INTERNATIONAL MONETARY FUND

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NEW ZEALAND

August 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; 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 2023 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 August 23, 2023 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 August 23, 2023, following discussions that ended on June 15, 2023, 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 July 14, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for New Zealand.

The documents listed below 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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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2023 Article IV Consultation with New Zealand

FOR IMMEDIATE RELEASE

Washington, DC – August 28, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with New Zealand.

New Zealand's economy is in the midst of a necessary, policy-induced slowdown following the strong post-pandemic recovery. With exemplary management of the pandemic, New Zealand recovered faster than most other advanced economies. This supported activity and, together with generous fiscal and monetary support, resulted in strong investment and consumption. But this came at the cost of overheating against capacity constraints exacerbated by restrictions on labor movement due to border closures, and disruptions in global supply chains. The external balance has also deteriorated significantly. Policies have adjusted meaningfully in response. The Reserve Bank of New Zealand (RBNZ) tighten monetary policy since October 2021, increasing the policy rate by 525 bps to 5.50 percent. Following an expansionary fiscal policy in FY2021/22, spending moderated slightly in FY2022/23 due to winding down of COVID-related expenditures. The economy is now slowing, but significant and persistent labor market constraints that has put upward pressure on wages, and the large positive output gap have kept inflation high. House prices have corrected significantly, but affordability remains an issue. Financial stability risks however appear contained.

The economy is expected to continue on its slow growth as monetary tightening takes hold. The bulk of the impact of the rate hikes will be felt in 2023 and 2024 given the usual lags in transmission. Growth is expected to slow to around 1 percent y/y in 2023 and 2024, with the possibility of a technical recession, despite some short-term boost from higher spending to address the North Island weather events and funding to meet central government cost pressures. Inflation is likely to decline gradually to the 1–3 percent target range only in 2025 given the pick-up in non-tradable inflation. With the border reopening, net migration has picked up sharply and should further alleviate labor market tightness, though the effect on net demand is unclear.

Risks to the outlook stem from the external environment and a potential need for stronger tightening of monetary and financial conditions. Global developments relating to growth, deepening geo-economic fragmentation, and financial stability shocks can significantly alter the baseline assumptions for New Zealand. Persistently high inflation and wage growth could compel the RBNZ to tighten monetary policy further or keep rates high for longer, especially if fiscal policy does not consolidate as planned in the forecast period. This will have consequences for growth, household consumption, and house prices, and even financial stability implications under severe stress.

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

Executive Board Assessment[2]

Executive Directors noted that following a strong post-pandemic recovery New Zealand's economy has slowed substantially due to policy tightening to contain overheating pressures, but inflation remains well above the target range of the Reserve Bank of New Zealand (RBNZ). Against this background, Directors underscored the importance of careful calibration of the fiscal and monetary policy mix to rebalance the economy and help address long-term structural needs.

Directors welcomed the RBNZ's commitment to reduce inflation to target levels in a data-dependent manner. They saw little scope to lower policy rates currently given the tight labor market and stubborn core inflation, and emphasized that a reignition of inflationary pressures would call for additional monetary policy tightening. Compiling a monthly inflation index would enhance the effectiveness of monetary policy.

Directors agreed that reconstruction spending should be prioritized in the aftermath of the North Island weather events, but also emphasized the need for medium-term fiscal consolidation to support rebalancing efforts and create space for addressing longer-term challenges related to population aging and climate change. They supported calls for increasing the efficiency of discretionary spending and welcomed the reinstatement of fiscal rules and the authorities' commitment to fiscal sustainability.

Directors noted that financial stability indicators show few signs of stress, but household and financial balance sheets should continue to be monitored closely. They welcomed the addition of debt-to-income restrictions to the macroprudential toolkit. They noted that the RBNZ should stand ready to provide liquidity if funding markets come under stress, including from spillovers from global financial markets. Directors pointed to housing shortages, noting a strong need to improve affordability and expand housing supply including for social housing. Directors welcomed efforts to further enhance the AML/CFT framework.

Directors commended the authorities' efforts to foster durable, inclusive, and green growth, noting challenges from large infrastructure deficits, climate change, low productivity, aging, and inequality. They welcomed the 2022 Digital Strategy for New Zealand which aims to grow the digital workforce, address labor shortages and skills mismatches, and increase the digital inclusion of under-represented groups. Directors were encouraged by the decoupling of greenhouse gas emissions and economic growth and noted strong policy initiatives under the Emissions Reduction and National Adaptation Plans, including the review of the Emissions Trading Scheme.

[2] 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 summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Table 1: Main Economic Indicators, 2019-2028

(Annual percent change, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projections					
NATIONAL ACCOUNTS										
Real GDP (production)	3.1	-1.5	6.1	2.7	1.1	1.0	2.1	2.2	2.4	2.4
Domestic demand	3.1	-1.8	10.3	3.5	-0.3	-1.1	1.5	1.9	2.2	2.3
Private consumption	3.2	-2.2	7.9	2.9	-0.5	-2.2	1.9	2.3	2.3	2.2
Public consumption	4.7	7.2	8.2	4.5	-0.5	1.6	1.2	0.3	0.5	0.2
Investment	2.1	-7.8	18.4	3.7	-1.3	-0.8	0.8	2.3	3.6	3.9
Public	1.6	7.2	8.9	-0.4	3.6	0.7	2.2	4.1	4.4	4.6
Private	5.1	-8.1	13.8	5.2	1.0	-2.1	0.4	1.7	3.3	3.7
Private business	5.0	-10.3	16.5	7.2	1.9	-2.5	-0.3	1.5	3.4	3.5
Dwelling	5.3	-3.1	8.4	1.0	-1.1	-1.2	2.0	2.2	3.3	4.1
Inventories (contribution to growth, percent)	-0.5	-0.8	1.3	0.0	-0.8	0.2	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	0.0	1.6	-4.9	-1.6	1.2	2.1	0.5	0.2	0.0	0.0
Real gross domestic income	3.3	-0.8	5.2	1.4	-0.1	0.3	2.0	2.1	2.4	2.2
Investment (percent of GDP)	24.0	22.2	25.2	26.6	26.6	26.4	26.1	25.9	25.8	26.0
Public	5.3	5.7	5.9	6.0	6.2	6.3	6.3	6.4	6.4	6.5
Private	18.7	16.5	19.3	20.6	20.3	20.1	19.8	19.5	19.4	19.5
Savings (gross, percent of GDP)	21.1	21.2	19.2	17.5	18.7	19.7	20.3	20.7	21.1	22.1
Public	-2.5	-4.4	-3.5	-3.5	-3.4	-3.5	-2.2	-1.3	-0.4	0.0
Private	23.6	25.5	22.7	21.1	22.1	23.3	22.5	22.0	21.6	22.1
Potential output	3.1	1.6	1.5	1.9	2.1	2.3	2.4	2.5	2.5	2.4
Output gap (percent of potential)	0.9	-2.3	2.1	2.9	1.8	0.6	0.3	0.1	0.0	0.0
LABOR MARKET										
Employment	1.3	1.3	2.2	1.7	1.4	0.6	1.6	1.4	1.4	1.5
Unemployment (percent of labor force, ann. average)	4.1	4.6	3.8	3.3	3.8	5.0	4.6	4.5	4.5	4.4
Wages (nominal percent change)	3.4	3.8	3.8	6.5	6.7	4.2	3.8	3.6	3.4	2.6
PRICES										
Terms of trade index (goods and services, % change)	0.3	1.2	-1.1	-2.9	-4.7	-2.5	-0.7	-0.4	0.1	-0.3
Consumer prices (avg, % change)	1.6	1.7	3.9	7.2	4.9	2.6	2.5	2.3	2.1	2.0
GDP deflator (avg, % change)	2.4	2.2	2.9	5.5	5.8	0.9	2.5	3.3	3.0	2.2
MACRO-FINANCIAL										
Official cash rate (policy rate, percent, avg)	1.4	0.4	0.3	2.2	5.0	4.8	4.3	3.5	2.5	2.5
Credit to the private sector (percent change)	5.6	3.9	6.1	4.3	-0.8	0.1	2.9	3.5	4.0	4.3
Interest payments (percent of disposable income)	8.0	6.0	5.0	8.4	9.4	8.3	8.4	7.0	6.5	6.5
Household savings (percent of disposable income)	3.4	3.6	3.6	3.2	2.7	2.5	2.4	2.3	2.9	3.6
Household debt (percent of disposable income)	169	170	173	170	156	147	143	141	140	126
GENERAL GOVERNMENT (percent of GDP) 1/										
Revenue	37.8	36.2	37.7	39.3	39.0	38.6	39.6	40.1	40.2	40.4
Expenditure	36.6	42.5	40.1	43.9	41.6	42.9	42.4	41.8	41.2	40.4
Net lending/borrowing	1.2	-6.2	-2.5	-4.6	-2.6	-4.2	-2.8	-1.6	-0.9	0.0
Operating balance	3.2	-4.4	-0.2	-1.9	0.9	-1.4	-0.3	0.8	1.0	1.9
Cyclically adjusted primary balance 2/	2.3	-3.9	-2.3	-4.1	-2.6	-4.4	-2.2	-0.1	1.6	2.6
Gross debt	26.2	38.5	46.0	48.6	44.6	48.1	51.3	53.0	51.0	48.7
Net debt	4.3	9.7	10.6	16.7	21.5	27.8	32.0	33.9	32.6	30.3
Net worth	93.2	85.5	94.6	97.7	91.8	89.2	85.1	82.1	81.9	82.8
BALANCE OF PAYMENTS										
Current account (percent of GDP)	-2.9	-1.0	-6.0	-9.0	-7.8	-6.6	-5.8	-5.2	-4.7	-3.9
Export volume	2.6	-13.5	-2.4	0.3	7.4	9.0	7.7	4.3	5.1	4.7
Import volume	2.2	-15.8	14.8	5.4	1.5	0.2	4.6	3.0	4.2	3.8
Net international investment position (percent of GDP)	-53.7	-55.8	-46.4	-51.2	-53.1	-58.8	-62.0	-63.9	-65.3	-66.2
Gross official reserves (bn US$)	17.0	13.0	16.4	13.7	…	…	…	…	…	…
MEMORANDUM ITEMS										
Nominal GDP (bn NZ$)	320	323	352	380	406	413	432	457	482	504
Percent change	5.7	1.1	9.1	8.0	6.6	1.9	4.7	5.7	5.4	4.7
Nominal GDP per capita (US$)	42,275	41,292	48,775	47,198	48,827	48,409	49,631	51,545	53,605	55,789
Real gross national disposable income per capita (NZ$)	53,631	52,621	54,703	54,996	55,133	55,133	54,758	56,291	57,243	58,574
Percent change	2.8	-1.9	4.0	0.5	0.2	-0.7	1.3	1.5	1.7	2.3
Population (million)	5.0	5.1	5.1	5.1	5.2	5.2	5.3	5.3	5.4	5.4
US$/NZ$ (average level)	0.659	0.650	0.708	0.636	…	…	…	…	…	…
Nominal effective exchange rate	105.9	104.5	109.9	106.6	…	…	…	…	…	…
Real effective exchange rate	101.7	100.9	107.6	105.4	…	…	…	…	…	…

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

1/ Fiscal year.

2/ In percent of potential GDP.

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

July 14, 2023

KEY ISSUES

Context. After a strong post-pandemic recovery, New Zealand has entered a marked, but orderly, policy-induced slowdown. Monetary policy has been appropriately tightened to address the above-target inflation and unsustainably low unemployment rate. The external balance has deteriorated significantly, reflecting the economic overheating of recent years. The housing market continues to correct, and although financial stability risks appear contained, affordability remains a concern.

Outlook and Risks. The economy is likely to continue its slow growth in the near term as monetary tightening continues to take hold. Inflation will likely decline but remain above target in 2024, with new discretionary spending adding to pressures. Risks stem mainly from policy missteps, housing market developments, and global spillovers.

Policy recommendations.

- **Macroeconomic policies** should retain a restrictive bias to rebalance the economy internally and externally. Fiscal policy should help address overheating while managing cost pressures and post-cyclone spending needs. Over the medium term, a careful balancing and prioritization is needed to address long-term, structural needs such as closing productivity gaps and investing in climate change-related projects.
- The **financial sector** remains sound, but rapid rate rises could impact financial stability through credit risks to borrowers and disruptions to funding markets. The first line of defense would be the ample capital and liquidity levels. If further stresses manifest, the RBNZ should use macroprudential tools, leaving monetary policy to focus on addressing inflation. The addition of debt-to-income restrictions for mortgages is a welcome addition to the RBNZ's macroprudential toolkit to address future unsustainable credit and asset price growth.
- **Structural policies** should continue to tackle inequality by boosting education investment and outcomes. Reducing the labor market tightness should be prioritized, especially for supporting the construction sector and boosting climate-resilient infrastructure. Greater digitalization provides scope for greater productivity and inclusion gains. Boosting supply remains critical for housing affordability.

Approved By
Anne-Marie Gulde-Wolf (APD) and Kenneth Kang (SPR)

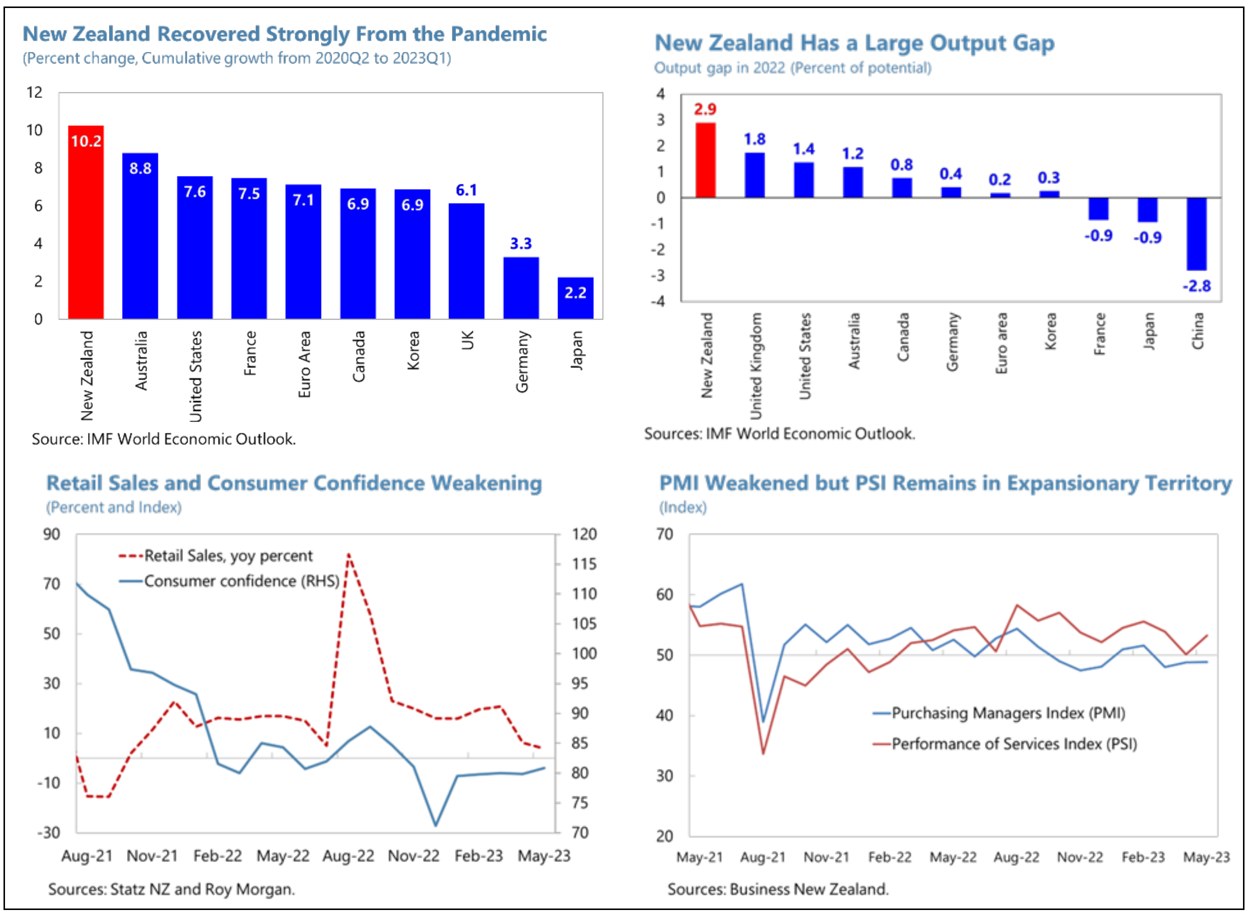
Discussions were held in Wellington and Auckland during June 1–15, 2023. The mission team comprised Evan Papageorgiou (head), Pragyan Deb, Narayanan Raman, and Nour Tawk (all APD). Oscar Parkyn (OED) joined the discussions. Abdullah Alnasser and Nadine Dubost (both APD) assisted in the preparation of this report.

CONTENTS

BOTTOMING OUT AMID HIGH INFLATION

A. Context and Recent Developments

1. New Zealand's economy is now in a recession after a strong post-pandemic recovery. Compared to most other advanced economies, New Zealand recovered from the pandemic faster, gaining 10 percent since the middle of 2020 aided by generous fiscal support, strong investment, and private consumption (Figure 1). But this came at the cost of significant overheating against capacity constraints exacerbated by restrictions on labor movement due to border closures and disruptions in global supply chains. Following significant policy tightening, the economy entered a technical recession, with real GDP declining by 0.1 percent q/q (SA) in 2023Q1, following a 0.7 percent decline in 2022Q4 GDP. High frequency indicators, such as retail sales, point to ongoing demand slowdown amid weaker sentiment. Wholesale activity is also subdued with manufacturing (PMI) and services (PSI) surveys weakening in recent months.



New Zealand Recovered Strongly From the Pandemic (Percent change, Cumulative growth from 2020Q2 to 2023Q1). Source: IMF World Economic Outlook.

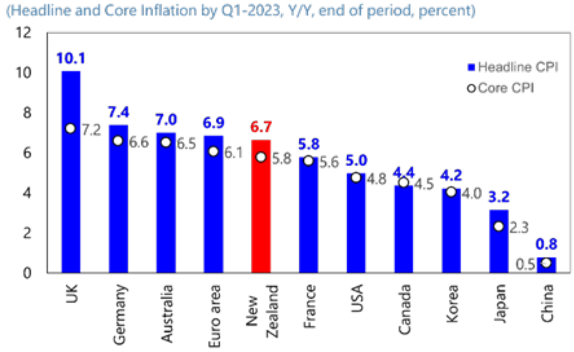
New Zealand Has a Large Output Gap. Output gap in 2022 (Percent of potential). Sources: IMF World Economic Outlook.

Retail Sales and Consumer Confidence Weakening (Percent and Index). Sources: Statz NZ and Roy Morgan.

PMI Weakened but PSI Remains in Expansionary Territory (Index). Sources: Business New Zealand.

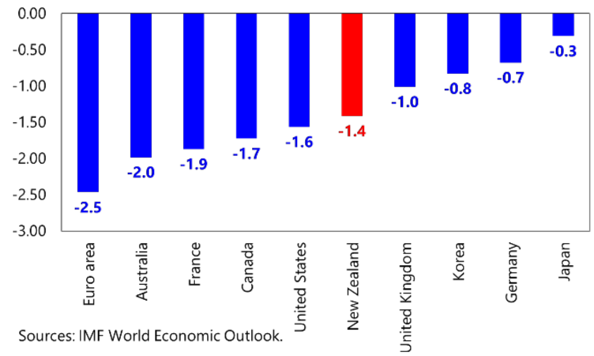
2. Significant and persistent labor market constraints and the large positive output gap have kept inflation high. Like in most advanced economies, inflation is cooling but remains well above the Reserve Bank of New Zealand's (RBNZ) 1–3 target range at 6.7 percent in 2023Q1. Devastation caused by the North Island weather events, namely the Auckland flash floods in January and Cyclone Gabrielle in February, have added to pressures, but inflation expectations have improved (Figure 2). Labor markets conditions remain tight with record high labor force participation and no slack, as seen in the historically low levels of unemployment and underemployment rates. This has put upward pressure on wages, particularly for services and construction. Although the recent surge in migration has eased some labor market pressure, wage growth expectations, particularly in the short term, remain high.

Inflation is Above Target in Most AEs
(Headline and Core Inflation by Q1-2023, Y/Y, end of period, percent)



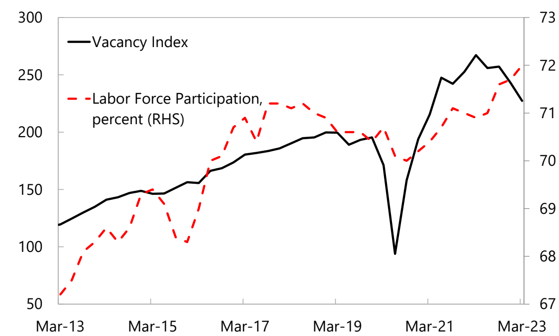
Sources: IMF staff calculations.

Unemployment Rate is Below Long-Term Average
(Unemployment rate at end-2022 relative to 2014-2021 average, percent)



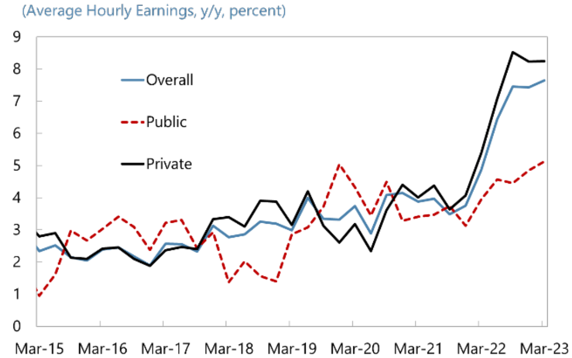
Sources: IMF World Economic Outlook.

Vacancy Index Remains High Despite Record Participation
(Vacancy Index, 2010=100; RHS: Participation Rate, Percent)



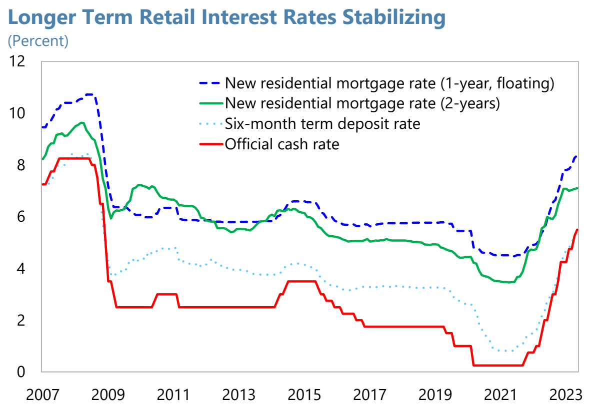
Sources: Ministry of Business, Innovation and Employment; Stats NZ.

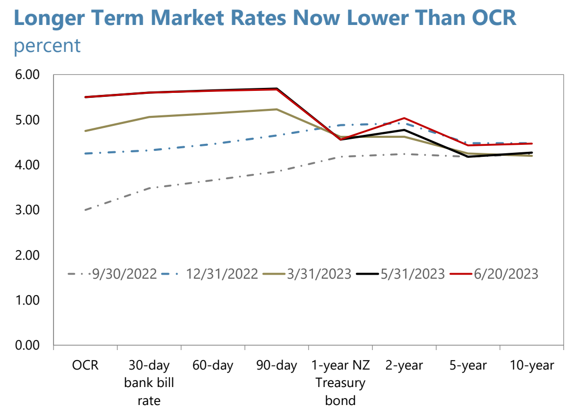
Wages Are Rising Rapidly
(Average Hourly Earnings, y/y, percent)



Source: Stats NZ

3. The RBNZ has tightened monetary policy aggressively to address the above-target inflation and the unsustainably tight labor market. The RBNZ was one of the first advanced economy central banks to tighten monetary policy in October 2021, and following a 25 bps increase in May, the official cash rate (OCR) has been raised by 525 bps cumulatively (Figure 2). As a result, both wholesale and retail interest rates have risen significantly since mid-2021. In recent months, rates have started to stabilize, reflecting competitive pressures and market expectations that the RBNZ is close to the peak of its tightening cycle. Longer-term rates are now firmly below the OCR and short-term rates. The RBNZ has continued to shrink its holdings of government securities accumulated during the pandemic under the Large-scale Asset Purchase (LSAP) program through off-market operations with Treasury. Annex IX examines the fiscal implications of the LSAP program.



