1.5 percent y/y in 2021Q1.** The consumer price index rose 0.8 percent q/q, bringing the year-on-year inflation rate to 1.5 percent, from 1.4 percent in 2020Q4. The small pickup was driven by commodity prices and rising rents. The inflation outturn is broadly in line with RBNZ and staff projections. Notwithstanding some volatility in the near term, overall inflationary pressure has remained contained.

**Statement by Chris White, Alternate Executive Director for New Zealand**  
**May 5, 2021**

On behalf of our New Zealand authorities, we welcome the resumption of bilateral surveillance and the 2021 Article IV reports. We thank the mission team for a frank and engaging consultation and for its well-considered advice, with which we broadly agree.

**Context and COVID-19 health response**

New Zealand entered the COVID-19 crisis in a strong position. Economic growth had averaged around 3.5 percent over recent years supported by strong population growth. Disciplined fiscal policy had reduced net core Crown debt to less than 20 percent of GDP. Unemployment was a little over 4 percent and inflation stable at just below the targeted 2 percent. With the official cash rate at 1 percent, some conventional monetary policy space remained, and the financial system was in good health. As in other economies, macroeconomic policy was adapting to a regime of lower neutral interest rates and low inflation.

The authorities reacted swiftly and decisively to COVID-19. In the face of early infections, the government implemented a strict seven-week nationwide lockdown beginning in March 2020. This effectively eliminated COVID-19 in the community, a position that has been protected by closed borders, save for returning residents and some essential workers who are subject to managed isolation protocols on arrival.

Subsequent small outbreaks in the community arising from transmission at the border have been quickly eliminated. Given a similar successful strategy in Australia, in late April 2021 the border was reopened for incoming travellers from Australia. A nationwide vaccination program is underway and expected to be completed this calendar year.

Building on this platform, the authorities' policy agenda has three overarching goals – to keep New Zealand safe, to accelerate the recovery, and to lay the foundation for the future with a particular focus on tackling climate change, housing supply and affordability and child poverty.

**Economic performance and outlook**

The government's elimination strategy has served New Zealand well, protecting both lives and livelihoods. It allowed the economy to reopen quickly after the initial lockdown. While the early restrictions led to a large contraction in the June 2020 quarter (-12.2 percent), the sharpest on record, this was less severe than expected and was followed in September by a record quarterly rebound (14 percent). December fell back slightly (-1 percent) reflecting volatility that may continue into 2021 given uncertainties, but growth is expected to pick up steadily into 2022 and beyond.

The authorities supported workers and businesses through the early restrictions with significant investment in policies to preserve jobs and employment relationships, particularly a NZ\$ 14.6b (4.6 percent GDP) wage subsidy scheme and a range of financial support measures for businesses, communities and individuals. This was assisted by the banking system extending temporary principal and interest deferrals for mortgage holders and SMEs. The sizable fiscal impact and rapid removal of health restrictions preserved employment and underpinned the v-shaped economic recovery. Unemployment in December 2020 was 4.9 percent, down from 5.3 percent in September and well below estimates of nearly 10 percent at the start of the pandemic. While it is expected to rise again in 2021, the peak is likely to be lower than the 6.7 percent that followed the GFC.

The impact of the pandemic has been uneven across and within sectors, and across cohorts. Service sectors were hit hard, particularly tourism: during the winter season, when net tourism flows normally subtract from activity, the impact of increased domestic spending by New Zealanders was positive, though demand patterns were different; however, the summer season, when international tourism normally peaks, has been heavily affected by the absence of international visitors. Employment outcomes have been worse for women, youth and Pacific people. Conversely, the construction sector has expanded rapidly in the face of increased residential and public sector activity, demonstrating a flexible labour market, though capacity constraints are emerging.

Private consumption rebounded strongly in the second half of 2020 as a result of accumulated savings, substantial public transfers, and confidence effects linked to the elimination strategy and sharply rising house prices. Business confidence came back more slowly but has improved considerably this year, though investment intentions remain subdued as business take a wait-and-see approach. The current account deficit narrowed from 3.3 percent to 0.8 percent of GDP from December 2019 to December 2020 as imports have fallen more than exports and the terms of trade have been strong, supported by high dairy prices.

The outlook remains highly uncertain and is reliant on the progression of the pandemic and global vaccination programs, and the timing of full reopening of the border.

### **Fiscal policy**

The government supported the economy through unprecedented fiscal stimulus in 2020, allocating NZ\$ 63b (19.3 percent of GDP) for COVID-19 response, recovery and rebuild initiatives over and above increases in automatic stabilisers. Measures focused on protecting jobs and incomes, supporting the unemployed, increasing training opportunities and supporting New Zealanders' physical and mental health.

Fiscal support peaked in 2020 but the fiscal position remains stimulatory in 2021. Around NZ\$ 10b of COVID-19 funding remains unallocated and is available should downside risks emerge. Temporary escalations of restrictions to address small outbreaks have triggered wage subsidies targeted at the hardest hit firms and the newly approved Resurgence Support Payment scheme which provides one-off cash payments to support businesses. As the focus moves from response to recovery and rebuild, a major focus is on infrastructure investment in health, school property, roads, rail and public transport, freshwater supply and public housing. With NZ\$ 69b committed and planned from 2017 to 2024, and a further allowance of NZ\$ 7.8b to be allocated over the next four Budgets, this represents a step change in investment levels that will start to address a long-running infrastructure deficit.

Despite the strong starting point and better than expected performance to date, it is appropriate that the fiscal position remains supportive of the economic recovery. Fiscal support is expected to be withdrawn gradually with deficits on a declining path through to the middle of the decade. After peaking at slightly over 52 percent of GDP in 2023, net core Crown debt is forecast to start falling and will be around 47 percent of GDP by 2025.