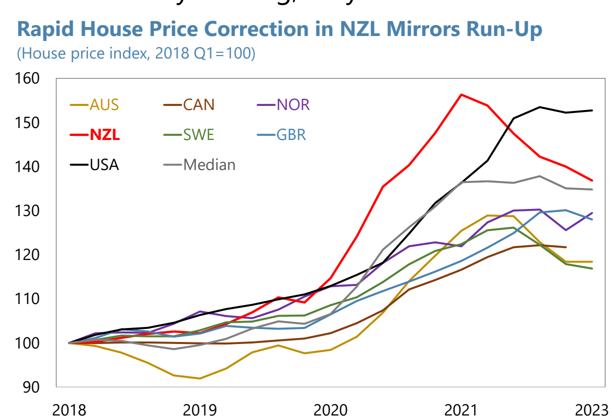


Sources: Reserve Bank of New Zealand; and IMF staff calculations.

4. The external balance has deteriorated significantly, reflecting the overheating of the New Zealand economy. The current account deficit has expanded rapidly over the past couple of years, fueled by a large output gap, strong domestic economy, and expansionary fiscal policy, coupled with one-off COVID factors that favored durable goods imports. At the same time, international tourism and education exports have been weak and are only now rebounding (Annex II). As a result, New Zealand's external position in 2022 was weaker than implied by medium-term fundamentals and desirable policies, a change from last year's assessment (Annex III).

5. A significant decline in public expenditures and transfers as pandemic support waned contributed to offsetting the costs of natural disasters in 2023. In FY2022/23, strong revenue outturns, identified savings and reprioritized expenditure were more than offset by emergency relief measures following the North Island weather events, alongside higher financing costs, increased spending on health and education, and subsidies to alleviate the cost-of-living crisis.[1] In addition to the tragic effect of the floods on human lives, damages from the North Island weather events are estimated to be NZ$9–14.5 billion. Gross public debt, at 45 percent of GDP, remains sustainable, and there is substantial fiscal space (Annex IV). The authorities re-instated fiscal rules in 2022 on debt and the fiscal balance (Annex VII), and while they are not currently binding, they communicate commitment to fiscal sustainability.

6. House prices peaked in November 2021 and have corrected significantly. New Zealand's housing market was among the first in advanced economies to turn, with prices now having fallen by around 13 percent relative to the peak in November 2021. The rapid correction reflects, price misalignments given the speed of the run-up in house prices during the pandemic, monetary policy tightening and the steps taken



Source: OECD and CoreLogic.

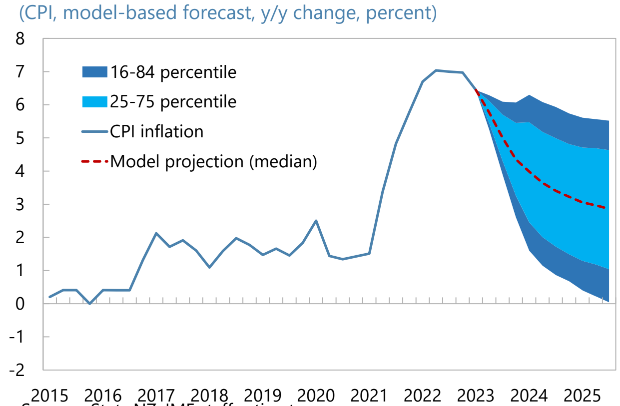
[1] FY2022/23 refers to the period July 1, 2022–June 30, 2023.

to improve supply, particularly in Auckland. Despite the decline in housing prices the rental market remains tight, and affordability, as measured by mortgage interest payments relative to income, has worsened. The RBNZ is now allowed to impose debt-to-income (DTI) restrictions on mortgage lending, complementing the longstanding loan-to-value ratio (LVR) limits, but they are not expected in the near term given the decline in new mortgage approvals and housing prices. The May 2023 Financial Stability Report indicated an increase in loan delinquency rates for households, but not for mortgages due to low unemployment and still-high housing equity for most borrowers.

B. Outlook: Ongoing Low Growth and an Uncertain Inflation Path

7. The economy will likely continue growing slowly in the short term as monetary tightening takes hold. The bulk of the impact of monetary tightening since 2021 will be felt in 2023 and 2024 given lags in transmission. Staff expect growth to slow to around 1 percent y/y in 2023 and 2024, despite some short-term boost from reconstruction activity and higher spending after the floods. The slowdown is likely to be led by weakness in domestic private demand—both consumption and investment. Trade is likely to have some positive impact on growth given the strong boost from the recovery in tourism which is overcoming near-term weakness in exports due to weather related disruptions, and higher goods imports related to reconstruction needs. Inflation is likely to decline gradually, coming into the 1–3 percent target range only in 2025. While external price pressures are easing, given the stickiness of nontradeable prices, the outlook remains highly uncertain. With the border reopening, net migration has picked up sharply in recent months and should further alleviate labor market tightness, though the effect on net demand is unclear. Unemployment is expected to rise to 5 percent by 2024.

Outlook for Inflation Remains Highly Uncertain
(CPI, model-based forecast, y/y change, percent)



Sources: Stats NZ, IMF staff estimates.
Note: See IMF (2022) Selected Issues Paper for methodological details.

C. Risks and Alternative Scenario

8. The risks to the baseline scenario stem from the external environment, policy missteps, and lack of coordination. Given the small, open economy nature of New Zealand, global developments relating to growth, deepening geo-economic fragmentation, and financial stability shocks can significantly alter the baseline assumptions for domestic growth (see Annex V for a top-down risk assessment). Important risks arise from monetary policy miscalibration, both in New Zealand and in the major economies, which can affect global economic and financial conditions amid already high uncertainty of economic activity. This could result from central banks prematurely pausing their monetary policy tightening, or even pivoting to an easing monetary policy stance, risking de-anchoring inflation expectations (such as by incomplete fiscal consolidation) and triggering a wage-price spiral in tight labor markets. The knee-jerk reaction to tighten further or keep rates high for longer can also lead to excessive economic hardship and create a longer global growth slowdown. Domestic risks are centered around housing market disruptions with financial stability and growth implications, due to high household debt, borrowers' vulnerability to rising interest rates, and banks' high exposure to housing.[2] Upside risks are also emerging, with a rising net migration easing labor constraints, potentially resulting in a faster-than-expected return of inflation to target.

9. **Persistently high inflation and rapid wage growth could tip the economy into a deeper and more protracted slowdown.** In an alternative, downside, scenario, encompassing higher spending and persistent consumption, high wage growth will continue to exert pressure on inflation. The need to arrest a wage spiral and control inflation expectations would force the RBNZ to tighten monetary policy further or keep rates high for longer, especially if fiscal policy is more stimulative than assumed in the baseline. The environment of tighter domestic financial conditions and higher rates will increase the risk of disorderly conditions in the housing market, which would have significant consequences for household consumption and overall growth and could result in a prolonged or deeper recession. Pressures on the external account will also take longer to resolve as a result, increasing vulnerabilities to external shocks. Given the dominance of variable rate mortgages in the stock of housing loans,[3] rate rises will also trigger pockets of household distress, particularly among lower income borrowers and those who made their purchase near the top of the housing cycle. This could have significant direct effects on New Zealand's banking system.

Authorities' Views

10. **The authorities broadly agreed with staff's assessment and noted downside risks to the highly uncertain outlook.** Although the authorities project a marginally faster decline in inflation and the current account deficit than staff, they noted a wide range of possible outcomes given volatility in recent data and the uncertain impact of the floods and migration. They stated that inflation expectations have become more adaptive which could add to persistence, but also see short-term expectations return to target quickly if the reduction in tradeable and volatile prices continues. The authorities agreed that while the cyclical increase in the current account deficit adds to vulnerabilities, it is likely to reverse in the near term and through 2027. They also noted that New Zealand's net foreign liabilities have remained low relative to history, at just under 50 percent of GDP, having benefitted from favorable revaluations in recent years.

POLICIES FOR SUSTAINABLE GROWTH

A careful calibration of policies is needed as New Zealand continues on its marked, but orderly, policy-induced slowdown. Given the pressing capacity constraints and high and persistent inflation, the fiscal-monetary policy mix must retain a restrictive bias to rebalance the economy internally and externally and rely on automatic stabilizers to address the impact of slower growth. Monetary policy has

[2] An unexpected slowdown in China could have a significant impact on New Zealand given China's importance as a trading partner. Cyber threats and natural disasters are additional sources of risk.

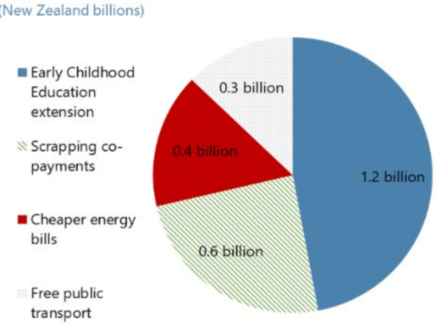
[3] Around half of mortgages in New Zealand are fixed for less than 1 year and will reset at a higher rate over the next 12 months.

appropriately turned tight to address the risks of high and prolonged inflation. The government reinstated its fiscal rules last year underlying its commitment to fiscal discipline and long-term sustainability, but new discretionary spending without offsetting measures will work against the monetary tightening and delay the fiscal consolidation. Fiscal policy should focus on addressing overheating while managing short term demand pressures, and, with careful balancing and prioritization, address long-term, structural needs such as closing productivity gaps and investing in climate change-related priorities. A systemic risk assessment on housing and household-related exposures shows that vulnerabilities have declined slightly relative to the 2022 consultation, but remain elevated nonetheless.

A. A Need for Fiscal Consolidation Amid High Cost of Living and Reconstruction

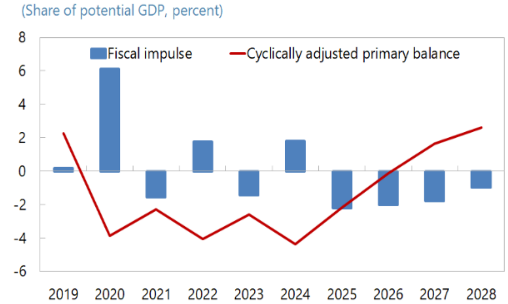
11. The expansionary fiscal stance for FY2023/24 reflects reconstruction needs for the North Island weather events and discretionary spending. Operating allowances were increased in Budget 2023 to NZ$4.8 billion per year (1.1 percent of average GDP), with an additional NZ$1.1 billion toward infrastructure reconstruction and capital expenditure in FY2023/24.[4] In addition, the government established the National Resilience Plan with NZ$6 billion over 10 years for asset repair and replacement. Even after netting out reconstruction spending, there were several new spending and cost-of-living initiatives, including extension of early childhood education, scrapping prescription co-payments, extending free public transport to children and half-price fares to young adults, and lowering energy bills for lower income households. Identified savings and reprioritization of previous expenditure and revenue raising initiatives netted off only a small share of new spending initiatives, and the elevated cost funding pressures contributed almost ¾ of the operating allowances. Considering this, and weaker-than-budgeted revenue as the economy slows, the general government cyclically adjusted primary balance (CAPB) is expected at -4.4 percent of potential GDP with fiscal impulse of 1.8 percent of potential GDP for FY2023/24. The fiscal consolidation is projected to begin from FY2025/26, as spending is dialed back. The CAPB will turn positive in the medium term.

New Measures Announced in Budget 2023
(New Zealand billions)



Source: New Zealand Treasury.

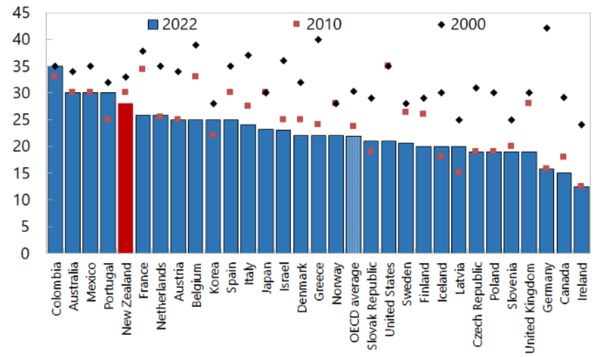
Fiscal Consolidation Expected from 2025
(Share of potential GDP, percent)



Sources: New Zealand Treasury, IMF staff estimates.
Note: Figure reflects fiscal year data, year ending June 30.
Fiscal impulse denotes the change in the cyclically adjusted primary balance.
Negative values denote fiscal consolidation.

[4] Budget allocations in New Zealand span a period of five years (four years ahead and the current fiscal year).

Corporate Income Tax Rate
(Percent)



Sources: OECD.

12. The authorities should prioritize reconstruction efforts in the near term without unduly adding to demand, while aiming for a frontloaded fiscal consolidation. Fiscal policy faces a challenging year ahead, with pressing spending needs toward rebuilding and alleviating the high cost of living. Empirical evidence of state-contingent fiscal multipliers for New Zealand suggests that in the current state of tight monetary policy, spending shocks can have different effects on aggregate demand when they are done for consumption or investment.[5] Spending toward productive and cost-efficient post-disaster reconstruction, as well as other climate-related adaptation projects should be prioritized, as it may not necessarily boost growth partly as public investment spending may crowd out private investment. Nevertheless, public investment toward necessary and high-value infrastructure projects and reconstruction, are likely to have greater positive externalities. At the same time, new spending initiatives should be carefully executed to identify cost savings and reductions in public consumption. Cost-of-living support should be targeted and temporary, better focused on supporting vulnerable households and viable businesses, including by using means testing. These efforts can reduce demand and support monetary policy in achieving price stability, while allowing automatic stabilizers to function countercyclically.

13. Tax reforms should remain a priority to improve efficiency, equity, and sustainability of revenues. Although New Zealand has adequate overall revenue and suitably-broad tax bases, there is a need to consider the role of the tax system in economic policy.[6] The tax preference design merits careful debate, and enhancing the tax revenue options, such as by introducing capital and land value taxes will yield fairer and more equitable tax revenue outcomes, given that capital gains tend to accrue to wealthier households. Reforming the corporate income tax, which has been reduced over the years but remains high compared to peer advanced economies, would boost business investment, and encourage entry of new businesses, leading to higher productivity growth and more efficient revenue outturns that do not crowd out investment. Relatedly, the effects of higher inflation call to attention the tradeoff between ad-hoc cost-of-living adjustments to counteract the effect of fiscal drag. Addressing tax bracket creep by periodically (or systemically)

[5] Haug and Power (2022) find that estimates of spending multipliers for New Zealand vary by the state of monetary policy (loose or tight), and by the spending purpose (consumption or investment). They find that government consumption multipliers do not depend on the monetary policy stance and are statistically significant (and positive), but government investment multipliers are not statistically significant during periods of tight monetary policy. Other relatively recent New Zealand-specific studies by Lyu (2021) and Hamer-Adams and Wong (2018) offer broadly similar findings and examine revenue (tax) multipliers as well.

[6] See also the 2022 (and earlier) New Zealand Article IV Staff Reports.

raising income brackets can limit the distributional implications of inflation, especially for lower income and vulnerable households, and partly limiting the need for more transfers.

14. New Zealand's debt ceiling rule helps ensure ample fiscal buffers against natural disasters or macroeconomic shocks. Reinstated, but new, fiscal rules of a net core Crown debt ceiling of 50 percent of GDP and fiscal surpluses are well calibrated (Annex VII), and ensure there are sufficient buffers in place to address natural disasters.[7] However, given New Zealand's exposure to climate shocks, natural disaster costs should be explicitly incorporated into the Budget framework.

15. Long-term fiscal challenges from large infrastructure gaps and aging underscore the need for strategic public investment in the medium term. The adoption of a "golden-rule"[8] style operating balance is appropriate to support borrowing for long-term investments which grow capital stock. Still, policymakers will also need to develop a pipeline of projects with clearly defined goals and tradeoffs that can help the financing and delivery of infrastructure. Reconstruction post-North Island weather events provides a chance to strengthen infrastructure resilience against disaster risks, which can also bridge the infrastructure gaps and reduce exposure to climate shocks. Likewise, with expected higher spending on pension and healthcare from aging demographics, continued investment over the medium term in reforming the health system by creating a national health service to replace the existing district health boards is also welcome, alongside the capital expenditure for boosting the physical health infrastructure. Superannuation reforms are also necessary to address the intertemporal challenges of funding public pension payments from current revenues while the taxpayer base is affected by the aging population.

Authorities' Views

16. The authorities hold the view that a frontloaded fiscal expansion to respond to New Zealand's needs, with backloaded consolidation is appropriate. They consider the planned spending for FY2023/24 necessary given the rebuilding needs following the North Island weather events, new cost-of-living measures, and funding of cost pressures. They agreed with staff on the need for a tighter stance in line with the fiscal rules and explained that the weather events have temporarily delayed fiscal consolidation, but it will be achieved in the forecast period (four years). On the prospect for tax reforms, the authorities agreed that there could be fiscal and integrity benefits to new tax bases (such as capital gains) but noted the economic trade-offs and that accessing new tax bases is not on the tax policy work program at this time. They pointed to New Zealand's comparatively broad tax base, the introduction of a new top personal income tax rate in 2021, and the increase in the trustee tax rate announced in Budget 2023. They agreed with staff on

[7] The debt ceiling is equal to 30 percent of GDP when excluding the New Zealand Superannuation Fund.

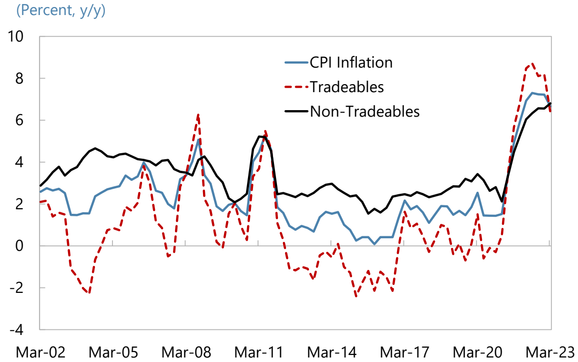
[8] A "golden-rule" style operating balance means that operating expenses (including day-to-day consumption and transfer payments) are paid out of operating revenues. This approach supports intergenerational equity, as the current generation would pay for its own consumption, including capital depreciation. Long-term investments would lead to future generations receiving both an asset and a liability.

the need to bridge infrastructure gaps, with new capital expenditure in Budget 2023 earmarked for boosting disaster resilience and housing supply, among others.

B. Monetary Policy Should Stay the Course to Address Inflation for Now

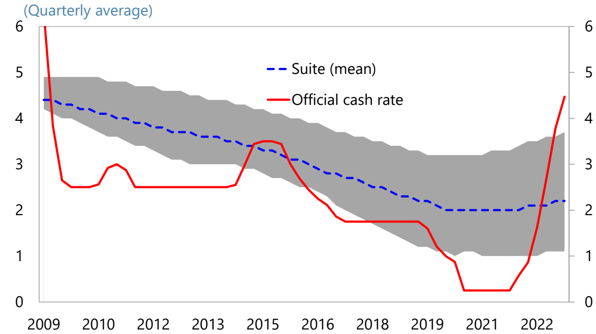
17. Monetary policy has turned very restrictive, but the absence of slack suggests the time is not yet right to cut rates. Standard estimates of output and employment gaps show that, with most reasonable assumptions, they are likely to remain positive into 2024, limiting the scope for lowering the OCR, which some market participants expect in the near term. Inflation appears to have peaked with headline inflation now moderating on the back of a decline in prices of tradeable goods, particularly global fuel prices, as well as the impact of significant monetary tightening since 2021. So far, there has been no indication that the health of banks has been adversely affected by the rate hikes: capital and liquidity positions remain strong and asset quality and earnings have been maintained. But policy will need to be exceptionally nimble. The rapid rate rises to date will have a contractionary impact on household consumption over the next 24 months—a period in which interest rates on more than ¾ of mortgages outstanding by value are scheduled to reset—but this may have unforeseen effects on household balance sheets. Should funding markets experience stress, the RBNZ can respond by utilizing macroprudential and other financial stability tools rather than through a change to the monetary policy stance, which needs to keep its focus on inflation. In particular, the RBNZ should use its liquidity windows as needed.

Non-Tradeable Inflation Has Picked Up As Well
(Percent, y/y)



Source: Stats NZ

OCR and Neutral OCR Indicator Suite 1/
(Quarterly average)



Source: Reserve Bank of New Zealand.
1/ Shaded area indicates the range between the maximum and minimum values from a suite of neutral OCR indicators.

18. A reignition of inflation pressures, including due to insufficient fiscal consolidation, would call for a further tightening of monetary policy. The OCR path should be calibrated to developments in the economy, including external shocks and fiscal and other policy responses. In particular, shocks that directly impact inflation or spur a pick-up in domestic demand such as a slower pace of fiscal consolidation than envisaged in the baseline will require a reassessment of the monetary tightening path, including reverting to a more aggressive pattern of increases, so as to put inflation durably on a path the RBNZ's 1–3 percent target. In that regard, there is scope for Stats NZ—the national statistics office—to re-examine the prospects for compiling a monthly inflation index, concurrently with its standard quarterly measure, to support decision-making by the RBNZ in a period of exceptionally high uncertainty (see below).

19. The RBNZ undertook two reviews of its monetary policy framework in 2022-23 (Annex VIII). The Review and Assessment of the Formulation and Implementation of Monetary Policy (RAFIMP) looked at the conduct of monetary policy in 2017-22 and made recommendations on improving monitoring and analysis of supply shocks and interaction with fiscal policy and strengthening communication. The RAFIMP appropriately identifies the main areas to strengthen the monetary policy framework. The second was the statutory review of the monetary policy Remit and Charter, finished in June 2023 and concluded that the monetary policy framework in New Zealand remains appropriate. In response to concerns that the requirement to assess house prices introduced in 2021,[9] alongside the RBNZ's price stability and maximum sustainable employment mandates, complicated communication of policies, the new Remit takes note of the pursuit of monetary policy objectives to financial stability and seeks to avoid unnecessary volatility in output, interest rates and the exchange rate. The MPC is now only asked to "seek to understand and communicate" house price considerations, alongside the interactions between monetary and fiscal policies financial stability implications of monetary policy decisions and the risks to the RBNZ's own financial position arising from the choice of monetary policy instruments and its monetary policy decisions. During the consultation, the RBNZ flagged the need to improve data and real-time information to aid monetary policy decisions and highlighted the lack of monthly consumer price data as an important gap. The lack of a monthly CPI series makes New Zealand an outlier among advanced economies and is holding back a timelier formulation and assessment of monetary policy. A review of the financial resources of the RBNZ is ongoing.

Authorities' Views

20. The authorities agreed that monetary policy will need to remain restrictive for a prolonged period. They noted that the rapid increase in the OCR was starting to cool the economy and suggested that the decline in tradables inflation and improvements in global supply chains are helping bring inflation lower. The net inflationary impact of the recent increase in net migration was uncertain. The RBNZ pointed to the decline in various measures of inflation expectations to its target range as a further signal that expectations are well-anchored. The RBNZ does not plan to deviate from its current plan on unwinding its balance sheet, which had expanded during the pandemic under the LSAP. Stats NZ is examining the possibility of publishing more price data on a monthly basis to enable more timely monitoring of inflation developments but noted that a monthly CPI series would require additional resources.

C. Rebalancing the Housing Sector While Maintaining Financial Sector Resilience

21. Housing prices are expected to continue declining into 2024 with systemic risk implications. The interaction of the large housing price declines and high household debt is the major systemic risk for New Zealand. Staff expect the housing market to stabilize by Q1 2024, representing a decline of 20 percent relative the November 2021 peak, with a gradual recovery

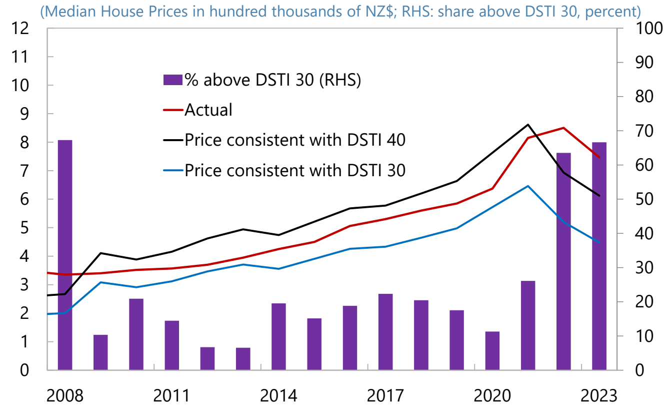
[9] See ¶31 and ¶36 of the 2021 New Zealand Article IV Staff Report.

thereafter. Household liabilities will likely mirror the decline in housing prices: after peaking at 175 percent of disposable income in March 2022, household debt is projected to fall to 161 percent by end-2023. Over the long term, this should strengthen households' financial resilience and lay the foundation for more sustainable consumption going forward. However, the near-term adjustment will weigh on household consumption and GDP growth. Taken as a whole, this argues that New Zealand's systemic risk assessment has improved somewhat since the previous consultation given the significant adjustment in housing prices that have reduced misalignments, very low unemployment and positive housing equity for most borrowers even after the decline in prices. Nevertheless, it continues to point to elevated vulnerabilities, especially if households' debt repayment capacity is severely impaired under a loss of disposable income scenario (such as via a marked and prolonged increase in unemployment). This requires ongoing monitoring (such as via stress tests) and policy adjustments (for instance through stronger safety nets including the income insurance scheme) to support macrofinancial and economic stability.

22. **Notwithstanding the correction, housing affordability remains a concern in the near term, and efforts to expand supply should continue.** The structural features of New Zealand's housing shortage have not been addressed by the cyclical downturn in prices. Despite the decline in prices, higher mortgage rates have hampered affordability by raising mortgage payments for borrowers. A borrowing capacity approach suggest that median housing prices are 50 percent above the price the median household could afford to finance with a debt service-to-income ratio of 30 percent. In 2022 this measure shot up to the same level as before the global financial crisis, as interest rates increased and is expected to remain elevated.[10] There is an urgent need to expand supply, particularly in fast-growing regions. Continuing reforms to the Resource Management Act (RMA), with the introduction of the Natural and Built Environment and the Spatial Planning bills in parliament in 2022, are welcome and would allow for higher density construction and better planning for climate change and natural disasters.

House Prices and Borrowing Capacity

(Median House Prices in hundred thousands of NZ$; RHS: share above DSTI 30, percent)



1/ Year ended in June 2023 are estimates based on prices in March 2023.

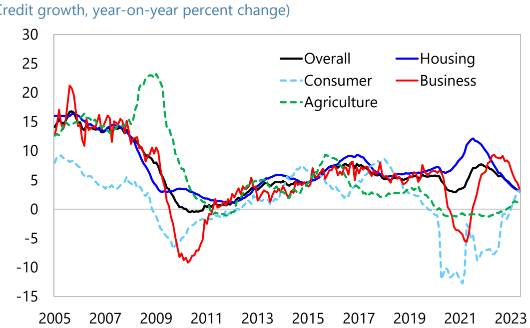
23. **Although credit growth has slowed, financial stability indicators point to continuing health.** Growth in overall credit outstanding peaked in November 2021 and has since slowed in tandem with the slowdown in mortgages. New mortgages approved declined on a year-on-year basis for 21 months in a row, the longest such stretch on record. Notwithstanding the weakness in

[10] Attainable housing 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 30 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 a purchase with up to 80 percent loan-to-value. Actual housing prices are the median value of dwellings in June of each year.

credit demand and declining house prices, aggregate financial stability indicators have not deteriorated. Banks remain well-capitalized and liquid, and their profitability is close to historical norms (Table 5 and Figure 7). Asset quality is also robust: the non-performing loan (NPL) ratio remains low at 0.5 percent as of May 2023. The RBNZ continues to phase in higher capital requirements. As planned, the additional capital buffer for domestic systemically important banks (D-SIBs) came into effect in July 2022, raising their minimum capital requirements to 10 percent. All commercial banks in New Zealand exceed this threshold.

Growth in Credit Outstanding Slowing Since November 2021, Driven by Slowdown Mortgages

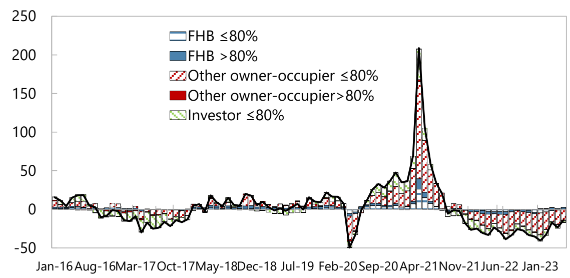
(Credit growth, year-on-year percent change)



Source: RBNZ.

Decline in New Residential Mortgages Continued

(Percent y/y, contribution by borrower type and LVR 1/)



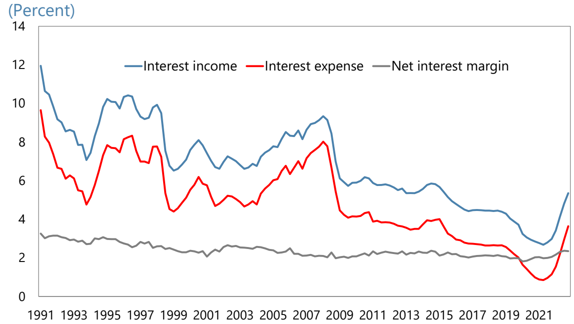
Sources: RBNZ; and IMF staff calculations.

1/ FHB: First-home buyer. LVR: Loan-to-value ratio.

24. The financial system has thus far not shown signs of stress due to banking sector issues overseas. New Zealand banks and customers report very small exposures to US banks at the center of recent volatility in the sector, and funding appears unaffected. That said, higher demand for credit in light of rebuilding following the weather events would likely require greater recourse to the wholesale markets. Disruptions in these markets could impact financial intermediation and credit creation, impacting growth. The structure of bank capital in New Zealand has been a source of stability: Tier-1 capital is almost entirely composed of common equity with additional Tier-1 instruments playing a small role (Figure 7). The November 2022 stress test exercise on the banking system conducted by the RBNZ showed while loan impairments would rise significantly , the banking system would be able to meet regulatory capital minimums, though D-SIBs could face difficulties in meeting their higher capital requirements.[11] Banks also appear to be insulated against interest rate risks as balance sheets are largely composed of

Commercial Banks: Interest Income,[1] Expense[2] and Net Interest Margin

(Percent)



[1]As a percent of interest-bearing assets

[2]As a percent of interest-bearing liabilities

Source: Reserve Bank of New Zealand.

[11] The stress test considered the impact of a stagflation scenario that combined an economic downturn, sharp corrections in asset prices, high interest rates due to lingering inflation and a 1-in-25-year cyber event.

variable rate instruments, and there is active use of hedging instruments to address the remaining risks.[12]

25. Slowing credit growth and falling house prices suggest a tightening of macroprudential restrictions is not called for at this time. As mortgage rates reset, the RBNZ expects to see an uptick in loan delinquencies but thus far, strong labor market conditions and the still-significant levels of housing equity among the majority of borrowers has kept arrears low. New Zealand banks' conservative credit policies, coupled with high capital levels suggests non-performing loans would remain manageable even if they rise as expected. Notwithstanding these supportive factors, the RBNZ complies and publishes data on leverage—both relative to income and collateral values—to track potential areas of risk. Falling house prices and the decline in new mortgage approvals allowed the central bank to ease existing loan-to-value (LVR) restrictions in May 2023. The easing represents an appropriate countercyclical application of measures. Nevertheless, even with this change, the restrictions remain tighter than their pre-pandemic settings. The RBNZ also appropriately expanded its macroprudential toolkit to add debt-to-income restrictions (DTIs) in 2023 and is consulting before taking a decision on when and at what level they might be introduced, likely in 2024. Financial sector policies are instead focused on addressing medium- to long-term issues, including enacting and implementing the new Deposit Takers Act (DTA),[13] which, among other features, would provide deposit insurance for up to NZ$100,000 per account, per institution once fully implemented by 2024.[14]

26. New Zealand continues to strengthen its AML/CFT framework. New Zealand's 2nd Enhanced Follow-Up Report in May 2023 did not request re-ratings of technical compliance with the FATF standard. It remains in enhanced follow-up and will report back to the FATF in June 2024. The authorities have made several legislative and operational changes to strengthen technical compliance and effectiveness, including measures to strengthen transparency of beneficial ownership information and AML/CFT supervision. New Zealand continues to express concern about the issue of loss of correspondent banking relationships (CBRs) among the Pacific Island Countries (PICs). After examining options to set up safe payment corridors, the RBNZ has ceased most work in this area, noting that a collaborative international approach is needed to address the issue. The authorities emphasized New Zealand's commitment to supporting such an effort.

Authorities' Views

27. The authorities noted that while housing prices have fallen recently there remain fundamental supply and affordability challenges. House prices have fallen in part due to higher interest rates, but this only partially reverses the very large increases of recent years. Affordability remains a significant concern, especially accessing affordable rental housing, particularly for those on low incomes. A comprehensive approach to address the demand for and supply of housing is

[12] Reported in the RBNZ's May 2023 Financial Stability Report.

[13] See also Annex VII of the staff report for the 2022 Article IV consultation.

[14] The NZ$ 100,000 deposit insurance limit is estimated to fully protect 93 percent of depositors in New Zealand.

underway, including reform of the RMA and actions laid out in the National Policy Statement on Urban Development. The authorities emphasized their commitment to invest in social housing, including via greater allocation under Budget 2023.

28. The authorities concurred that the financial system remains stable. Banks' strong capital and liquidity positions have helped insulate the system from external shocks, while the strong labor market conditions have kept credit defaults low. The RBNZ intends to closely monitor the system in light of slowing growth, the rapid tightening of financial conditions and elevated uncertainty in international financial markets. Although retail interest rates have surpassed rates that 2020 and 2021 borrowers were stress tested for, mortgage arrears are still lower than pre-COVID levels and risk of widespread default is considered low. Having added DTI to the macroprudential toolkit, the RBNZ is working on establishing the appropriate long-run setting for the new instrument alongside LVR restrictions. With the enactment of the DTA in July 2023, the authorities have started preparing for the implementation of the new regulatory regime for deposit takers, and the depositor compensation scheme.

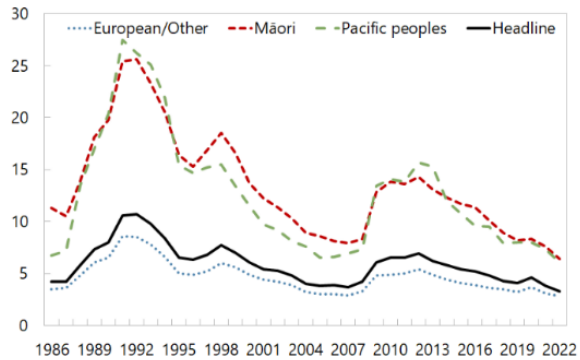
D. Fixing Today's Problems and Planning for the Long Term

29. Tackling inequality and addressing labor market integration should remain a priority. Inequality in New Zealand exceeds the OECD median, underscoring uneven access to education and disparate incomes across ethnic groups and genders. Māori and Pacific peoples are particularly vulnerable, with unemployment rates persistently higher than the national average. Lower employment contributes to income inequality: household disposable income data shows that Māori and the Pacific peoples earn markedly below the national mean and median disposable income, while quintile household income data shows their concentration in the lowest and second lowest quintile. Household income gaps also exist across genders in New Zealand, with women concentrated in the lower income quintiles. As the minimum wage has become more binding over time, resulting in potential spillovers to the rest of the wage distribution, it does not appear to conclusively reduce pay inequities across ethnicities.[15] In addition, the pass-through of the minimum wage to men is higher than women, despite women earning less than men across all professions, about 88 cents for each dollar that men earn.

30. The return of migrants can help alleviate labor supply. Border closures during the pandemic resulted in the loss of migrant labor, which play a key role in New Zealand's workforce. While net migration picked up in recent months, it will take time to catch up, particularly in light of global shortage of skill migrants and competition amongst countries to acquire them. Furthermore, although a rapid influx of immigrants will increase labor supply, it will also add to demand pressures in the short term, particularly in the housing and rental markets. Overall, however, the effect of migration on net demand is not immediately clear.

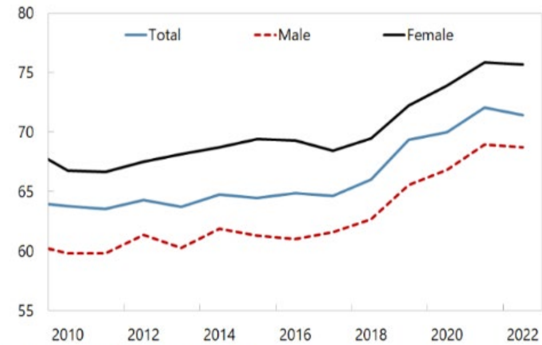
[15] See Selected Issues Chapter 2.

Unemployment by Ethnicity
(Percent, S.A.)



Sources: New Zealand Ministry of Social Development, Stats NZ.

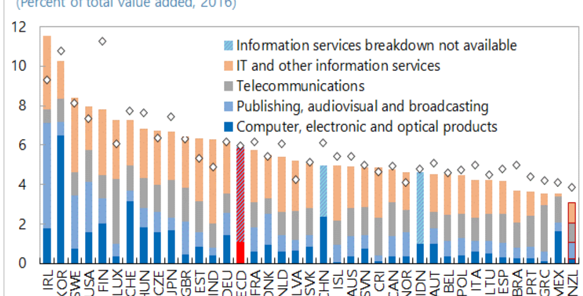
The Minimum Wage Has Become More Binding
(Minimum wage as share of hourly median earnings, percent)



Sources: Stats NZ, IMF staff estimates.
Note: Data is deflated to 2011 CPI.

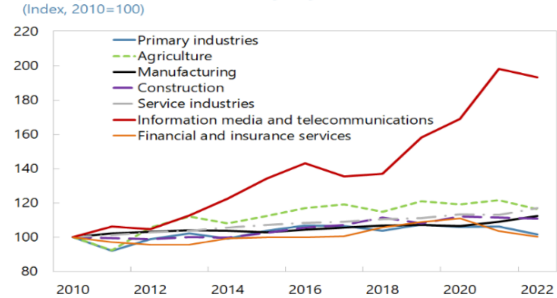
31. Enabling the transfer of digital technologies among sectors can improve productivity and reduce inequality. New Zealand has the smallest ICT sector among OECD countries, despite having the highest labor productivity growth compared to other sectors.[16] As a result, there is limited use of advanced technologies among firms in other sectors, holding back the traditionally positive productivity spillover effects from ICT to other industries (Han et al., 2011). Boosting the development of the ICT sector requires tackling the chronic shortage of ICT skills, as well as increasing investment in digital innovation above current moderate levels. The 2022 *Digital Strategy for New Zealand* serves as a roadmap of a new digital plan with 11 initiatives ranging from cyber security, improving rural connectivity, and the earlier, digital technologies industry transformation plan.[17] The initiative seeks to improve digital inclusion for disadvantaged groups[18] through providing digital skills training, reducing costs of digital infrastructure, and ensuring their access to non-digital government services is vital to reduce inequality.

ICT Industries Share of Value Added
(Percent of total value added, 2016)



Sources: OECD.

Hourly Labour Productivity, by Sector
(Index, 2010=100)



Sources: Stats NZ., IMF staff estimates.

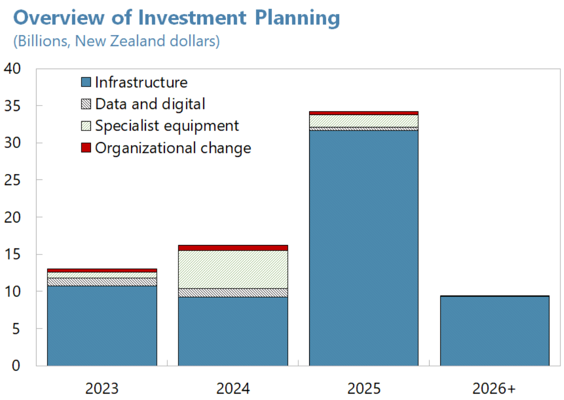
32. Boosting resilience to natural disasters and closing infrastructure gaps requires further investment in physical capital and efficient resource management. New Zealand's historical

[16] Boosting productivity in New Zealand by unleashing digitalization (OECD 2022).

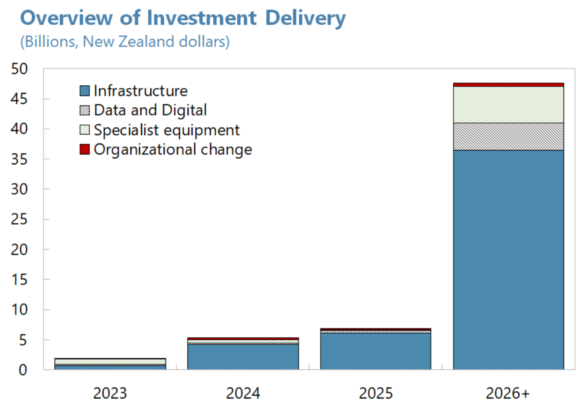
[17] See the Action Plan for the Digital Strategy for Aotearoa initiative announced in September 2022.

[18] Digital Inclusion User Insights- Pacific Peoples.

infrastructure deficits[19] and exposure to natural disaster shocks necessitate further spending on infrastructure investment. The planned infrastructure spending post Cyclone Gabrielle is thus necessary but should prioritize improving resilience and adaptation to climate shocks, especially as it is significantly backloaded.[20] Efficient spending should be prioritized and further allocated towards the construction sector, to boost its resilience and increase its capacity and help close the infrastructure gaps. Improved planning and sequencing, alongside a clear and well-communicated pipeline of investments, will be needed to overcome supply bottlenecks and ensure a timelier implementation of projects, while labor policies should prioritize alleviating labor shortages.



Sources: New Zealand Treasury.



Sources: New Zealand Treasury.

33. Economic activity and greenhouse gas (GHG) emissions continue to decouple but the rapid decline in the emissions price is a cause for concern.[21] GHG emissions remain below 2019 levels even as the economy recovered strongly. As a result, the gap between the projected path for emissions and targets narrowed, with the 2050 target now expected to be fully met even under the ambitious reductions target for biogenic methane.[22] The emissions price peaked in mid-November 2022 but declined sharply by around 36 percent in June. As a result, the Emissions Trading Scheme (ETS) auction did not clear for the first time in March 2023, which was repeated in the June auction. Uncertainty about the government's commitment to climate goals, particularly given the impact of higher emissions prices on inflation, and concerns about an oversupply of units, including those generated from afforestation were cited as key factors underpinning this correction. These price

[19] Infrastructure gaps are estimated to be around NZ$104 billion (Sense Partners, 2021).

[20] The authorities have continued to strengthen transparency around public procurement and recently published data recorded in their tender portal, making this information easily accessible and widely available. Work to design and develop a digital data platform that will capture procurement information from government agencies and join up various data sources in alignment with the Open Data Contracting Standard is ongoing. While a central register showing beneficial ownership is not yet available, the Government Procurement Rules include instructions to agencies to conduct adequate due diligence before awarding contracts.

[21] See Selected Issues, Chapter 1.

[22] New Zealand's Nationally Defined Contribution (NDC) under COP 26 is a 50 percent reduction of net GHG emissions relative to 2005 gross emissions (or around 30 MtCO2e) by 2030 and net zero for all GHG emissions except biogenic methane by 2050. Separately, under domestic legislation, New Zealand aims to reduce biogenic methane emissions by 10 percent by 2030, and by 24-47 percent by 2050, all relative to the 2017 level.

developments are a concern: without a sustained increase, the ETS will not be able to incentivize the behavioral shifts to achieve emissions goals. Further, as auction proceeds are intended to be channeled into the Climate Emergency Response Fund (CERF), underperformance in future auctions raises the fiscal burden of financing public investment to support climate goals. In response, the authorities launched a review of the ETS in June to strengthen the mechanism and have asked for public feedback on a number of options aimed at increasing demand for, and lowering the supply of, credits to spur higher prices. The consultations will close in August and final proposals and decisions are expected soon after.

34. The government released several high-profile climate policy announcements in 2022. In June, the first Emissions Reduction Plan (ERP) was published, alongside the first 3 emissions budgets covering 2022-35. The ERP outlines cross-cutting and sector-specific measures to lower emissions and meet New Zealand's climate commitments. The National Adaptation Plan—released in August—discusses the principles underpinning the adaptation strategy. In December, the authorities' proposal for pricing agriculture emissions was released. It envisages pricing biogenic methane and nitrous oxide separately at the farm level, and recycling levies to support mitigation efforts. The proposals' full impact will depend on how quickly prices rise to a level consistent with agriculture emissions targets. The policy documents provide a useful high-level overview of climate targets and strategies and should be fleshed out in as much detail as possible. In particular, there is an urgent need to set out metrics that allow for the transparent monitoring of progress and estimation of costs of proposed measures to help prioritize investments. To address the cost-of-living crisis, the authorities largely reduced incentives for the purchase of zero emissions vehicles, temporarily cut the fuel excise and road user charges, delayed a biofuels mandate and introduced discounted fares on public transit in 2022. The fuel excise cuts could have increased emissions significantly if maintained but were appropriately allowed to expire from July 2023.

35. Mitigation policies, with ETS as the centerpiece, can deliver the emissions reduction targets, and the key is to ensure their proper design and implementation. Using an average price of NZ$75 per NZ unit, the ETS is envisaged to contribute around a third of the emissions reduction over 2022-25. A more ambitious price scenario could close the gap between New Zealand's targets and projected emissions even more quickly. There are, however, several areas where the price-based framework can be further strengthened including pricing agriculture emissions and ensuring the ETS supports efforts to lower gross emissions. These will need to be complemented by a green public investment to spur mitigation and adaptation efforts, cross-sectoral policies and sector-specific measures, which will also play an important role in supporting the transition to a low-emissions and climate-resilient economy.

Authorities' Views

36. The authorities agreed on the importance of structural policy reform. On infrastructure investment they stressed the need for project prioritization through a pipeline to alleviate capacity shortages, better pricing and procurement, and continued maintenance of current assets. The authorities were confident the recently launched Digital Technologies Industry Transformation Plan would help grow the digital workforce, address labor shortages and skills mismatches, and increase under-represented group participation, including Māori, Pacific Peoples, women, and disabled people. They noted the need for the government to foster collaboration between the digital sector, government, and the education system, to improve digital skills and participation in the sector. The authorities agreed that the consecutive minimum wage increases have led to the minimum wage increasing as a proportion of the median wage wages but noted that any potential effect on employment has been counteracted by tight labor market conditions, especially since 2020. They highlighted that the first set of agreements under the Fair Pay Agreement Act would be negotiated over the coming years.

37. The authorities reiterated New Zealand's commitment to climate targets and adaptation. They noted that the emissions budgets for 2022-35 will be key in ensuring New Zealand will meet its climate targets and that the ETS and other policies will be adjusted with this in mind. In their view, the ETS auction mechanism is currently functioning as designed, ensuring that credits are not sold at too low a price, which would be damaging to the integrity of the framework in the long run. Their view is that the ETS needs to be reviewed in order for it to continue to drive gross emission reductions and a transition to a low carbon economy. On pricing agriculture emissions, the authorities noted that domestic legislation specifies that the sector would default into the ETS in 2025 if no agreement is reached. They remain committed to pricing agricultural greenhouse gas emissions starting with standardized, mandatory reporting in the near term. On ensuring rebuilding after the floods is consistent with adaptation goals, work to identify options together with regional councils is underway. Preliminary estimates suggest there are around 700 homes (provisionally) where rebuilding is not advisable.

STAFF APPRAISAL

38. New Zealand's economy is in the midst of a necessary, policy-induced slowdown. The economy is likely to continue slowing as the bulk of the impact of monetary policy tightening will be felt in 2023 and 2024. This is despite some short-term boost from higher spending to address the North Island weather events and funding to meet central government cost pressures. Inflation is likely to decline gradually to the 1–3 percent target range only in 2025 given the pick-up in non-tradeable inflation. The current account deficit is high and New Zealand's external position in 2022 was weaker than implied by medium-term fundamentals and desirable policies. But it is partly the outcome of the post-pandemic boost in goods imports and foregone education and tourism exports due to the closed borders. The expected slowdown, economic rebalancing and the recovery in services exports should ease pressures on the current account deficit, but careful monitoring is warranted.

39. Careful calibration of policies is needed. Given the pressing capacity constraints and high and persistent inflation, the monetary and fiscal policy mix must strike a restrictive bias to rebalance the economy—internally and externally—and rely on automatic stabilizers to address the impact of slower growth. Over the longer term, fiscal policy will need to maintain an appropriate balance to address long-term structural needs such as preparing for the costs related to aging, closing productivity gaps, and investing in climate change-related priorities. To that end, there is a need to revisit the design of revenue measures via tax reforms that will best serve New Zealand's long-term prospects.