These trajectories are prudent and sustainable and retain considerable space to respond to future shocks. The 2021 Budget later in May will see a return to the use of specified operating and capital allowances. Given the degree of global uncertainty, the government has chosen not to set a net debt target at this stage to avoid the risk of a fixed target driving policy choices that undermine the recovery. A strong direction of travel is established by the government's decision, set out in the 2021 Budget Policy Statement, to prioritise deficit reduction in the short term and debt reduction from the mid-2020s, and the government will be able to consider more specific targets once uncertainty abates.

## **Monetary policy**

The Reserve Bank moved quickly to respond to the COVID-19 crisis. In March 2020 it cut the official cash rate by 75 bps to 0.25 percent and followed this with the introduction of quantitative easing for the first time in New Zealand through its Large Scale Asset Purchase program for government and Local Government Funding Agency bonds, now sized at a maximum of NZ\$ 100b. In December 2020, the Bank further increased its stimulus through a Funding for Lending program to reduce banks' funding costs and in February 2021 announced that all operational work had been completed to enable a negative official cash rate, which will be deployed if needed.

Inflation has remained below the 2 percent mid-point of the inflation target since the start of the crisis and employment is below its maximum sustainable level. With ongoing slack in the economy as a whole and the outlook remaining highly uncertain, the Monetary Policy Committee assesses that continued stimulatory settings are required for an extended period.

## **Financial policy**

The financial sector remains sound. Banks are well capitalized and liquid, non-performing loans are low and stress tests indicate robustness even to severe shocks. Business lending growth has been sluggish, but there are limited signs of firm distress, though insolvencies are expected to increase as government support is withdrawn. Housing lending has accelerated, fuelled by accommodative monetary policy, a shortage of supply and the removal of loan to value ratio restrictions (LVRs) in 2020. While early in the crisis most commentators expected house prices to fall, they have in fact increased 24 percent in the year to March 2021 and the proportion of new lending to investors has increased. LVRs were reintroduced in March 2021 and will be tightened in May 2021. The Reserve Bank is considering deploying other macro-prudential tools to further protect against the risk to the financial sector and household balance sheets of a correction in prices.

The 2017 Financial Sector Assessment Program (FSAP) continues to guide financial sector reforms. The Reserve Bank deferred implementation of its increase in bank capital requirements by two years in the face of the pandemic. Funding has been increased to support a more intensive supervisory regime. Phase two of the review of the Reserve Bank Act has now concluded its major policy decisions and implementation is split across two new statutes.

The Reserve Bank of New Zealand Bill is expected to pass this year. It introduces a financial policy remit and modernises the Bank's governance and accountability arrangements to provide appropriate democratic oversight and align with New Zealand governance norms while reflecting the unique characteristics of a central bank and preserving operational independence. A Deposit Takers Bill will be introduced later this year. It will create a single regulatory regime for all bank and non-bank deposit takers as well as introducing deposit insurance protection up to NZ\$ 100,000 per depositor per institution, and reforming the crisis resolution framework.

## **Structural policy**

The government agenda is focused on ensuring productive, inclusive and sustainable economic growth.

While sharply rising house prices have been fuelled by accommodative monetary policy that has increased demand, the underlying problem is one of supply: New Zealand's house prices were less unaffordable than international comparators before the pandemic. The government's approach is to tackle both sides of the issue at the same time. A recent package of measures designed to increase supply and remove incentives for speculators included NZ\$ 3.8b in funding for infrastructure to accelerate supply, broader eligibility and larger contributions to support first home buyers, an extension from five to ten years of the period during which properties are subject to capital gains tax (family homes are exempted) and the removal of mortgage interest deductibility for landlords. This is accompanied by a longer-term agenda which includes the

replacement of the Resource Management Act to strengthen the planning system and streamline consenting processes. The public housing agency Kainga Ora will invest NZ\$ 9.8 b across the next four years to deliver a total of 18,000 public and transitional homes.

The labour market has proved significantly more resilient than initially expected, supported by the wage subsidy scheme. While the immediate response to the pandemic focused on preserving employment relationships through the very sharp contraction, the focus has moved to measures to ensure a rapid recovery of labour markets as the lasting impact on jobs and business has started to emerge. This has included incentives for employers to take on and retain apprentices, more funding for vocational learning and expansion of the flexi-wage scheme to reach more categories of workers including beyond the benefit population. NZ\$ 1.3b was also allocated to a range of jobs for nature initiatives that will create 11,000 jobs and green the recovery in areas such as freshwater, biosecurity and enhancing biodiversity.

Reforms to the overseas investment screening regime are designed to support investment in productive assets. The reforms introduce a new national interest test, consistent with the design used in many economies and applying in narrow circumstances. For the great majority of foreign investment, the new regime will be substantially more business friendly by simplifying tests to increase certainty, reducing scope of approvals, and improving operational efficiency and reducing turnaround times.

In January 2021 the newly formed Climate Change Commission released its initial, draft advice on meeting New Zealand's 2050 emissions reduction commitments. The report concludes that reducing emissions will create new job, business and export opportunities and can be achieved at low cost. Action is needed across all sectors of the economy, with a particular focus on transport, agriculture and energy, and will require a full suite of tools including carbon pricing, regulation and investment. The Commission has proposed emissions budgets for the first three five-year periods. Following a period of consultation, the recommendations will be finalised by 31 May 2021 and the government will respond before the end of the year with an emissions reduction plan to achieve the emissions budgets.