40. Fiscal policy should prioritize reconstruction efforts post weather events without unduly adding to demand. While the announced spending in Budget 2023 toward weather events is necessary, the fiscal stance must be further calibrated to current economic conditions limiting discretionary spending to reduce inflation pressures. Careful budget execution via reprioritization of expenditure, such as the planned reduction in personnel expenses, and identification of cost savings, is needed to limit the fiscal impulse in FY2023/24. Measures intended to defray the higher cost of living (such as reduced transport fares) should be better targeted toward supporting vulnerable households using means testing where possible. The planned fiscal consolidation over the medium term should be preserved and frontloaded to reduce demand pressures.

41. The rapid tightening of monetary policy is starting to cool the economy and lower inflation. However, as the output gap is projected to remain positive into 2024, there is little scope to lower the OCR at this juncture. Should new data confirm that inflation is now on a durable downward path to the target, a pause in the tightening cycle could be warranted. On the other hand, a reignition of demand, including due to insufficient fiscal consolidation, and a stalling of inflation above target would call for further tightening of monetary policy, and there is a need for greater recognition of the fiscal-monetary policy interaction.

42. Financial stresses from the monetary tightening should be addressed through financial stability tools. While financial stability indicators show few signs of stress, the rapid rise in interest rates could adversely impact household and financial balance sheets, and should be monitored closely. With slowing credit growth and falling house prices, additional macroprudential measures are not called for at this time. The recent addition of DTI restrictions to the macroprudential toolkit is appropriate and will give the central bank more instruments to address future financial stability risks. The RBNZ should stand ready to provide liquidity if funding markets come under stress, including from spillovers from global financial markets.

43. Housing affordability remains a concern, and efforts to expand supply should continue. The rapid correction in prices to-date reflects in part the rapid run up, among the fastest globally, but also tighter monetary policy, the use of macroprudential measures and steps taken to increase supply, particularly in Auckland. However, the cyclical downturn in prices does not imply that the structural housing shortage has been addressed. There is a strong need to expand housing supply, including for social housing to improve affordability. To that end, the recent increase in new housing is welcome and policy reforms to enable greater supply should continue. Achieving long-term affordability depends critically on freeing up land supply, improving planning and zoning, and fostering infrastructure investment to enable fast-track housing developments and reduce construction costs and delays.

44. The decoupling of greenhouse gas emissions and economic growth continued, narrowing the gap between projected emissions and targets. However, the sharp decline in the emissions price could put the emissions targets and financing for needed investment at risk and should be addressed urgently. The Emissions Reduction Plan and National Adaptation Plan provide a useful high-level view of climate goals and targets and should be complemented with more detail on targets and costs to enable the prioritization of policies. The decision to allow the cuts in fuel duties and excise to expire from July 2023 is welcome as they were costly and would have resulted in higher demand for fossil fuels, leaving emissions higher than in the baseline if made permanent.

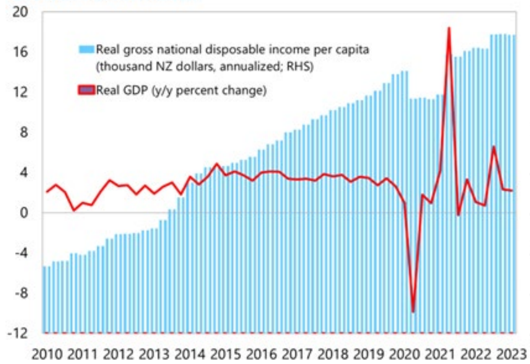
45. Efforts to enhance and improve public investment should continue, and structural policies should promote durable growth. Long-term challenges from large infrastructure deficits, climate change and ageing demographics underscore the need for further public investment. Delivering high value infrastructure – including transport and housing - while strengthening resilience against natural disasters should remain a priority. Tax reforms to broaden the tax base to other more progressive sources, such as capital gains and land taxes, can hep align tax collection with long-term economic priorities. Boosting digitalization and the development of the information and communications technology sector can improve productivity.

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

Figure 1. Rapid Recovery After the Pandemic

Notwithstanding the recent slowdown, real GDP growth has bounced back after the pandemic…

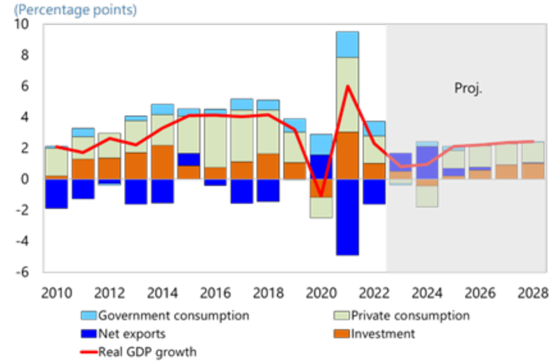
Growth Performance



…with strong demand from all segments – government, private consumption, and investment.

Contribution to Growth

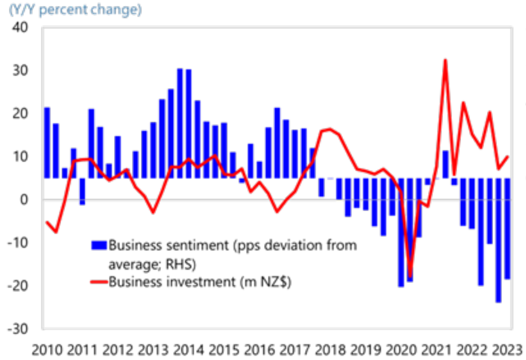
(Percentage points)



Business sentiment is weak, though business investment has held up so far…

Business Sentiment and Investment

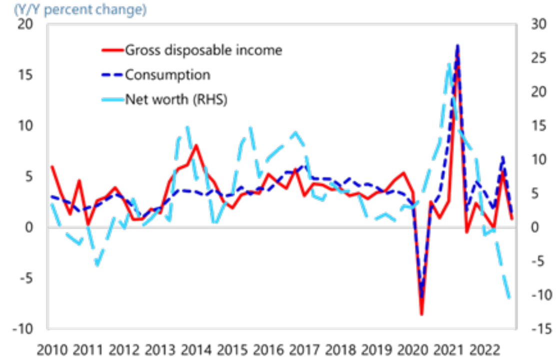
(Y/Y percent change)



…as has household consumption, though net wealth has declined significantly given correction in housing.

Real Household Consumption, Income, and Wealth

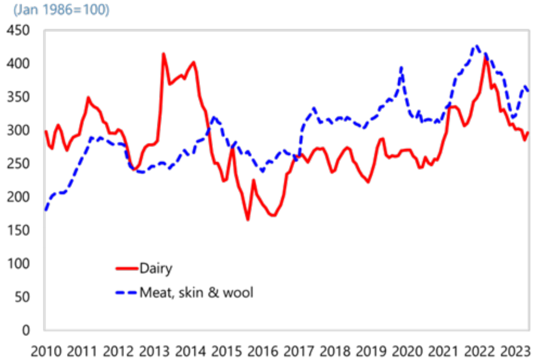
(Y/Y percent change)



Resource pressures are however extreme with historically tight labor markets…

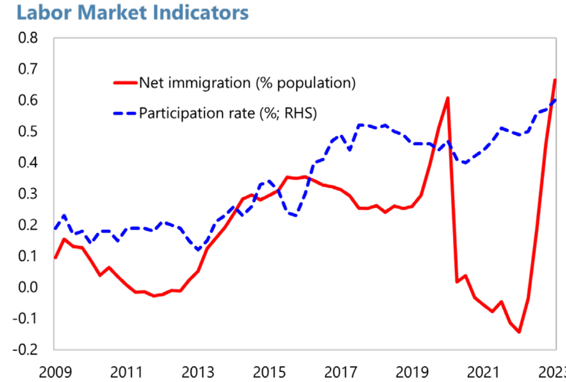
Export Commodity Price Indices

(Jan 1986=100)



…that will take time to correct despite the recent pickup in immigration as borders reopen.

Labor Market Indicators



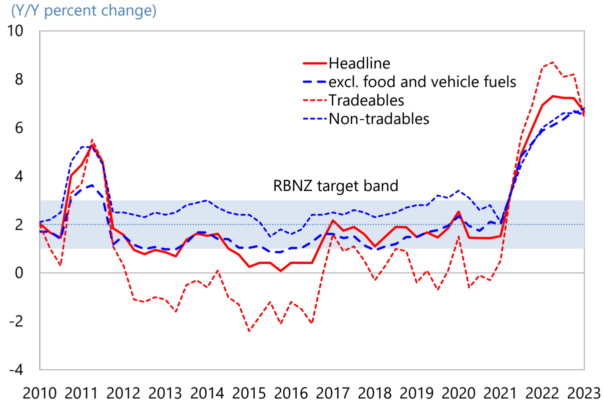
Sources: Stats NZ; Haver Analytics; and IMF staff calculations.

Figure 2. Monetary Conditions Have Tightened Significantly

Headline inflation has risen rapidly, well above the target band…

CPI Inflation

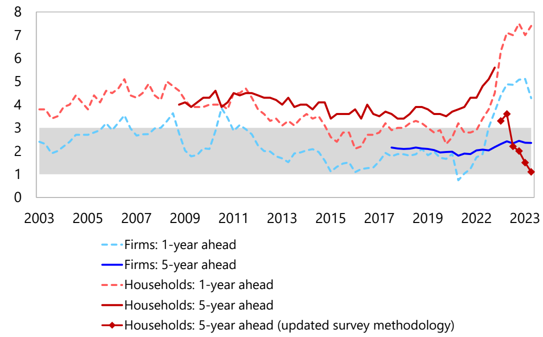
(Y/Y percent change)



…but short-term inflation expectations may be peaking and long-term ones are in check.

Inflation Expectations from RBNZ Surveys of Expectations

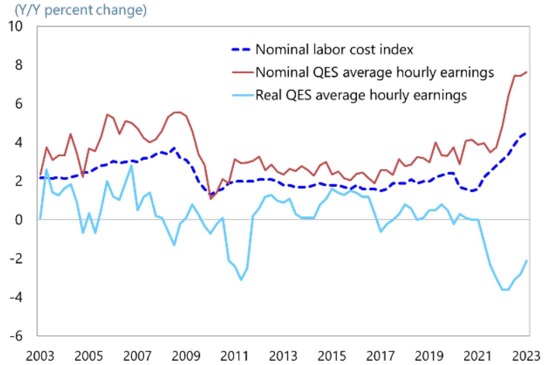
(Y/Y percent change, sample means)



Hourly earnings rebounded recently…

Private Sector Wage Growth

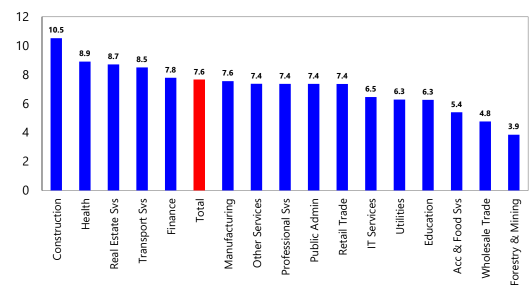
(Y/Y percent change)



…with strong increase particularly in services and construction.

Wage Growth by Sectors

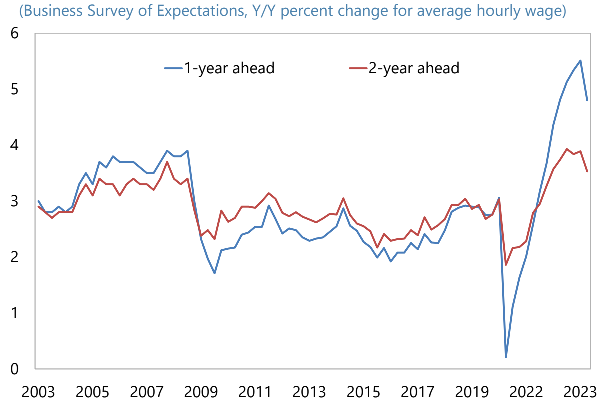
(Average Hourly Earnings in 2023Q1, Y/Y percent change)



While slowing, wage growth expectations remain high.

Wage Growth Expectations

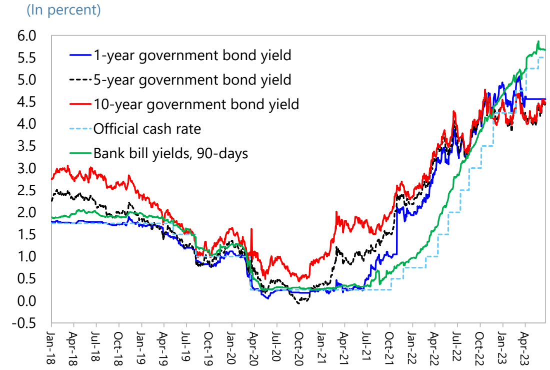
(Business Survey of Expectations, Y/Y percent change for average hourly wage)



Short-term rates rising alongside OCR, but longer-term rates stabilized at lower levels.

Interest Rates

(In percent)

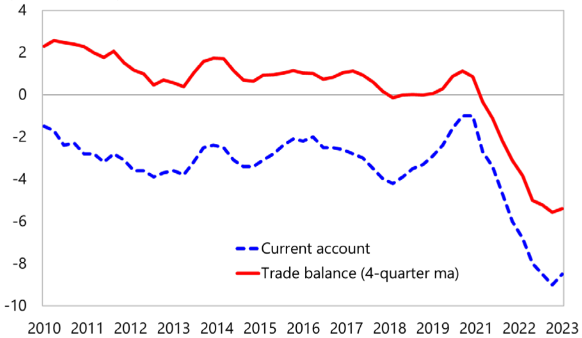


Sources: RBNZ; Haver Analytics; and IMF staff calculations.

Figure 3. The Current Account Deficit Increased Sharply

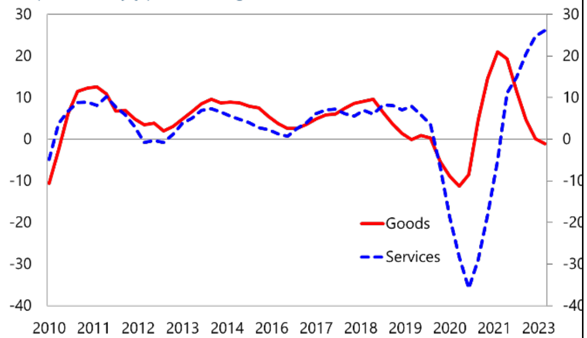
The current account and trade balance has deteriorated, reflecting higher international prices and overheating…

Current Account
(Percent of GDP)



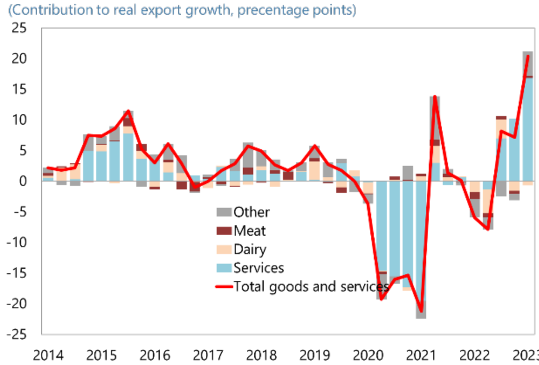
…with a surge in import volumes, particularly services, adding to the pressures.

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



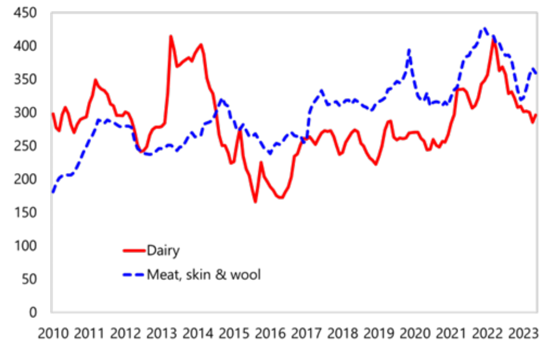
Notwithstanding the recent pickup, services exports (tourism and education) have driven the weakness in overall exports.

Export Composition
(Contribution to real export growth, precentage points)



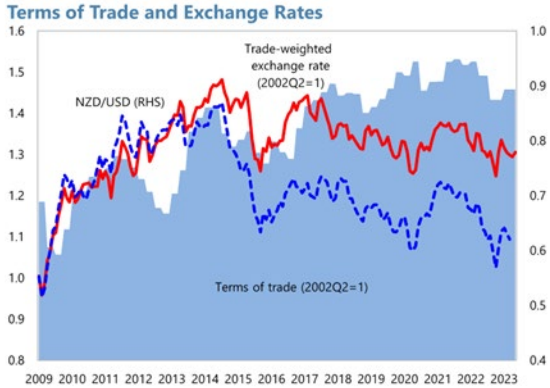
Key export prices were supportive during much of 2022 but have now started weakening.

Export Commodity Price Indices
(Jan 1986=100)



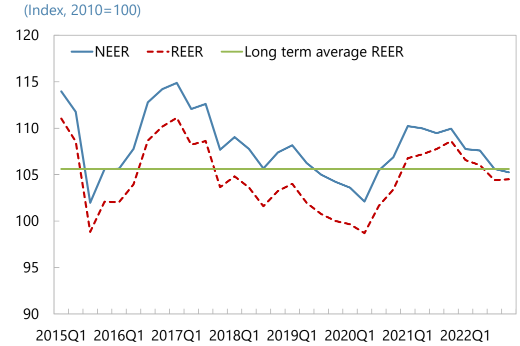
Terms of trade and bilateral exchange rates remain stable but volatile, reflective of international environment…

Terms of Trade and Exchange Rates



…while the REER and NEER have shown more stability and remain close to their long-term average.

New Zealand Exchange Rates
(Index, 2010=100)

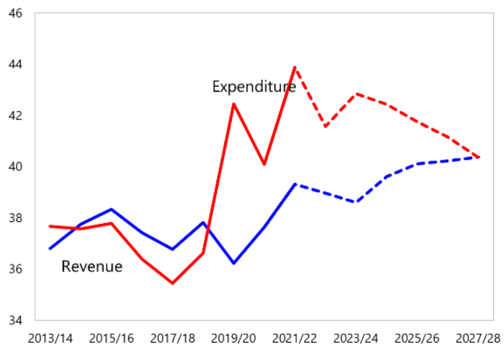


Sources: RBNZ; Haver Analytics; World Travel & Tourism Council; and IMF staff calculations.

Figure 4. The Fiscal Position Remains Resilient

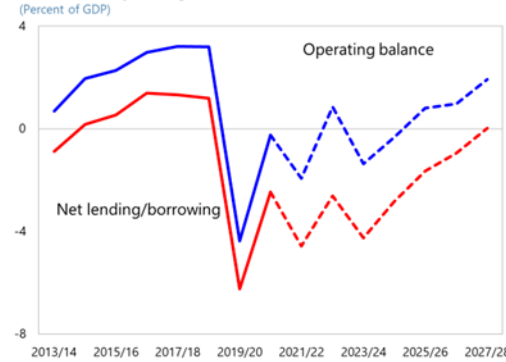
Expenditure is projected to grow given post-Cyclone reconstruction needs…

General Government Revenue and Expenditure
(Percent of GDP)



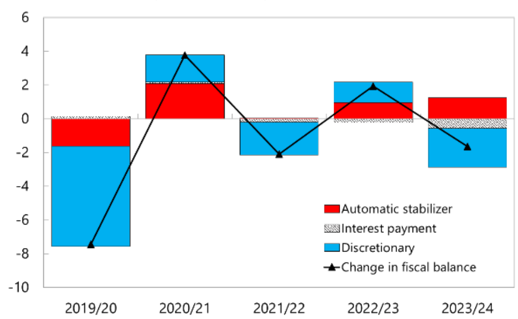
…leading to a slower pace of consolidation in the medium term.

Overall and Operating Balance
(Percent of GDP)



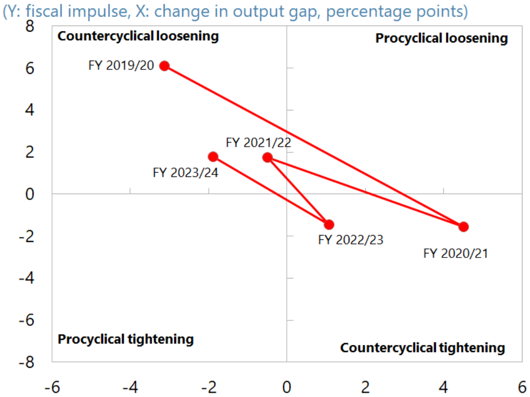
Discretionary flood-related support measures are expected to loosen fiscal policy…

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



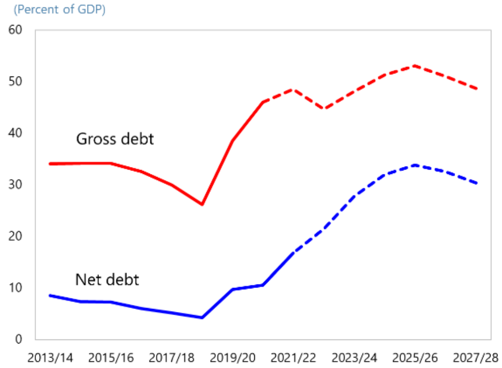
…leading to an expansionary stance in FY2023/24.

Discretionary Fiscal Policy and Cyclical Conditions
(Y: fiscal impulse, X: change in output gap, percentage points)



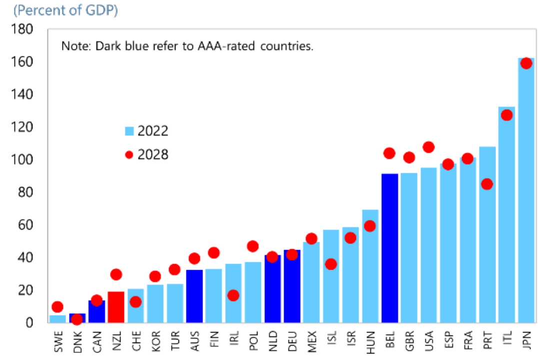
The government debt ratio is projected to stabilize after peaking in the medium term…

General Government Debt
(Percent of GDP)



….and is expected to remain low compared to other advanced economies.

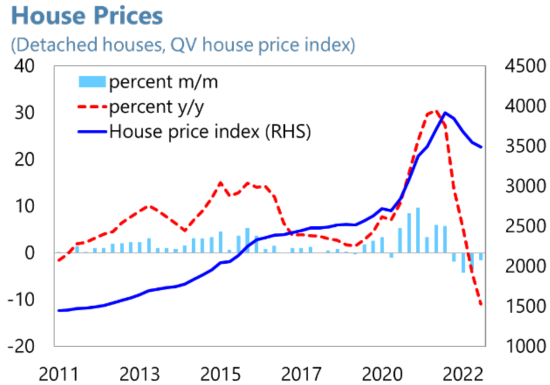
Net Public Debt
(Percent of GDP)



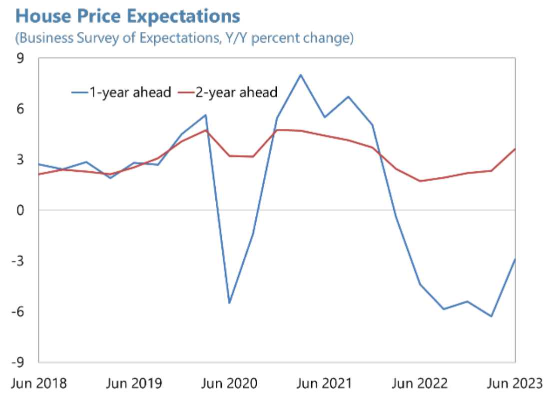
Sources: The Treasury New Zealand, *Budgets 2022* and *2023*; and IMF staff calculations.

Figure 5. The Housing Market Is Correcting

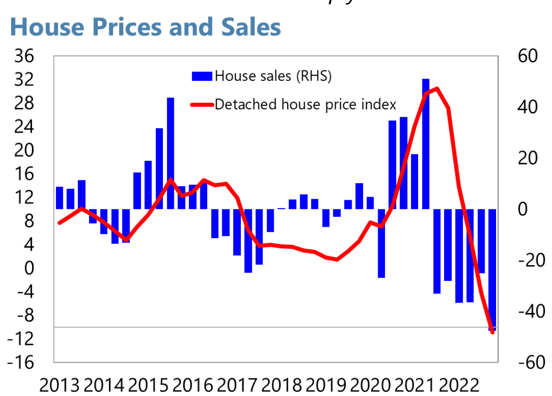
House price are correcting, but remain above pre-pandemic levels, and are showing signs of bottoming out...



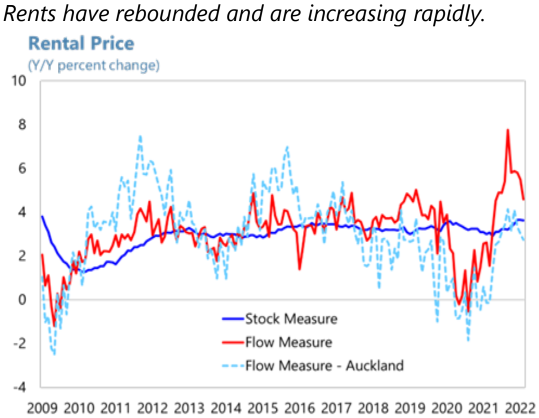
...sentiment seem to be bottoming out as well, with expectations of a modest price recovery in 2025.



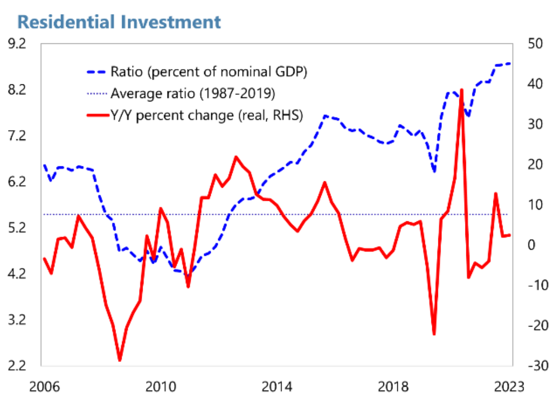
Sales volumes have declined sharply and remain low.



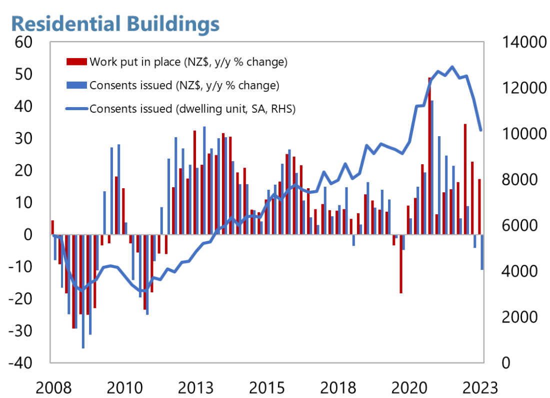
Rents have rebounded and are increasing rapidly.



Residential investment has been volatile...



...amid declining building consents.



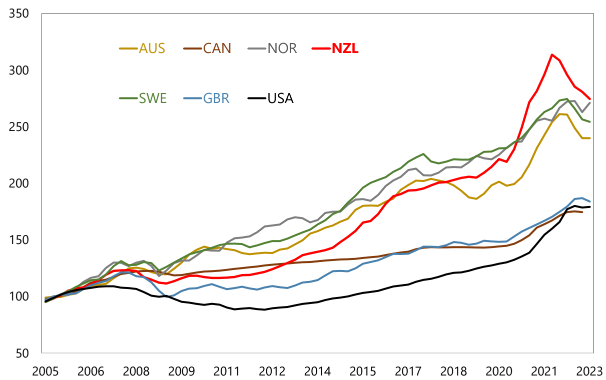
Sources: RBNZ; Haver Analytics; and IMF staff calculations.

Figure 6. Household Debt and Balance Sheet Risks Are Elevated

House prices have increased strongly by international comparison...

Real House Prices in Selected OECD Countries

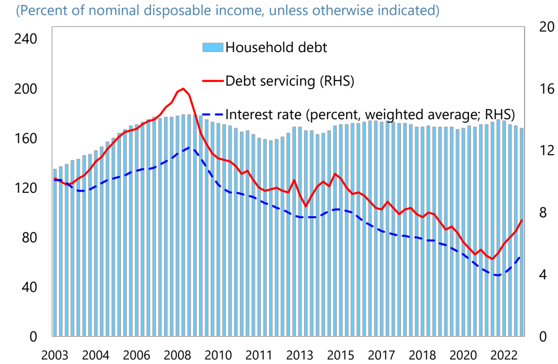
(House price index, 2005=100)



...with household debt remaining elevated as the debt servicing ratio has started rising.

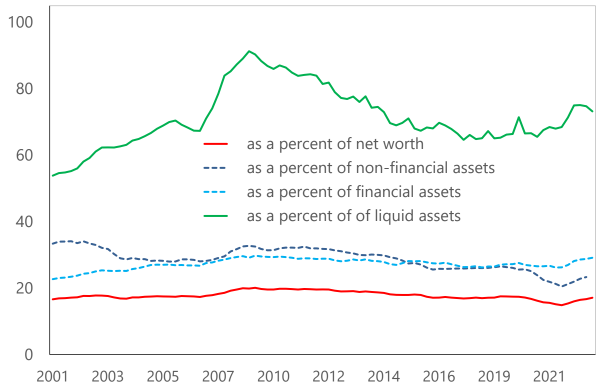
Household Debt and Debt Service

(Percent of nominal disposable income, unless otherwise indicated)



Household debt is rising relative to assets due to falling house prices and drawdown of savings.

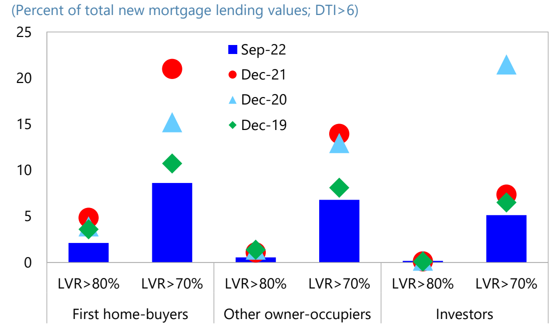
Household Debt



High debt-to-income loans now account for a smaller share of new loans among all borrowers.

Share of High DTI Loans

(Percent of total new mortgage lending values; DTI>6)

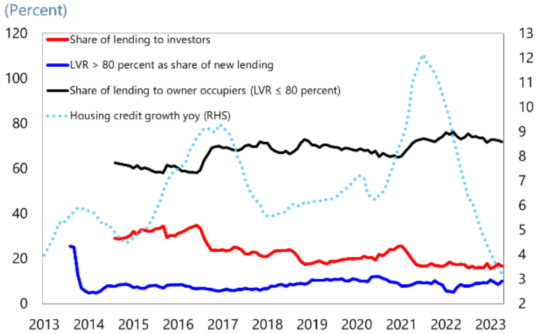


Sources: RBNZ, Stats NZ, and Haver Analytics.

High loan-to-value ratio continues to trend downward but is picking up again in the first-time homebuyer segment...

Mortgages Approvals by Borrower and Leverage, Housing Credit Outstanding

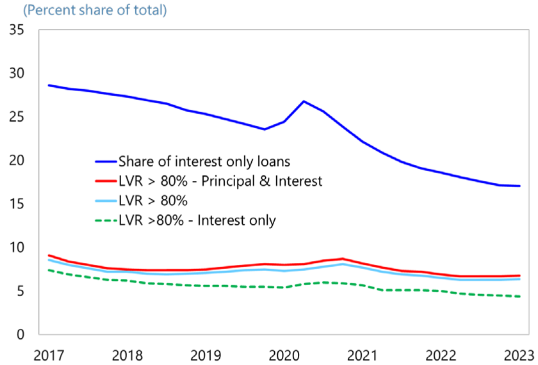
(Percent)



... while the share of outstanding interest-only loans stabilized below its pre-pandemic level.

Existing Residential Mortgage Lending

(Percent share of total)



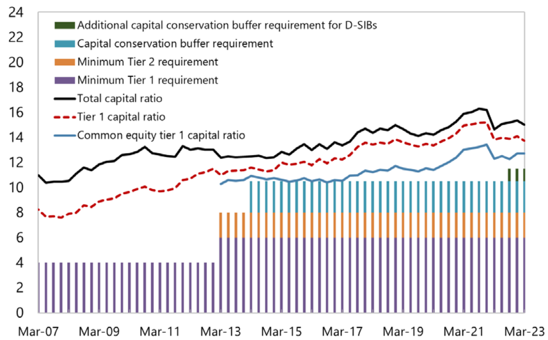
Sources: RBNZ; Stats NZ; Core Logic; and Haver Analytics.

Figure 7. Financial Stability Indicators Remain Strong

Even as new capital requirements are phased in, banks continue maintain capital in excess of the new requirements…

Capital Ratios of Registered Banks

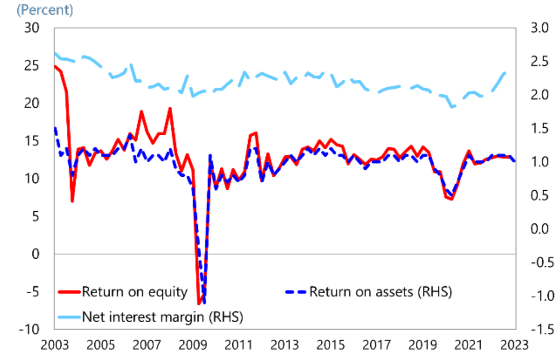
(Percent of risk-weighted assets)



…while profitability remains close to historical norms.

Profitability

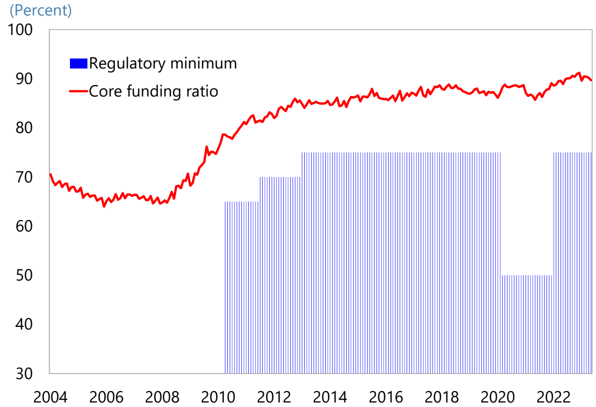
(Percent)



The core funding ratio is also well above the regulatory minimum.

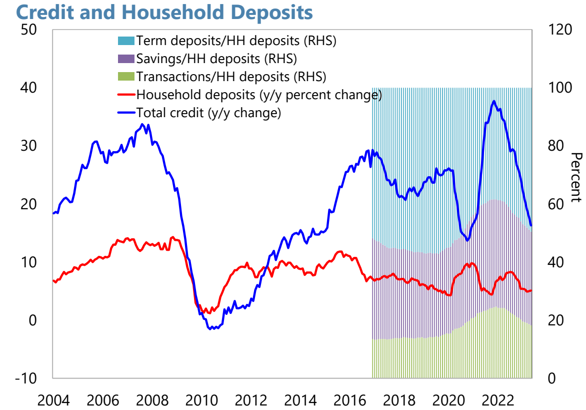
Core Funding Ratio

(Percent)



Household credit slowing while deposits shifting away from transaction balances.

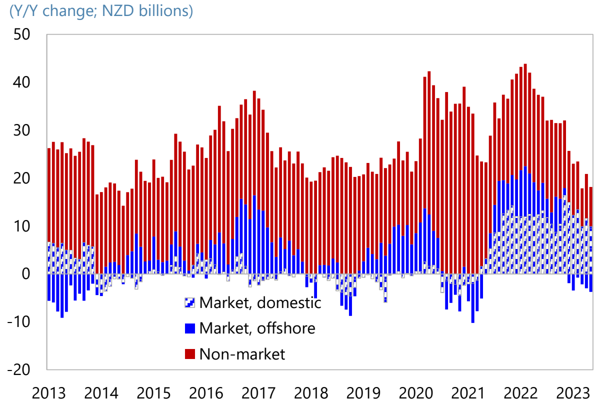
Credit and Household Deposits



Banks are tapping the domestic market to meet wholesale funding needs while net offshore funding has turned negative.

Total Funding

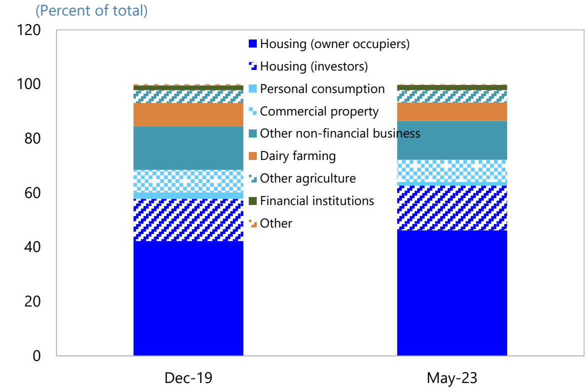
(Y/Y change; NZD billions)



Banks' exposure to the housing sector continues to increase.

Loans by Purpose

(Percent of total)



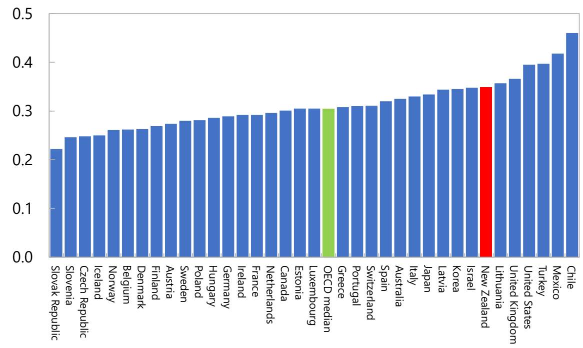
Source: RBNZ.

Figure 8. Tackling Inequality in New Zealand

Inequality has been a long-standing issue…

Gini Coefficient

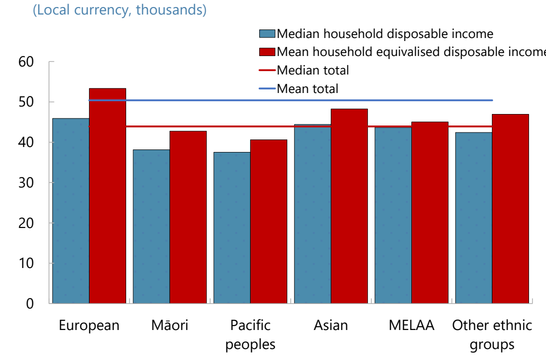
(Latest available data, 2017-2019)



…persistently facing ethnic groups in New Zealand…

Household Disposable Income, by Ethnicity

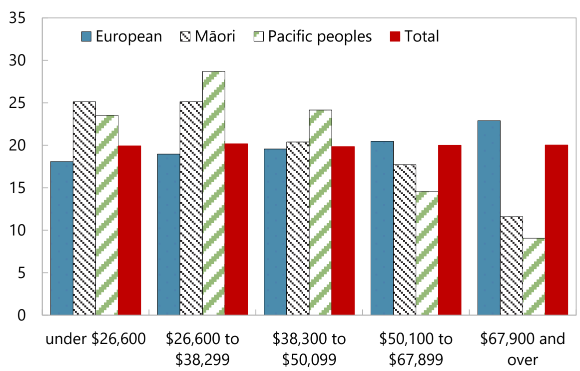
(Local currency, thousands)



…and exacerbating income inequality…

Household Disposable Income, Quintiles and Ethnicities

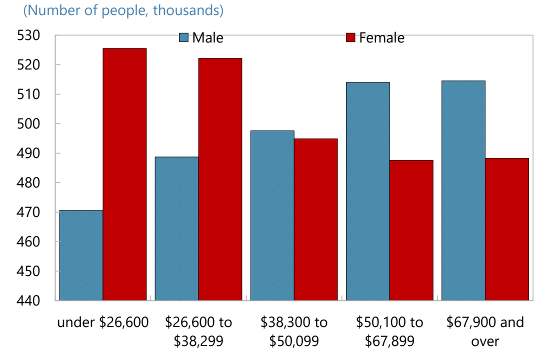
(Percent of total)



…across genders as well.

Household Disposable Income, Quintiles and Gender

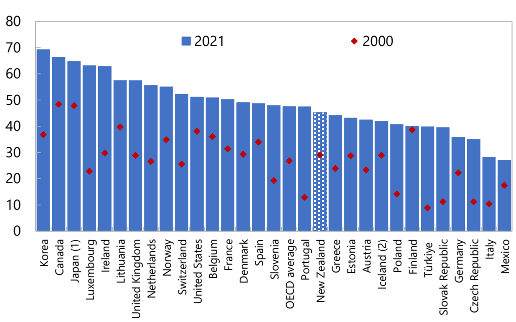
(Number of people, thousands)



Tertiary education levels have increased…

Trends in the Share of Tertiary Educated 25-34 Years Old

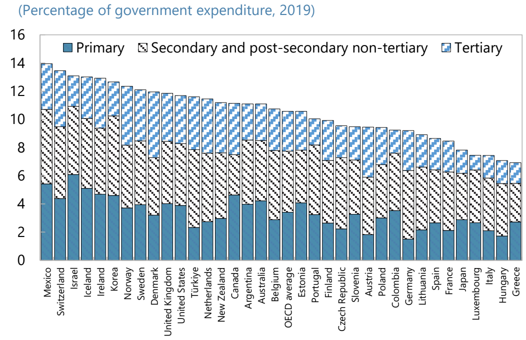
(Percent)



…as public expenditure towards education grows.

Total Expenditure on Education

(Percentage of government expenditure, 2019)



Sources: Stats NZ; OECD; and IMF staff calculations.

Table 1. New Zealand: Main Economic Indicators, 2019-28
(Annual percent change, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projections					
NATIONAL ACCOUNTS										
Real GDP (production)	3.1	-1.5	6.1	2.7	1.1	1.0	2.1	2.2	2.4	2.4
Domestic demand	3.1	-1.8	10.3	3.5	-0.3	-1.1	1.5	1.9	2.2	2.3
Private consumption	3.2	-2.2	7.9	2.9	-0.5	-2.2	1.9	2.3	2.3	2.2
Public consumption	4.7	7.2	8.2	4.5	-0.5	1.6	1.2	0.3	0.5	0.2
Investment	2.1	-7.8	18.4	3.7	-1.3	-0.8	0.8	2.3	3.6	3.9
Public	1.6	7.2	8.9	-0.4	3.6	0.7	2.2	4.1	4.4	4.6
Private	5.1	-8.1	13.8	5.2	1.0	-2.1	0.4	1.7	3.3	3.7
Private business	5.0	-10.3	16.5	7.2	1.9	-2.5	-0.3	1.5	3.4	3.5
Dwelling	5.3	-3.1	8.4	1.0	-1.1	-1.2	2.0	2.2	3.3	4.1
Inventories (contribution to growth, percent)	-0.5	-0.8	1.3	0.0	-0.8	0.2	0.0	0.0	0.0	0.0
Net exports (contribution to growth, percent)	0.0	1.6	-4.9	-1.6	1.2	2.1	0.5	0.2	0.0	0.0
Real gross domestic income	3.3	-0.8	5.2	1.4	-0.1	0.3	2.0	2.1	2.4	2.4
Investment (percent of GDP)	24.0	22.2	25.2	26.6	26.6	26.4	26.1	25.9	25.8	26.0
Public	5.3	5.7	5.9	6.0	6.2	6.3	6.3	6.4	6.4	6.5
Private	18.7	16.5	19.3	20.6	20.3	20.1	19.8	19.5	19.4	19.5
Savings (gross, percent of GDP)	21.1	21.2	19.2	17.5	18.7	19.7	20.3	20.7	21.1	22.1
Public	-2.5	-4.4	-3.5	-3.5	-3.4	-3.5	-2.2	-1.3	-0.4	0.0
Private	23.6	25.5	22.7	21.1	22.1	23.3	22.5	22.0	21.6	22.1
Potential output	3.1	1.6	1.5	1.9	2.1	2.3	2.4	2.5	2.5	2.4
Output gap (percent of potential)	0.9	-2.3	2.1	2.9	1.8	0.6	0.3	0.1	0.0	0.0
LABOR MARKET										
Employment	1.3	1.3	2.2	1.7	1.4	0.6	1.6	1.4	1.4	1.5
Unemployment (percent of labor force, ann. average)	4.1	4.6	3.8	3.3	3.8	5.0	4.6	4.5	4.5	4.4
Wages (nominal percent change)	3.4	3.8	3.8	6.5	6.7	4.2	3.8	3.6	3.4	2.6
PRICES										
Terms of trade index (goods and services, % change)	0.3	1.2	-1.1	-2.9	-4.7	-2.5	-0.7	-0.4	0.1	-0.3
Consumer prices (avg, % change)	1.6	1.7	3.9	7.2	4.9	2.6	2.5	2.3	2.1	2.0
GDP deflator (avg, % change)	2.4	2.2	2.9	5.5	5.8	0.9	2.5	3.3	3.0	2.2
MACRO-FINANCIAL										
Official cash rate (policy rate, percent, avg)	1.4	0.4	0.3	2.2	5.0	4.8	4.3	3.5	2.5	2.5
Credit to the private sector (percent change)	5.6	3.9	6.1	4.3	-0.8	0.1	2.9	3.5	4.0	4.3
Interest payments (percent of disposable income)	8.0	6.0	5.0	8.4	9.4	8.3	8.4	7.0	6.5	6.5
Household savings (percent of disposable income)	3.4	3.6	3.6	3.2	2.7	2.5	2.4	2.3	2.9	3.6
Household debt (percent of disposable income)	169	170	173	170	156	147	143	141	140	126
GENERAL GOVERNMENT (percent of GDP) 1/										
Revenue	37.8	36.2	37.7	39.3	39.0	38.6	39.6	40.1	40.2	40.4
Expenditure	36.6	42.5	40.1	43.9	41.6	42.9	42.4	41.8	41.2	40.4
Net lending/borrowing	1.2	-6.2	-2.5	-4.6	-2.6	-4.2	-2.8	-1.6	-0.9	0.0
Operating balance	3.2	-4.4	-0.2	-1.9	0.9	-1.4	-0.3	0.8	1.0	1.9
Cyclically adjusted primary balance 2/	2.3	-3.9	-2.3	-4.1	-2.6	-4.4	-2.2	-0.1	1.6	2.6
Gross debt	26.2	38.5	46.0	48.6	44.6	48.1	51.3	53.0	51.0	48.7
Net debt	4.3	9.7	10.6	16.7	21.5	27.8	32.0	33.9	32.6	30.3
Net worth	93.2	85.5	94.6	97.7	91.8	89.2	85.1	82.1	81.9	82.8
BALANCE OF PAYMENTS										
Current account (percent of GDP)	-2.9	-1.0	-6.0	-9.0	-7.8	-6.6	-5.8	-5.2	-4.7	-3.9
Export volume	2.6	-13.5	-2.4	0.3	7.4	9.0	7.7	4.3	5.1	4.7
Import volume	2.2	-15.8	14.8	5.4	1.5	0.2	4.6	3.0	4.2	3.8
Net international investment position (percent of GDP)	-53.7	-55.8	-46.4	-51.2	-53.1	-58.8	-62.0	-63.9	-65.3	-66.2
Gross official reserves (bn US$)	17.0	13.0	16.4	13.7	...	...	...	...	...	...
MEMORANDUM ITEMS										
Nominal GDP (bn NZ$)	320	323	352	380	406	413	432	457	482	504
Percent change	5.7	1.1	9.1	8.0	6.6	1.9	4.7	5.6	5.4	4.7
Nominal GDP per capita (US$)	42,275	41,292	48,775	47,198	48,827	48,409	49,631	51,545	53,605	55,789
Real gross national disposable income per capita (NZ$)	53,631	52,621	54,703	54,996	55,133	54,758	55,472	56,291	57,243	58,574
Percent change	2.8	-1.9	4.0	0.5	0.2	-0.7	1.3	1.5	1.7	2.3
Population (million)	5.0	5.1	5.1	5.1	5.2	5.2	5.3	5.3	5.4	5.4
US$/NZ$ (average level)	0.659	0.650	0.708	0.636	...	...	...	...	...	...
Nominal effective exchange rate	105.9	104.5	109.9	106.6	...	...	...	...	...	...
Real effective exchange rate	101.7	100.9	107.6	105.4	...	...	...	...	...	...

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

1/ Fiscal year.

2/ In percent of potential GDP.

Table 2. New Zealand: Fiscal Accounts, 2017/18-2027/28 1/

(In percent of GDP, unless otherwise indicated)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
						Projections					
GENERAL GOVERNMENT 2/											
Revenue	**36.8**	**37.8**	**36.2**	**37.7**	**39.3**	**39.0**	**38.6**	**39.6**	**40.1**	**40.2**	**40.4**
Tax revenue	30.6	31.7	30.5	32.6	34.3	34.0	34.1	34.8	34.9	35.0	35.2
Direct taxes	19.7	20.5	19.6	21.0	23.1	23.3	23.1	23.7	24.2	24.4	24.5
Individual and withholding	12.2	12.6	12.8	13.2	14.2	14.4	14.2	14.7	15.3	15.4	15.5
Corporate	5.5	6.0	4.8	5.8	6.8	6.8	6.8	6.8	6.7	6.8	6.8
Property	2.0	2.0	2.0	2.0	2.0	2.1	2.1	2.2	2.2	2.2	2.2
Indirect taxes	10.9	11.1	10.9	11.6	11.2	10.7	11.0	11.2	10.7	10.6	10.7
Of which: GST	7.4	7.4	7.3	7.9	7.6	7.5	7.7	7.6	7.7	7.6	7.7
Non-tax revenue	6.2	6.1	5.7	5.1	5.0	5.0	4.54	4.80	5.21	5.21	5.20
Expenditure	**35.5**	**36.6**	**42.5**	**40.11**	**43.9**	**41.6**	**42.9**	**42.4**	**41.8**	**41.2**	**40.4**
Expense	33.6	34.6	40.6	37.9	41.3	38.1	40.0	39.9	39.3	39.3	38.5
Employee expenses	8.3	8.6	9.1	9.0	9.1	8.9	9.4	9.2	8.9	9.0	8.9
Other operating expenses (excl. depreciation)	5.3	5.5	5.7	5.9	6.8	7.1	7.4	7.4	7.4	7.2	6.9
Social benefits	13.3	13.8	14.8	15.2	15.2	15.3	15.3	15.2	15.0	14.9	14.6
Other transfers	3.1	3.0	7.4	4.4	6.4	3.4	3.4	3.5	3.4	3.4	3.3
Interest	1.4	1.4	1.2	1.2	1.4	1.6	2.1	2.3	2.3	2.6	2.6
Other	2.2	2.3	2.4	2.3	2.3	1.8	2.3	2.3	2.3	2.3	2.3
Net acquisition of nonfinancial assets	1.9	2.0	1.9	2.2	2.6	3.5	2.9	2.5	2.5	1.9	1.9
Of which: Gross fixed capital formation	3.7	4.0	4.0	4.4	4.7	4.4	4.3	4.4	4.3	4.2	4.2
Operating balance	3.2	3.2	-4.4	-0.2	-1.9	0.9	-1.4	-0.3	0.8	1.0	1.9
Primary balance	1.9	1.8	-5.6	-1.8	-3.7	-1.5	-2.3	-0.6	0.4	1.4	2.4
Net lending (+)/borrowing (-)	**1.3**	**1.2**	**-6.2**	**-2.5**	**-4.6**	**-2.6**	**-4.2**	**-2.8**	**-1.6**	**-0.9**	**0.0**
GENERAL GOVERNMENT BALANCE SHEET 2/											
Liabilities	**57.4**	**57.6**	**73.4**	**76.5**	**77.0**	**70.2**	**73.3**	**75.2**	**76.7**	**73.5**	**70.1**
Gross debt	30.0	26.2	38.5	46.0	48.6	44.6	48.1	51.3	53.0	51.0	48.7
Other liabilities 3/	27.4	31.4	34.9	30.5	28.4	25.6	25.2	23.9	23.7	22.4	21.3
Assets	**148.7**	**150.8**	**158.9**	**171.1**	**174.7**	**162.0**	**162.5**	**160.3**	**158.8**	**155.3**	**152.9**
Financial assets	65.4	65.4	71.4	82.6	82.3	73.9	74.1	72.2	72.7	71.8	71.6
Debt relevant	24.8	22.0	28.9	35.4	31.8	23.2	20.4	19.3	19.2	18.4	18.4
Other	40.6	43.4	42.6	47.2	50.5	50.7	53.7	52.8	53.5	53.4	53.2
Nonfinancial assets	83.3	85.4	87.5	88.5	92.4	88.1	88.4	88.1	86.1	83.5	81.4
Net financial worth	**8.0**	**7.8**	**-2.0**	**6.1**	**5.3**	**3.7**	**0.8**	**-3.0**	**-4.0**	**-1.7**	**1.5**
Net debt 4/	**5.2**	**4.3**	**9.7**	**10.6**	**16.7**	**21.5**	**27.8**	**32.0**	**33.9**	**32.6**	**30.3**
Central government	1.9	0.8	5.7	6.8	13.0	17.3	23.1	26.7	28.1	26.5	23.8
Local government	3.3	3.5	4.0	3.8	3.7	4.1	4.7	5.3	5.7	6.1	6.5
Net worth	**91.4**	**93.2**	**85.5**	**94.6**	**97.7**	**91.8**	**89.2**	**85.1**	**82.1**	**81.9**	**82.8**
Central government	49.0	50.6	41.5	51.5	54.6	51.7	49.7	46.4	44.8	45.9	48.1
Local government	42.3	42.6	44.0	43.1	43.1	40.0	39.4	38.8	37.3	36.0	34.8
MEMORANDUM ITEMS											
Cyclically adjusted primary balance (percent of potential GDP)	2.4	2.3	-3.9	-2.3	-4.1	-2.6	-4.4	-2.2	-0.1	1.6	2.6
Fiscal impulse (change in CAPB; in percent of potential GDP)	0.4	0.2	6.1	-1.6	1.8	-1.5	1.8	-2.2	-2.0	-1.8	-1.0
Change in real revenue (percent)	3.9	6.1	-3.8	10.3	4.0	1.4	-1.1	3.3	4.2	3.5	3.4
Change in real primary expenditure (percent)	4.2	6.9	17.5	0.3	8.7	-3.8	1.6	-0.8	1.4	0.9	0.8
New Zealand Superannuation Fund											
Budget transfers (+ = receipts)	0.2	0.3	0.5	0.6	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Net assets	13.2	13.6	14.0	17.3	17.7	17.6	18.6	19.5	19.7	19.8	19.9
Contributed capital	5.2	5.3	5.6	5.8	6.2	6.1	6.4	6.7	6.8	7.0	7.1
Central government											
Revenue	33.4	34.4	32.8	34.4	36.1	36.0	35.7	36.7	37.2	37.3	37.5
Expenditure	32.0	33.0	38.7	36.5	39.8	37.9	39.2	38.8	38.1	37.5	36.7
Net lending (+)/borrowing (-)	1.4	1.4	-5.9	-2.1	-3.7	-1.9	-3.5	-2.1	-0.9	-0.2	0.7
Local government											
Revenue	4.0	4.0	4.1	4.0	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Expenditure	4.1	4.3	4.5	4.4	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Net lending (+)/borrowing (-)	-0.1	-0.2	-0.4	-0.4	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
GDP (in billion NZ$)	296	310	317	343	363	397	409	422	444	469	493

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.

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, 2019-28
(In percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projections					
Current account	-2.9	-1.0	-6.0	-9.0	-7.8	-6.6	-5.8	-5.2	-4.7	-3.9
Balance on goods and services	0.0	1.1	-3.3	-5.8	-5.7	-4.4	-3.8	-3.4	-3.0	-2.9
Exports of goods and services	27.4	24.0	22.0	23.8	23.7	25.8	26.8	26.4	26.4	26.5
Exports of goods	18.8	18.3	18.1	19.1	17.3	17.3	16.9	16.0	15.2	14.5
Exports of services	8.6	5.7	3.9	4.7	6.4	8.6	9.9	10.5	11.2	12.0
Imports of goods and services	27.4	22.9	25.3	29.7	29.4	30.3	30.6	29.8	29.4	29.4
Imports of goods	20.0	17.5	19.8	22.4	21.7	22.4	22.6	22.1	21.9	21.9
Imports of services	7.4	5.4	5.5	7.3	7.7	7.9	7.9	7.6	7.5	7.5
Primary income, net	-2.6	-1.8	-2.5	-3.0	-2.1	-2.1	-2.0	-1.8	-1.6	-0.9
Inflows	2.9	2.6	2.8	2.7	3.0	3.0	3.0	3.0	3.0	3.0
Outflows	5.5	4.4	5.3	5.7	5.0	5.2	5.0	4.7	4.6	3.9
Secondary income, net	-0.2	-0.2	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Inflows	0.8	0.7	0.8	0.8	0.9	0.6	0.7	0.7	0.7	0.7
Outflows	1.0	1.0	0.9	0.9	0.9	0.7	0.8	0.8	0.7	0.7
Capital and financial account										
Capital account, net	0.0	0.0	0.0	-0.1	0.5	0.0	0.0	0.0	0.0	0.0
Financial account, net	-2.2	-2.4	-4.6	-6.3	-5.8	-6.6	-5.8	-5.2	-4.7	-3.9
Direct investment	-2.1	-1.6	-2.2	-3.1	-3.0	-2.3	-2.5	-2.4	-2.3	-1.9
Equity	-2.5	-1.6	-2.2	-2.7	-2.2	-1.7	-1.9	-1.9	-1.7	-1.5
Debt	0.4	0.0	0.0	-0.4	-0.8	-0.6	-0.6	-0.6	-0.5	-0.4
Portfolio investment	1.8	4.4	-3.8	-1.7	-2.5	-2.9	-2.1	-1.7	-1.5	-1.2
Equity	1.2	1.4	3.2	-3.2	1.0	-0.4	0.5	0.8	0.8	0.8
Debt	0.6	3.0	-7.1	1.5	-3.6	-2.6	-2.6	-2.6	-2.4	-2.0
Financial derivatives	-0.6	-2.5	0.0	-0.3	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Other investment	-1.1	-0.6	0.2	-0.9	-0.3	-1.3	-1.3	-1.3	-1.2	-1.0
Reserve assets	-0.2	-2.1	1.3	-0.3	…	…	…	…	…	…
Net errors and omissions	0.7	-1.3	1.4	2.9	1.5	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET										
Net international investment position	-53.7	-55.8	-46.4	-51.2	-53.1	-58.8	-62.0	-63.9	-65.3	-66.2
Equity, net	-5.8	-8.3	3.5	-3.4	-3.8	-5.8	-6.9	-7.6	-8.1	-8.4
Assets	42.6	47.3	56.3	45.2	47.1	47.1	47.1	47.1	47.1	47.1
Liabilities	48.4	55.6	52.7	48.6	50.8	52.9	54.0	54.7	55.1	55.5
Debt, net	-56.2	-53.4	-56.6	-53.7	-55.4	-59.1	-61.1	-62.4	-63.3	-63.9
Assets	40.3	45.2	35.8	38.5	37.4	37.4	37.4	37.4	37.4	37.4
Liabilities	96.5	98.6	92.4	92.2	92.8	96.5	98.5	99.7	100.7	101.3
External assets (gross)	91.1	98.4	98.8	89.7	90.5	90.5	90.5	90.5	90.5	90.5
Equity	42.6	47.3	56.3	45.2	47.1	47.1	47.1	47.1	47.1	47.1
Debt	40.3	45.2	35.8	38.5	37.4	37.4	37.4	37.4	37.4	37.4
External liabilities (gross)	144.9	154.2	145.2	140.8	143.6	149.3	152.5	154.4	155.8	156.7
Equity	48.4	55.6	52.7	48.6	50.8	52.9	54.0	54.7	55.1	55.5
Debt	96.5	98.6	92.4	92.2	92.8	96.5	98.5	99.7	100.7	101.3
Of which: NZ$ denominated	51.2	52.1	49.2	51.7	53.8	55.9	57.1	57.8	58.3	58.7
FX denominated	43.5	53.7	43.2	40.6	39.0	40.6	41.4	41.9	42.3	42.6
Short-term	29.5	33.7	30.2	29.3	30.5	31.7	32.3	32.7	33.0	33.2
MEMORANDUM ITEMS										
Gross official reserves (bn NZ$)	17.0	13.0	16.4	13.7	…	…	…	…	…	…
In months of prospective imports	4.3	2.6	2.5	2.5	…	…	…	…	…	…
In percent of short-term external debt	28.0	17.5	22.2	20.4	…	…	…	…	…	…

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

Table 4. New Zealand: Monetary and Financial Sector, 2019-28
(In billions of NZ$, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projections					
CENTRAL BANK										
Net foreign assets	19	11	14	16	17	17	18	19	20	21
Net domestic assets	-4	27	39	50	23	9	7	5	3	3
Net domestic claims	0	31	43	58	31	17	16	14	14	14
Claims on Central government (net)	-1	29	34	37	21	15	15	14	13	13
Claims on Other Depository Corporations	1	2	9	21	10	3	1	1	1	0
Other items net	-4	-3	-4	-8	-8	-9	-9	-10	-10	-11
Monetary base	15	38	54	66	40	26	25	24	23	24
DEPOSITORY CORPORATIONS										
Net foreign assets	-91	-100	-106	-105	-112	-114	-119	-126	-133	-139
Net domestic assets	417	466	498	504	528	531	554	582	611	638
Net domestic claims	489	544	576	594	624	629	657	690	725	758
Claims on Central government (net)	12	49	50	45	41	35	35	34	33	33
Claims on State and Local Government	8	10	7	7	7	7	8	8	9	9
Claims on Public Nonfinancial Corporations	1	2	2	1	1	1	2	2	2	2
Claims on Private Sector	459	473	505	528	562	572	599	632	667	698
of which: Private Sector Credit	456	469	504	527	562	572	599	632	667	698
Claims on Other Financial Corporations	10	12	11	12	13	13	14	15	15	16
Other items net	-72	-79	-79	-90	-96	-98	-103	-109	-114	-120
Broad money	326	366	392	399	416	417	435	456	478	499
MEMORANDUM ITEMS										
Private sector credit 2/	477	496	526	549	554	556	572	592	616	642
Housing loans 1/	274	296	326	340	340	339	350	364	382	400
Business loans 1/	115	109	116	124	128	130	134	139	144	150
Household deposits	185	203	217	228	243	248	259	274	289	303
					In percent of GDP					
Private sector credit 2/	149	153	149	144	136	135	132	130	128	127
Housing loans 1/	86	92	92	89	84	82	81	80	79	79
Business loans 1/	36	34	33	33	32	32	31	30	30	30
Household deposits	58	63	61	60	60	60	60	60	60	60
					Percentage change					
Private sector credit 2/	5.6	3.9	6.1	4.3	0.9	0.4	2.9	3.5	4.1	4.1
Housing loans 1/	6.9	8.2	10.1	4.2	0.1	-0.3	3.2	4.1	4.9	4.7
Business loans 1/	6.5	-5.3	5.8	7.4	3.0	1.9	3.0	3.4	3.6	4.1
Household deposits	4.4	9.8	6.7	5.3	6.6	1.9	4.7	5.6	5.4	4.7

Sources: RBNZ and IMF staff calculations.
1/ Registered banks.
2/ Depository corporations.

Table 5. New Zealand: Financial Soundness Indicators, 2019-23

	2019	2020	2021	2022	2023 1/	
	As at end-year, unless otherwise indicated					
Interest rates (percent)						
90-day bank bill rate	1.5	0.5	0.5	4.5	5.2	
90-day bank bill rate, real	-0.1	-1.2	-3.3	-0.2	-1.4	
Stock market index (percent change)	30.4	13.9	-0.4	-12.0	-1.9	
Liquidity and funding (in percent)						
Liquid assets to total assets	13.5	17.0	16.8	18.0	16.5	2/
Liquid assets to short-term liabilities	20.4	25.1	24.2	27.1	25.0	2/
1-month maturity mismatch	6.7	6.8	7.4	8.9	7.8	2/
Core funding ratio	86.8	88.5	89.1	91.2	89.7	2/
Asset composition (percentage share of total)						
Agricultural	13.2	12.7	11.7	11.2	11.2	2/
Business	25.2	23.5	23.2	24.0	23.7	2/
Households	61.5	63.8	65.1	64.8	65.1	2/
Of which: Housing	58.0	60.8	62.5	62.3	62.6	2/
Asset quality (in percent)						
Non-performing loans to total loans	0.6	0.6	0.4	0.4	0.5	2/
Non-performing loans net of provisions to capital	2.0	2.2	2.3	2.8	3.5	
Non-performing loans (in millions of NZ$)	2,805	2,898	2,080	2,143	2,707.0	2/
Capital adequacy (in percent)						
Regulatory capital to risk-weighted assets	14.4	15.2	16.2	15.4	15.0	
Tier I capital to risk-weighted assets	13.5	14.3	15.2	14.1	13.7	
Common equity tier 1 to risk-weighted assets	11.5	12.4	13.4	12.7	12.7	
Capital to assets	7.7	7.6	7.8	8.3	8.6	2/
Profit Ratios (in percent)						
Return on assets	0.8	0.9	1.0	1.1	1.0	
Return on equity	10.9	12.0	12.6	12.9	11.2	
Net interest margin	2.0	1.9	2.0	2.4	2.4	

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

1/ As at end-March, unless otherwise indicated.

2/ As at end-May.

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.

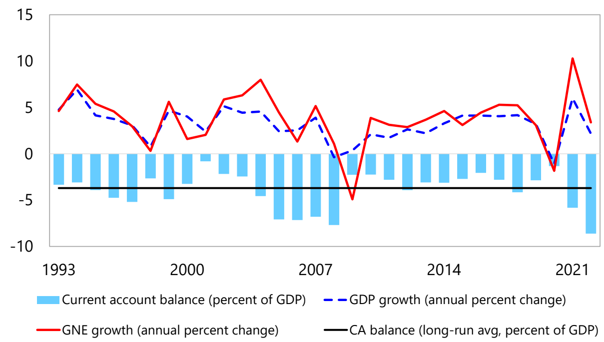
Annex I. Past Recommendations (2022 Article IV Consultation)

	Fund Recommendations	Policy Actions
Monetary Policy	• Monetary policy should remain data dependent, and continued, swift policy normalization will be appropriate under baseline conditions.	• The RBNZ tightened monetary policy aggressively to address the above-target inflation, raising the OCR by 525 bps cumulatively.
Fiscal Policy	• Tightening of fiscal policy is appropriate, and the fiscal stance should be calibrated to evolution of the pandemic and economic conditions. Remove fuel excise duty reduction. • Authorities should update their fiscal targets to provide an anchor for fiscal policy and manage long-term spending pressures needed for promoting long-term growth.	• Fiscal policy contracted in FY2022/23, as reprioritized expenditure partly offset costs from the early-2023 natural disasters. Fuel excise duty reduction expired in June 2023. • New fiscal rules mandate that the operating balance before gains and losses returns to a small surplus over time, while the net core crown debt remains below 50 percent of GDP.
Housing and Financial	• Continued focus is needed on addressing housing imbalances. Increasing the stock of social housing remains important as a durable solution to housing affordability is achieved over time by addressing supply constraints. • Raising bank capital requirements and enlarging the MPM toolkit will help the system weather future shocks.	• The authorities emphasized their commitment to invest in social housing, including via greater allocation under Budget 2023. Continuing reform, including to the RMA, underway to address supply. • RBNZ appropriately expanded its macroprudential toolkit to add DTIs.
Climate	• Prices on agricultural emissions (New Zealand's largest emissions source) will be important to incentivizing adoption of new technologies and methods to lower emissions. • Proceeds of higher carbon prices should be invested in emissions reduction and compensate those adversely affected by price increases, particularly vulnerable groups.	• Authorities' proposal for pricing agriculture emissions was released in December 2022. ERP was published in June 2022 and National Adaptation Plan was released in August 2022. • The authorities have committed to channeling ETS proceeds into the Climate Emergency Response Fund to support multi-year climate investments.
Structural	• Promote innovation and digitalization, and tax reforms would support long-term growth. • Infrastructure spending should aim at reducing the infrastructure gap and supporting the transition to a net zero carbon growth path. • Minimum wage increases should be aligned with underlying labor productivity growth.	• Digital Technologies Industry Transformation Plan aims to grow the digital workforce and addressing labor shortages and skills mismatches. • Focus is on project prioritization for infrastructure investment. • Adult minimum wage increased from NZ$21.20 to NZ$22.70 per hour in April 2023.

Annex II. Current Account Deficit: Drivers and Prospects

1. **New Zealand's current account deficit increased sharply in 2022.** The deficit widened from a mere 1 percent of GDP in 2020, to 6 percent of GDP in 2021 and further to 9 percent of GDP in 2022—the highest level since 1987. This trend contrasts developments in Australia, that has seen very robust and persistent surpluses post-pandemic. Both exports and imports declined during the initial phase of the pandemic in 2020, with imports declining more than exports, reigning in the current account deficit to an abnormally low level. However, the economic rebound since 2021, along with significant government spending and stimulus, resulted in a large and rapid increase in domestic demand.

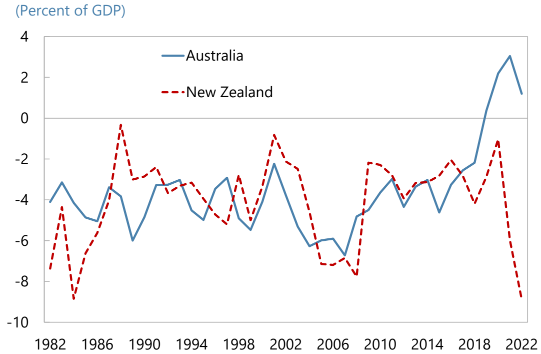
Current Account Balance and Growth
(Percent of GDP and annual change)



Sources: Haver Analytics; and IMF staff calculations.

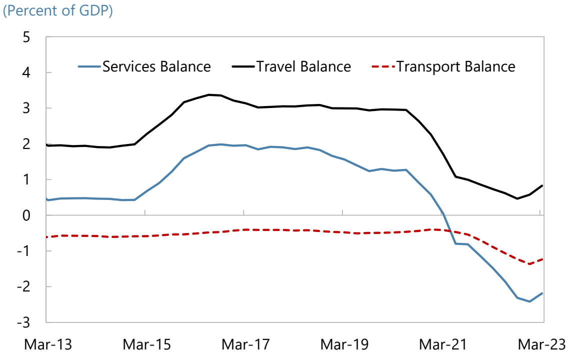
2. **While imports have spiked, exports, particularly in services, have been lackluster.** Higher domestic demand coupled with one-off COVID factors that favored durable goods imports, resulted in a rapid increase of goods imports. The import bill was particularly large as the increased demand came at a time when global prices spiked on the back of supply chain constraints and shipping disruptions. In contrast, despite the supportive international prices for dairy and meat, which resulted in a healthy terms-of-trade boost, exports have remained subdued, in part due to one-off weather-related factors and lately due to labor constraints. International tourism and students, which counted toward a significant share of New Zealand's exports pre-pandemic, suffered due to border closures, and are only now rebounding, but remain well below pre-pandemic levels.

Evolution of Current Account
(Percent of GDP)



Sources: Stats NZ; ABS; and IMF staff calculations.

Services Balance: Travel Restrictions and Transport Costs
(Percent of GDP)

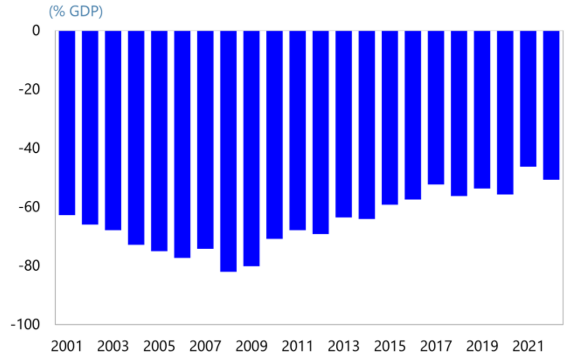


Sources: Stats NZ; and IMF Staff Calculations.

3. **Nevertheless, the net international investment position (NIIP) has improved and remains manageable.** Even before the recent deterioration in the current account, New Zealand has

historically run balance of payment deficits, averaging close to -4 percent of GDP in current account balances over the past 30 years, reflecting its long-standing structural savings-investment imbalance. These deficits have resulted in a sizable negative NIIP, currently at -50 percent of GDP. Yet, despite the persistent deficits, the NIIP has improved steadily in the post global financial crisis (GFC) period from -84 percent of GDP during the 2008 GFC to -50 percent of GDP in 2022, driven by lower interest payment and revaluation gains due to the low interest rate environment and robust receipts from tourism and education exports. Furthermore, the improvement in the structure of New Zealand's external balance sheet reduces vulnerabilities further. External NIIP liabilities are denominated mainly in New Zealand dollars and there is a net foreign currency asset position. As a result, a nominal depreciation of the New Zealand dollar 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. Furthermore, 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.

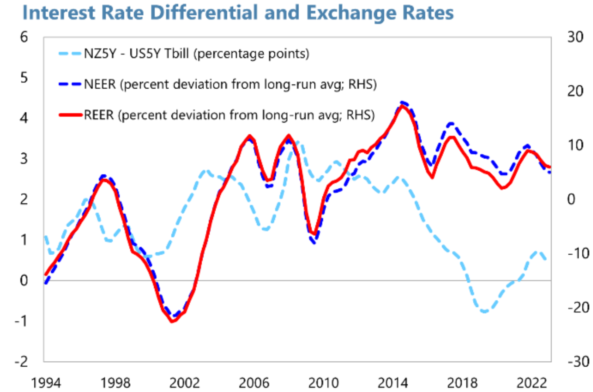
Net International Investment Position



Sources: Haver Analytics and staff calculations.

4. The REER and NEER are close to their long run averages and the New Zealand dollar has been floating since 1985. The REER appreciated to around 10 percent above its long-term average in 2021, reversing its depreciating trend from before the pandemic. The trend mirrored the increase in interest differential, which had turned negative in 2018. However, more recently, it has depreciated marginally to approach its long-term average level. Since the brief but large intervention during the GFC, when the RBNZ intervened in the currency market in the face of lapses of liquidity and significant volatility, the currency has been allowed to float freely. The authorities are strongly committed to a floating regime, which reduces the need for reserve holding and allows for automatic adjustment mechanisms to operate freely.

Interest Rate Differential and Exchange Rates

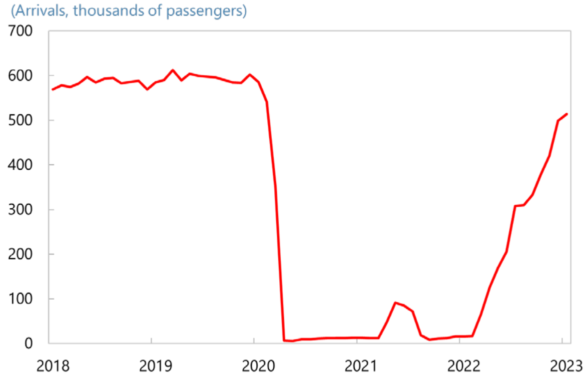


Sources: Haver Analytics; and IMF staff calculations.

5. The current account deficit is expected to remain large in the short term, but will likely recover over time. The monetary policy tightening and a gradual narrowing of the output gap on the back of weaker consumption, is set to lower goods imports in 2023 and lowering the current account deficit. Temporary factors may limit the speed of the current adjustment: the North Island weather events, and dry conditions in the South Island, will likely hamper agricultural exports, a problem exacerbated by softening food and commodity prices globally. In addition, a significant portion of the nation's higher petroleum bill will persist despite lower international oil prices due to the repurposing of the Marsden oil refinery to an import-only terminal. Higher rates will increase debt service costs and worsen the investment income. But the recovery in international tourism and education sectors, which has just begun, is likely to increase the services balance over time, pushing the current account deficit towards it long term average.

International Travel

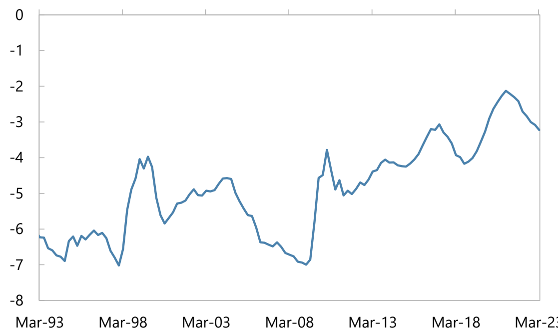
(Arrivals, thousands of passengers)



Sources: Haver Analytics and New Zealand Customs Service for 2021.

Higher Interest Rates will Weigh on Income Balance

(Percent of GDP)



Sources: Stats NZ and IMF Staff Calculations

Annex III. External Sector Assessment

New Zealand's external position in 2022 was weaker than implied by medium-term fundamentals and desirable policies. This represents a change in assessment from 2021 and results from the rapid increase in current account deficit, which came in at 9 percent of GDP in 2022—the highest level since 1987.

1. Model estimates confirm that New Zealand's external position in 2022 was weaker than the level implied by fundamentals and desirable policies.

- **The EBA current account (CA) regression suggests that the current account deficit in 2022 was weaker than implied by fundamentals and desired policy settings.** The model-estimated cyclically adjusted CA norm for 2022 was -2.0 percent of GDP. The underlying, cyclically adjusted, CA balance was -5.6 percent, taking into consideration the temporary compression in tourism inflows (1.8 percent), an increase in transportation and shipping costs (0.8 percent), and cyclical factors, primarily the positive output gap (0.8 percent). This results in an estimated CA gap of -3.6 percent of GDP. Applying the EBA-estimated elasticity of the current-account-to-GDP ratio with respect to the REER of -0.2 to this gap results in an estimated currency overvaluation of around 16 percent (text table).

EBA Real Exchange Rate Assessments

	2020	2021	2022
REER index regression	6.5	15.6	11.9
REER level regression	-2.8	9.2	7.2
Current account regression 1/	1.4 [2/]	5.0 [2/]	15.7 [2/]
External sustainability 1/	-6.4 [2/]	-3.0 [2/]	11.7 [2/]
Summary			
Mean	-0.3	6.7	11.6
Median	-0.7	7.1	11.8

Note: Figures show percent deviation from level implied by fundamentals and desired policy settings. +ve sign indicates actual REER is overvalued relative to the predicated level.
1/ The underlying current account balance was also lowered by 2.6 percent to account for the temporary impact of the COVID-19 pandemic, largely reflecting the transitory impact of lower tourism inflows (1.8 percent), and an increase in transportation and shipping costs (0.8 percent).
2/ CA/GDP to REER elasticity is estimated to be -0.23.

- **The EBA REER index and level regressions suggests that the New Zealand dollar was overvalued in real effective terms in 2022.** The models imply that, in real effective terms, the dollar was overvalued by 11.9 percent and 7.2 percent respectively.
- **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, which when compared with the cyclically adjusted CA deficit for 2022 (see above), gives an estimated gap of 2.7 percent. This implies that the currency is estimated to be overvalued by around 12 percent.

2. Based on the results of the EBA CA model, staff assesses the external position in 2022 to be weaker that the level implied by medium-term fundamentals and desirable policies. The results of the other models support this assessment. The current account model is calibrated to global and domestic policy variables and employs multilateral consistency adjustments to account for the temporary but extraordinary impact of the pandemic in order to provide a reliable estimate for the external position. However, econometric specifications of large-scale interactions between trade and capital flows can be limiting in the explanatory power and out-of-sample property of models and there may be shortcomings in some conclusions. Vulnerabilities related to the financial account remain contained (see Annex II), supported by a credible commitment to a floating exchange rate. Nevertheless, while the current account deficit is expected to narrow over time, the effects of temporary factors may continue affecting the external balance adjustment process over the next few years and is a source of vulnerability worth careful monitoring.

Annex IV. Sovereign Debt and Debt Sustainability Framework

Annex IV. Figure 1. Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Low	The overall risk of sovereign stress is low, reflecting low levels of vulnerability in the medium-, and long-term horizons.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low against a mechanical low signal on the basis of the strength of institutions, the depth of the investor pool, the credibility of macroeconomic policies and institutions in New Zealand, contributing to overall stability.
Fanchart	Low	…	
GFN	Low	…	
Stress test	…	…	
Long term	…	Low	Long-term risks are low as aging-related expenditures for health and social security and gross financing needs remain below 10 percent of GDP even in alternative scenario, and the debt path remains stable and relatively low.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			Yes

DSA summary assessment

Commentary: New Zealand is at a low overall risk of sovereign stress with a split AA+ sovereign credit rating (Aaa from Moody's and AA+ from S&P and Fitch). The post-pandemic recovery was stronger than most advanced economies, leading to a more pronounced cyclical position. Tax revenues exceeded pre-pandemic levels, while the withdrawal of Covid-related stimulus lowered overall expenditure. Going forward, a fiscal consolidation is expected in the medium term, but will be slower following the North Island weather events (flash floods in January and cyclone Gabrielle in February 2023). Given rebuilding needs following the North Island weather events, debt is expected to rise for the next few years before stabilizing. Medium-term liquidity risks as analyzed by the GFN Financeability Module are low. Over the longer run, New Zealand should continue with reforms to tackle risks arising from population aging and climate change. However, the long-term horizon at which these risks would materialize, and the authorities' planned measures will help contain risks.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex IV. Figure 2. Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

Sector		No.	Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected	CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected	CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected	CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected		4	State governments	Yes	
CPS / NFPS / GG: expected		5	Local governments	Yes	
CPS / NFPS		6	Public nonfinancial corporations	No	
CPS		7	Central bank	No	
CPS		8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on intra-government debt holdings

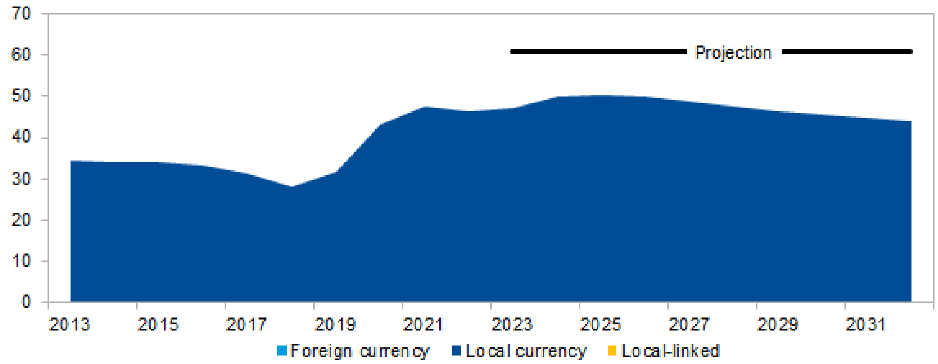
Sector		Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected	CG	1 Budget. central govt									0
CPS / NFPS / GG: expected	CG	2 Extra-budget. funds									0
CPS / NFPS / GG: expected	CG	3 Social security funds									0
CPS / NFPS / GG: expected		4 State govt.									0
CPS / NFPS / GG: expected		5 Local govt.									0
CPS / NFPS		6 Nonfin pub. corp.									0
CPS		7 Central bank									0
CPS		8 Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: In New Zealand, the general government consistent of the central government, state and local governments, and social security funds.

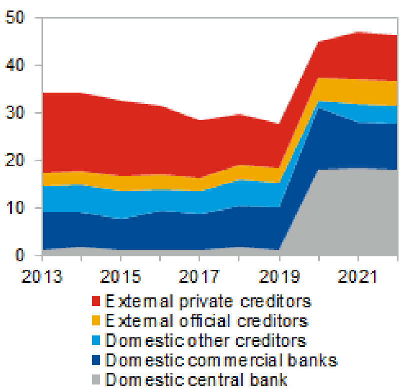
Annex IV. Figure 3. Public Debt Structure Indicators

Debt by currency (percent of GDP)



Note: The perimeter shown is general government.

Public debt by holder (percent of GDP)

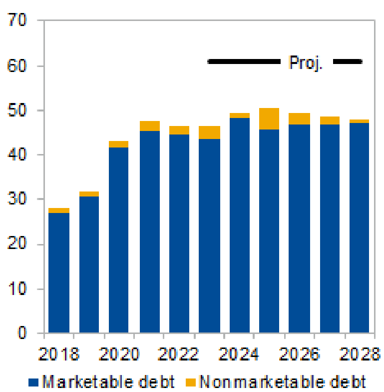


Note: The perimeter shown is general government.

Public debt by governing law, 2022 (percent)

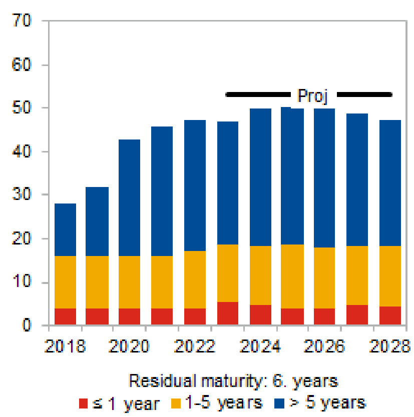
Note: The perimeter shown is general government.

Debt by instruments (percent of GDP)



Note: The perimeter shown is general government.

Public debt by maturity (percent of GDP)



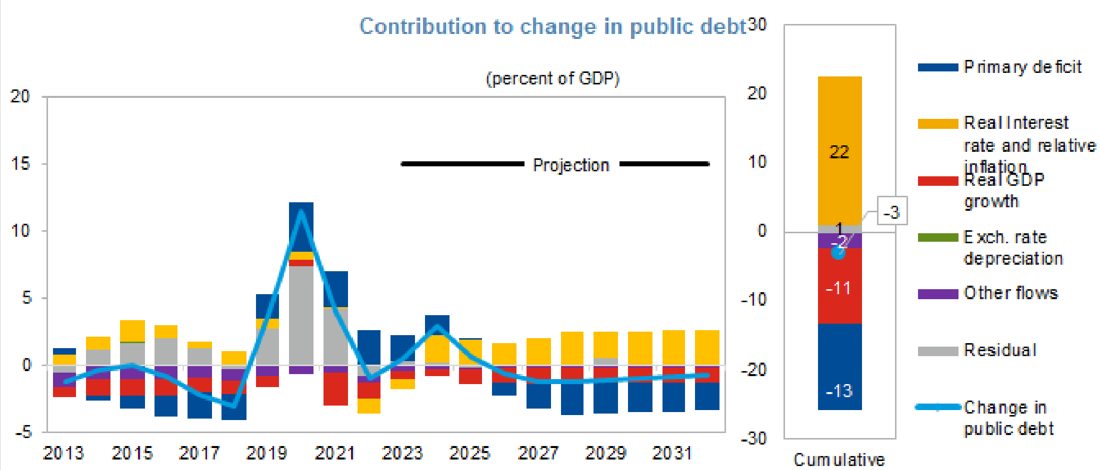
Note: The perimeter shown is general government.

Commentary: Public debt in New Zealand increased following the pandemic, but is expected to decline in the medium term following the planned consolidation over the forecast period. The share of FX debt in overall debt is very low and index-linked bonds also make a small share (less than 5 percent) of total outstanding debt.

Annex IV. Figure 4. Baseline Scenario

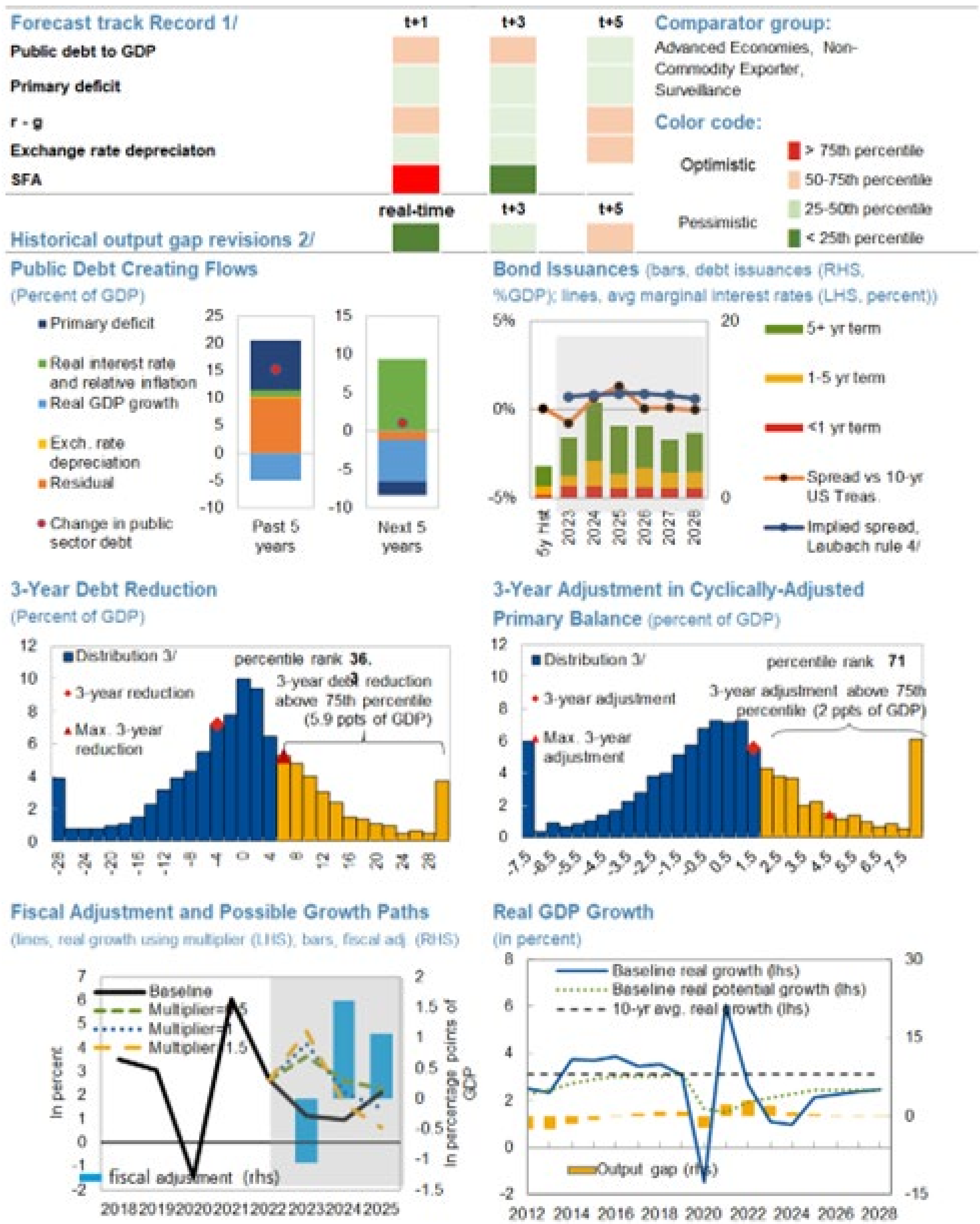
(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	46.4	47.0	49.9	50.5	49.9	48.7	47.5	46.4	45.4	44.6	43.9
Change in public debt	-1.0	0.5	2.9	0.6	-0.6	-1.2	-1.2	-1.1	-1.0	-0.8	-0.7
Contribution of identified flows	-0.2	0.2	2.7	0.8	-0.6	-1.2	-1.2	-1.7	-1.0	-0.9	-0.8
Primary deficit	2.6	1.9	1.5	0.1	-0.9	-1.9	-2.3	-2.3	-2.2	-2.2	-2.1
Noninterest revenues	38.6	38.2	39.1	39.7	39.9	40.0	40.3	40.5	40.6	40.8	41.0
Noninterest expenditures	41.1	40.0	40.6	39.8	39.0	38.1	37.9	38.2	38.4	38.7	38.9
Automatic debt dynamics	-2.3	-1.2	1.6	0.8	0.5	0.9	1.3	0.8	1.4	1.5	1.5
Real interest rate and relative inflation	-1.1	-0.7	2.0	1.9	1.6	2.1	2.5	1.9	2.5	2.6	2.6
Real interest rate	-1.1	-0.7	2.0	1.9	1.6	2.1	2.5	1.9	2.5	2.6	2.6
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-1.2	-0.5	-0.4	-1.0	-1.1	-1.2	-1.2	-1.1	-1.1	-1.1	-1.1
Real exchange rate	0.0	...	...	...	...	...	...	...	...	...	...
Other identified flows	-0.5	-0.5	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	-0.5	-0.5	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Contribution of residual	-0.8	0.4	0.2	-0.2	0.0	0.0	0.0	0.6	0.0	0.0	0.0
Gross financing needs	5.8	7.1	9.1	7.4	6.2	5.5	6.1	6.1	5.8	5.1	5.1
of which: debt service	3.7	5.6	7.8	7.5	7.3	7.6	8.6	8.6	8.2	7.4	7.4
Local currency	3.7	5.6	7.8	7.5	7.3	7.6	8.6	8.5	8.2	7.4	7.4
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	2.7	1.1	1.0	2.1	2.2	2.4	2.4	2.4	2.4	2.4	2.4
Inflation (GDP deflator; percent)	5.6	6.0	1.0	2.2	3.4	3.0	2.3	3.5	2.2	2.2	2.2
Nominal GDP growth (percent)	8.0	6.6	1.9	4.7	5.6	5.4	4.7	4.7	4.7	4.7	4.7
Effective interest rate (percent)	3.2	4.3	5.4	6.1	6.8	7.3	7.6	7.7	8.0	8.2	8.3



Staff commentary: Public debt will rise slightly but then stablize, as the planned fiscal consolidation takes place given the new fiscal rules that mandate a narrowing of primary deficits, and among stable economic conditions. Medium-term risks are low, reflecting New Zealand's low historical volatility, low terminal debt and institutional strength, as well as a large and stable banking sector, little FX debt and low GFN to GDP.

Annex IV. Figure 5. Realism of Baseline Assumptions



Commentary: The strong recovery has raised tax revenues while Covid-19 expenditure has been withdrawn, with savings repurposed for other spending. The staff projections in recent years are more closely aligned with the outturns, notwithstanding unpredictable shocks like the North Island weather events. Moving forward, the primary balance is projected to improve by the end of the medium term, albeit at a slower pace, and sustain small surpluses, helping debt stabilize. Factors such as New Zealand's fiscal institutional framework including its fiscal rules of low debt and small surpluses, a historical track record of running surpluses and containing its debt levels, as well as the exit from Covid-19 stimulus measures, provides credibility towards achieving sustained primary surpluses in the medium term.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

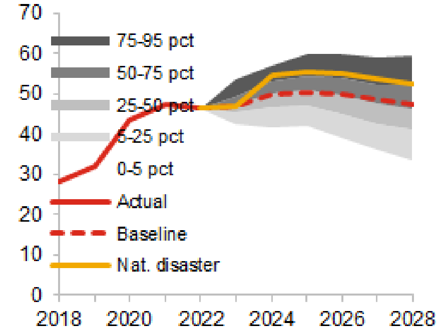
3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex IV. Figure 6. Medium-Term Risk Analysis

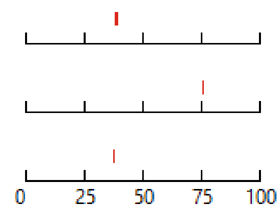
	Value	Contrib [1/]	Percentile in peer group [2/]

Final fanchart (pct of GDP)

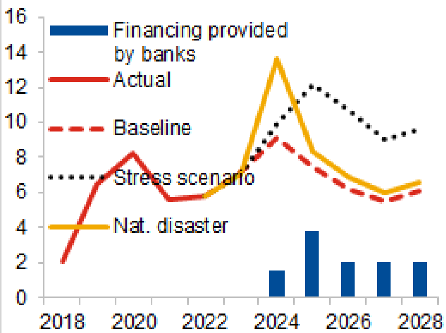


Debt fanchart module

	Value	Contrib [1/]
Fanchart width *(percent of GDP)*	25.8	0.4
Probability of debt non-stabilizaiton *(percent)*	25.5	0.2
Terminal debt-to-GDP x institutions index	8.2	0.2
Debt fanchart index (DFI)		0.8
Risk signal: [3/]		Low

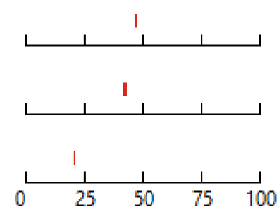


Gross financing needs (pct of GDP)



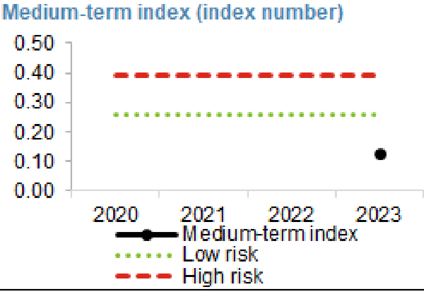
Gross financing needs (GFN) module

	Value	Contrib [1/]
Average baseline GFN *(percent of GDP)*	6.9	2.4
Banks' claims on the ge govt *(pct bank assets)*	4.4	1.4
Chg. In banks' claims in stress *(pct banks' assets)*	1.2	0.4
GFN financeability index (GFI)		4.2
Risk signal: [4/]		Low



Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term index (index number)



Medium-term risk analysis

	Value	Weight	Contribution
Debt fanchart index (normalized)	0.2	0.5	0.1
GFN finaceability index (normalized)	0.1	0.5	0.0
Medium-term index	0.1		
Risk signal: 5/	Low		
Final assessment:	Low		

Prob. of missed crisis, 2023-2028, if stress not predicted: 0.0 pct.
Prob. of false alarms, 2023-2028, if stress predicted: 79.5 pct.

Commentary: Both medium-term tools point to low levels of risk, alluding to mitigating fundamentals such as low historical volatility, strong institutional frameworks alongside fiscal rules, low terminal debt, and low gross financing needs alongside a stable banking sector and availability of domestic financing. The Debt Fanchart Module shows that debt is on a declining and stabilizing path while the GFN module shows that gross financing needs are consistently low. A natural disaster scenario (such as the recent Cyclone Gabrielle) raises debt in the short term but it returns to a declining path in the medium term.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is advanced economies, non-commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Annex IV. Figure 7. Long-Term Risk Analysis

Large Amortization Trigger

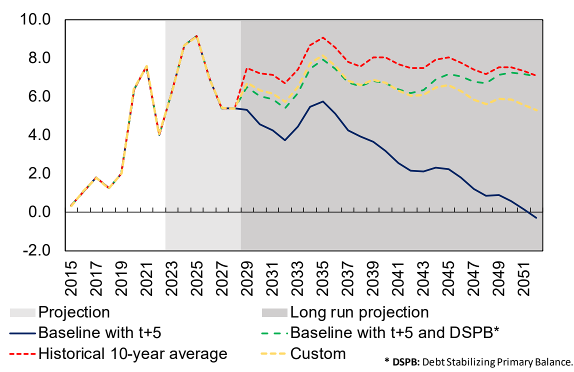
Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	

Overall Risk Indication	

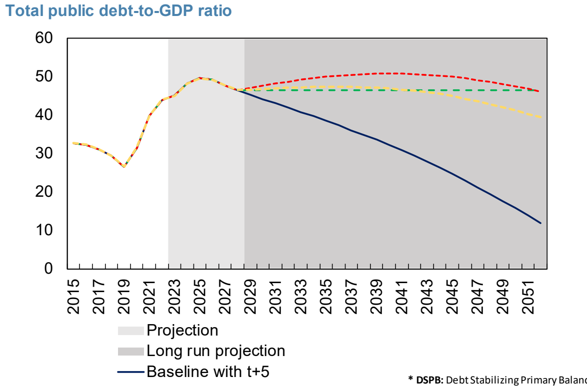
Alternative Baseline Long-term Projections (including Custom scenario)

	Baseline extension of fifth projection year	Custom baseline
Real GDP growth	2.4%	2.4%
Primary Balance-to-GDP	1.9%	0.5%
Real depreciation	-2.6%	-2.5%
Inflation (GDP deflator)	2.3%	2.5%

GFN-to-GDP ratio



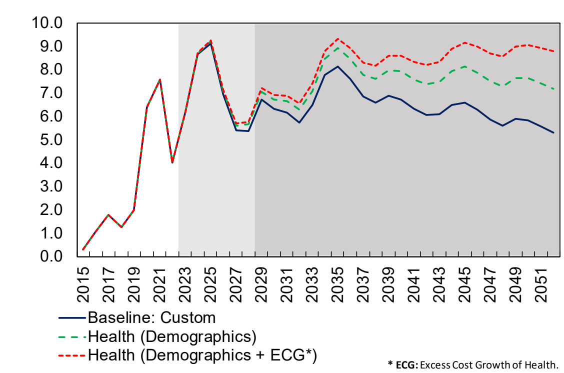
Total public debt-to-GDP ratio



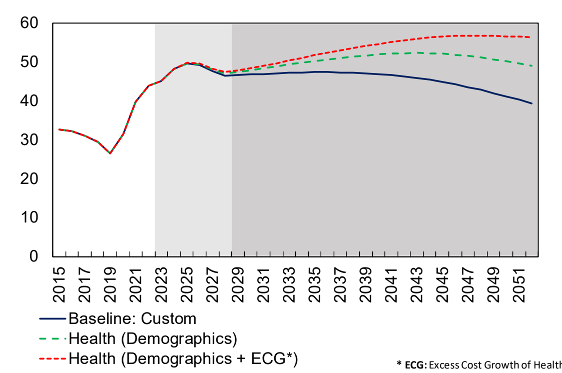
Commentary: Under different projections, gross financing needs and public debt remain relatively low, stable and contained. In case of sustained high primary surpluses in the long term (which may not be feasible), gross financing needs decline significantly. On the other hand, in case of a custom scenario where the primary balance is 0.5 percent of GDP, or a historical scenario with a primary deficit of 0.3 percent of GDP, gross financing needs remain stable, between 6 and 8 percent of GDP, while gross debt peaks at 50 percent of GDP.

Demographics: Health

GFN-to-GDP ratio



Total public debt-to-GDP ratio



Commentary: In the alternative baseline LT scenarios, gross financing needs do not exceed 10 percent of GDP and the debt path does not exceed 55 percent of GDP. Analysis of demographics and healthcare submodule suggests that even when considering the extra cost of healthcare, gross financing needs and debt paths are still relatively low. Based on the analysis, the assessment of long-term sovereign stress risk is low.

Annex V. Risk Assessment Matrix[1]

	Source of risks	Likelihood	Time horizon	Impact	Policies to reduce impact
	Conjunctural risks				
	Monetary policy miscalibration	**M**	Short to medium term	**H** Amid high economic uncertainty and volatility, central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. On the flip side, policy could remain too tight, resulting in unnecessary economic hardship.	Keep policy on a nimble footing, paying close attention to data. Monetary policy decisions should focus on the inflation outlook and the output gap, while addressing financial volatility with macroprudential and financial stability tools. Strengthen communication.
	Systemic financial instability	**M**	Short to medium term	**M** Sharp swings in global interest rates, risk premia, and assets repricing, causing markets dislocations and adverse cross-border spillovers.	Stand ready to use liquidity windows in the event funding stress. Continue to monitor banks' balance sheets.
	Abrupt growth slowdown or recession in China	**M**	Short to medium term	**M** Greater-than-expected economic disruptions in China from COVID resurgence, rising geopolitical tensions, and/or slowdown in the property sector will result in trade and tourism spillovers to New Zealand.	Combined monetary, fiscal policy easing.
	Other Risks: Domestic and Structural				
	Unexpectedly large or disorderly housing market disruptions.	**M**	Short to medium term	**M** Larger than expected declines in housing prices alongside tightening of financial conditions would adversely affect household wealth and consumption and could expose pockets of financial vulnerabilities.	Adjust interest rates if the correction puts inflation on a rapid path to the RBNZ's target. Provide targeted economic support to vulnerable households.
	Cyberthreats	**M**	Short to medium term	**M** 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.
	Extreme Climate Events	**M**	Medium term	**H** 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.
	Other Risks: External				
	Stronger economic outcomes than assumed	**M**	Short to medium term	**L** Inflation could moderate faster than expected allowing for easing of financial conditions. Tradeable goods prices could fall faster. Recovery in tourism and education sectors could be faster than assumed under the baseline.	Policy needs to be agile to changing circumstances.
	Deepening geo-economic fragmentation	**M**	Short to medium term	**M** Geopolitical tensions could impact New Zealand's export performance, impacting growth.	Combined monetary, fiscal policy easing.

[1]Based on the February 2023 Global Risk Assessment Matrix (G-RAM).

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

Recommendation	Time Frame	Update and Implementation
Financial Stability and Financial Sector Resilience		
Increase RBNZ resources for the supervision and regulation of banks, insurance companies, and FMIs.	ST	**In process.** A new funding agreement signed with the Minister of Finance in June 2020 provided the RBNZ with increased funding for the next five years, in part to support a more intensive supervisory model. Staff numbers have increased significantly in the financial policy area over the past several years, with a significant supervisory and a smaller policy footprint now established in Auckland, where many of the NZ operations of RBNZ-regulated entities are headquartered. Frontline supervision is supported and complemented by the establishment of dedicated Risk Specialists, Licensing & Authorizations and Resolution & Recovery functions. This process is ongoing with further investment likely required post 2025.
Strengthen cooperation and collaboration arrangements with Australian authorities.	ST	**In process**. Trans-Tasman cooperation is explicitly managed through the work under the Trans-Tasman Council on Banking Supervision (TTBC). The TTBC remit covers insurers and other entities in addition to banks. There is also a standing mechanism for coordination between New Zealand and Australian communications through a dedicated working group under the TTBC umbrella. In recent years, regulators on both sides participated in a hypothetical bank crisis simulation exercise in September 2017, and a follow-up exercise on communications coordination in 2019. Additional work-streams have also been established to coordinate arrangements with respect to managing cyber incidents, and entity specific Crisis Management Groups which plan preferred recovery or resolution options for Trans-Tasman groups. The RBNZ Act 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) is carried across to the deposit takers sectoral legislation under the Deposit Takers Act (DTA). Semi-annual supervisory colleges are in place between RBNZ Prudential Supervision and Specialist Supervision function and counterparts at the Australian Prudential Regulation Authority for exchange of information and coordination of Trans-Tasman supervision and enabling staff secondment/exchange.
Clarify responsibilities of the Treasury and RBNZ on financial sector issues to reinforce the role of RBNZ as prudential regulator and supervisor.	ST	**In process.** Governance and prudential regulation options have been examined in Phase 2 Review of the RBNZ Act. A new financial stability objective for the RBNZ was introduced in the RBNZ Act 2021. The Act also requires the

Recommendation	Time Frame	Update and Implementation
		Minister of Finance to issue a Financial Policy Remit outlining matters that the RBNZ will have to have regard to in pursuing its financial stability objectives, prudential standards and its implementation. The first Remit was issued 30 June 2022. The RBNZ Act designates a government department as the formal monitor of the RBNZ on behalf of the Minister of Finance (replacing the role played by the current board). The Minister has appointed the Treasury in the monitor role. The DTA further clarifies the role of the Minister in the prudential framework (e.g., role in the crisis management and deposit taker resolution frameworks).
Issue enforceable standards on key risks, governance, risk management, and controls to make RBNZ's supervisory expectations more transparent and support supervisory preventive action.	ST	**In process.** Prudential requirements for deposit takers will be set through 'standards' as a secondary legislative instrument. The DTA clearly sets out the areas where the RBNZ can set standards. The scope of standard-setting broadly aligns 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. IPSA already uses standards as the means to set prudential requirements for licensed insurers. The legislation is being reviewed to take account of experience and to follow up on the recommendations of independent reports in recent years. The RBNZ will continue to use standards to regulate the sector. As part of the review the RBNZ is expecting to introduce new standards for governance and risk management but legislation is not expected to be in force before 2026.
Review and extend the enforcement regime to promote preventive action and enhance sanctions powers, including by eliminating ministerial consent for directions, and making compliance with RBNZ policy documents evidence of prudent practice.	MT	**In process.** The DTA will expand the current enforcement toolkit (e.g., with the inclusion of enforceable undertakings and remedial notices) and removes the requirement for Ministerial consent to issue directions, thereby removing the current high threshold for using this tool to take corrective action. An Enforcement Framework has been developed and published. Dedicated resources for the Enforcement team has been increased.
Initiate on-site programs to test the foundation of the three-pillar approach and directors' attestations and increase supervisory engagement with institutions in order to require appropriate action.	ST	**In process**. In 2018 a team was formed for the purposes of performing deep dive on-site thematic reviews. These are performed across both the deposit taking and insurance sectors and focus on a range of risk, governance and compliance matters. Thematic reviews undertaken include; conduct and culture of banks and life insurers, role of the appointed actuary, bank liquidity and governance.

Recommendation	Time Frame	Update and Implementation
		The DTA empowers the RBNZ to undertake on-site inspections of deposit takers. 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). The current review of IPSA will consider the design of a similar on-site inspection power for the insurance sector.
Refine Financial Markets Authority (FMA) supervision by a) direct monitoring of aspects of asset management relevant to financial stability; b) ensuring quality of Financial Markets Supervisors; and c) enhancing insurance intermediary and conduct regulation and supervision.	I	a) **In process.** The FMA published findings of a thematic review of liquidity risk management practices in July 2021. Supplementing the FMA good practice guide of April 2020, the FMA is now preparing industry guidance, based on IOSCO recommendations, for consultation later in 2023. The FMA published a sector risk assessment on the Managed Investment Schemes sector in January 2023, to provide guidance to the market and to inform of future FMA and supervisor monitoring. The FMA has also completed thematic projects/ guidance related to demonstrating value for money and maturing the industry approach to better articulating and substantiating ESG labels and claims. b) **In process.** The relicensing process for supervisors concluded in early 2023. The current license duration is five years, and this was the second such re-licensing round. The process focused on areas identified for the sector in 2018, and licence conditions were strengthened where required. Following re-licensing the FMA is reviewing its ongoing approach to oversight of supervisors. The FMA continues to have strong engagement with Supervisors including through regular operational meetings, sector forums, chief executive and senior management relationship meetings and attending Board meetings. In 2020 and 2021, the FMA required supervisors to undertake and identify risks in the MIS sector and report back to the FMA (which contributed to the Sector Risk Assessment published by the FMA in January 2023). c) **In process.** The new financial advice regime, which came into effect on March 15, 2021, continues to be successfully embedded and operationalized. Full licensing of financial advice providers was completed in March 2023, and monitoring of the sector is now underway. In anticipation of the Conduct of Financial Institutions Bill and the Insurance Contracts Bill (that reforms and updates the Insurance Contract Law) passing into law, the FMA has established a program for implementation.

Recommendation	Time Frame	Update and Implementation
Expand the FMA's regulatory perimeter to include licensing and supervision of custodians and appropriate oversight of wholesale asset managers.	ST	**In process.** The FMA has received its outsourced thematic on custodial arrangements and is progressing work to consider whether there is a case for recommending the establishment of a regulatory regime for custodians. It is also refreshing guidance for custodians on their current obligations under the FMC regime. The FMA has conducted a thematic review of the use of wholesale investor exclusions under the FMC legislation, and has taken (and published) regulatory action, in the form of public warnings, where it has seen non-compliance in the use of these exclusions, and continues to investigate cases where further action may be required.
Adopt and implement proposed Financial Market Infrastructures (FMI) legislation on regulation, oversight, and enforcement powers.	I	**Completed**. The Financial Market Infrastructures Act (FMI Act) was enacted in May 2021. Financial Market Infrastructure Regulations 2023 were made on 22 May 2023 to support implementation of the FMI Act. Work on the issuance of standards under the Act has largely been completed with the standards expected to be published in July 2023. Work on the designation of FMIs under the Act is currently underway and is expected to be complete by March 2024.
Adopt the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMI) through detailed requirements in secondary legislation; change the frequency of FMI self-assessments in the proposed regime from three to two years; and enhance compliance of the designated FMIs with PFMI requirements.	ST	**In process**. The FMI Act provides the ability for the PFMI to be implemented via legally binding standards, a form of secondary legislation. The RBNZ and the FMA are currently finalising the relevant standards and expect to issue the standards by mid- 2023. The frequency of FMI self-assessments is intended to be changed from three to two years once these standards are in place.
Ensure that designated nonfinancial businesses and professions are subject to AML/CFT requirements, particularly company service providers, lawyers, and accountants.	MT	**Completed**. The *AML/CFT Amendment Act 2017,* which extends the coverage of the AML/CFT laws, has come fully into effect. The legislation now covers lawyers, conveyancers and businesses that provide trust and company services (from July 1, 2018); accountants (from October 1, 2018); and real estate agents (from January 1, 2019).
Expand data collection and modeling efforts to develop structural models for credit risk in commercial real estate (CRE) and corporate portfolios.	MT	**In process**. An annual stress testing program has been implemented since 2020. This includes regular solvency and liquidity stress tests, looking at severe but plausible scenarios for both banks and insurers. The program looks to consider a range of risks with a particular focus in 2022 and 2023 on climate change. This work has also included developing models to enable ongoing assessment of risks to dairy lending.

Recommendation	Time Frame	Update and Implementation
		Data collection has expanded as well, with a 'New credit flows' survey now in place to collect monthly new lending data on all business lending and the interest rates associated with that lending. Breakdowns for business lending include commercial property, which is further disaggregated into investment property; and residential and commercial property. Definitions align with the Bank Balance Sheet survey, in which we collect data on the stock of lending. Looking ahead, work is progressing towards collecting loan level data from banks. Once this data becomes available, this will enable much more in-depth analysis and modelling of risks across sectors, including commercial real estate and corporate portfolios.
	Macroprudential Framework	
Strengthen arrangements for macroprudential policy by increasing communication efforts; by increasing the transparency of the process to adjust the framework; and by maintaining an accountability framework that does not jeopardize the integrity and independence of the macroprudential decision-making process.	C	**In process.** In 2019, the RBNZ published a review of experience with its loan-to-value ratio policy and a framework document providing more clarity on the purpose and strategy for using macroprudential tools. The RBNZ is currently updating this framework and developing guidance notes on individual macroprudential tools. The publication of guidance notes has been delayed until after the implementation of the DTI framework and consultation on its calibration, as this might affect how we administer the loan-to-value policy. 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 (that is, macro-prudential policy). The DTA will subject macro-prudential powers to the same general framework as other standard-setting powers, with the exception that the scope of lending-standard tools in relation to property lending (e.g. LVRs and DTIs) needs to be empowered through regulation. The current Macro-Prudential Policy MoU will be superseded in the new prudential framework for deposit takers by the role played by the Financial Policy Remit and the process around the setting of standards (including lending standards).
Introduce DTI measures in the macroprudential toolkit.	I	**Completed.** Following advice from the RBNZ in 2021 on measures to address unsustainable house prices, the Minister of Finance agreed to add DTI restrictions to the macroprudential toolkit. The DTI restrictions were formally added to the toolkit in April 2023.

Recommendation	Time Frame	Update and Implementation
Implement DTI measures if the changes to the LVR do not reduce the risks in the housing sector.	I	**In process.** The RBNZ consulted with stakeholders on the possible introduction of DTI limits in late 2022. The framework for DTI restrictions was published in April 2023. Banks have 12 months to update their systems for the new framework, ahead of a possible implementation of the DTI restrictions in April 2024. We will consult on the calibration of the DTI limits prior to its implementation. Whether an intervention is needed will depend on the assessment of financial stability risks at the time.
Increase capital buffer requirements to reflect the concentration of the financial sector in four banks.	I	**Completed.** 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 by July 2020. In the context of the COVID-19 response, the start date was pushed out to July 2022. The first step up in capital requirements has taken effect with the part introduction of the D-SIB capital requirement.
Crisis Readiness, Management, and Resolution		
Strengthen domestic crisis management arrangements by reaching ex-ante agreement on roles, responsibilities, and processes; prepositioning, mobilization, logistics, and communications plans; and testing through simulation exercises.	MT	**In process.** Phase 2 Review of the RBNZ Act examined options to enhance the crisis management regime, most of which have been developed with reference to the 2017 FSAP recommendations. The DTA designates the RBNZ as the Resolution Authority, with a broader range of powers. A Depositor Compensation Scheme (DCS) will be introduced. The DTA also establishes an obligation on the Reserve Bank to issue a Statement of Approach to Resolution, which must include a description of the Reserve Bank's intended approach to co-operating with other departments and agencies, to engaging with the Minister The DTA also clarifies the role of the Minister in the crisis management and deposit taker resolution frameworks. An amendment to the Public Finance Act 1989 is also included in the DTA, and will 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 *de minimis* exemption in OBR.	MT	**Partially done.** The DTA will introduce a depositor compensation scheme with a NZ$100,000 limit per person per institution, 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	MT	**In process.** The DTA states that the RBNZ is the resolution authority, and will include clear objectives and functions, while widening resolution powers. The Act will also include "no creditor worse off" provisions, and provides obligations to regularly report on the conduct of a resolution. Ministerial consent for triggering all resolutions has been retained to align with existing New Zealand statutory management

Recommendation	Time Frame	Update and Implementation
that the RBNZ is the sole resolution authority and inserting an express requirement for ministerial consent for resolutions with fiscal or systemic implications only.		regimes. However, the requirement for Ministerial consent before directions may be issued has been removed.
C = continuous; I (immediate) = within one year; ST (short-term) = 1–3 years; MT (medium-term) = 3–5 years.		
Sources: IMF (2017), *New Zealand, Financial Sector Assessment Program—Financial System Stability Assessment*; and New Zealand authorities.		

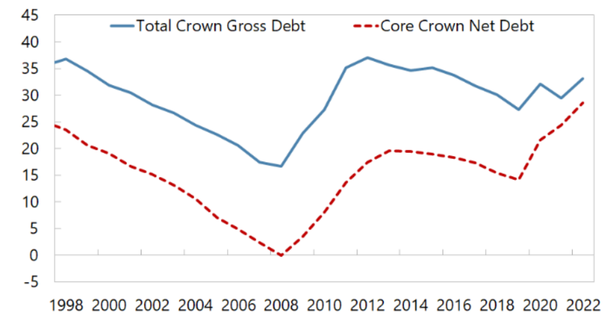
Annex VII. New Zealand's New Fiscal Rules

In 2022 the New Zealand Treasury recommended a new set of fiscal rules, which were adopted by the government, following the suspension of the debt target range at the start of the COVID-19 pandemic. The two new fiscal rules mandate that the operating balance before gains and losses (OBEGAL) returns to a small surplus over time, while the net core crown debt remains below 50 percent of GDP. The new fiscal rules are calibrated to ensure that the fiscal position is sustainable over time, and that buffers are sufficient to counter significant macroeconomic shocks and adequately fund natural disaster costs.

1. New Zealand has a longstanding history of using fiscal rules in their fiscal framework. The Public Finance Act of 1989[1] laid out the core legislative framework for an initial public financial management (PFM) framework. It was amended several times since then to clarify and revise the regulations for the use of public financial resources, most notably in 2004 and 2013. A first version of *fiscal rules*—provisions aiming to promote and maintain fiscal responsibility with respect to debt and balances through short-term intentions and longer-term objectives—was introduced with the Fiscal Responsibility Act of 1994.[2] The 2004 amendment to the Public Finance Act incorporated the Fiscal Responsibility Act and additional fiscal principles and reporting provisions were added. The first and second principles aimed at "reducing total debt to prudent levels so as to provide a buffers against factors that may impact adversely on the level of total debt[…] and once prudent levels of total debt have been achieved, maintaining those levels by ensuring that, on average, […], total operating expenses do not exceed total operating revenues[…]." As such, fiscal policy is guided by the principles to run appropriate operating balances to attain and maintain prudent public debt levels, and has shown considerable success in reducing public debt.

New Zealand Government Debt Indicators

(Percent of fiscal year GDP)



Sources: New Zealand Treasury, Stats NZ.

Notes: Gross total Crown debt equals total borrowings of the Crown. Core Crown net assets (excluding financial assets held by the NZS Fund).

2. After suspending the debt target range during the pandemic, New Zealand re-introduced a new set of fiscal rules in 2022[3]. The New Zealand Treasury reviewed the set of indicators commonly used to set fiscal strategy targets and advised the government to adopt, alongside a new net debt indicator to broaden the coverage of assets and liabilities, two new fiscal rules:

- An **operating rule** as the main fiscal rule: as a first rule, the Treasury recommended that the operating balance before gains and losses (OBEGAL) be brought back to a surplus, and then for small surpluses to be maintained on average over time.

[1] See "A Guide to the Public Finance Act" by the New Zealand Treasury.

[2] See "An Introduction to New Zealand's Fiscal Policy Framework" by the New Zealand Treasury.

[3] See "The Treasury's analysis and recommendations for fiscal rules" by the New Zealand Treasury.

- A **debt ceiling**: the second fiscal rule was to maintain net debt as share of GDP at a prudent level, estimated at 50 percent of GDP based on the net core Crown debt measure, or 30 percent of GDP based on the new net debt indicator which includes New Zealand's superannuation fund (NZSF), advances, and crown entity borrowings.

3. In setting the new fiscal rules, the appropriate criteria found that mainly, fiscal rules should be strict enough to support fiscal sustainability while being flexible. The new fiscal rules were calibrated so that fiscal sustainability remained a priority, while the Government maintained enough flexibility to support stability by allowing the Crown balance sheet to respond to shocks. Additional criteria included simplicity (a fiscal rule should be easily understood by policymakers and the public), operational guidance (the ability to translate the rule into clear guidance in the annual budget process, with the rule clearly under the control of policymakers), and resilience (the fiscal rule should remain for a sustained time and should not be abandoned after a shock).

4. The rule for balances considers equity and sustainability elements. In designing New Zealand's new fiscal rules, the Treasury recommended following a "golden-rule" style operating balance, where operating expenses (day-to-day consumption and transfer payments by the Crown) are paid out of operating revenues. This approach was found to best support intergenerational equity and living standards, given that when operating expenses are paid by operating revenue, the current generation pays for its own consumption. Following the golden-rule operating balance, the government could then borrow for long-term investments where appropriate, and have the cost be spread across generations. As a result, future generations would receive both an asset and a liability. At the same time, the golden-rule style operating balance would ensure consistency with sustainable net debt: as net investment (which may be paid by debt) grows the capital stock, it would also lead to an increase in the asset component of net worth. Any depreciation and write-downs would be paid out of operating revenue, further ensuring that the consumption of capital is paid by the generation who consumes it.

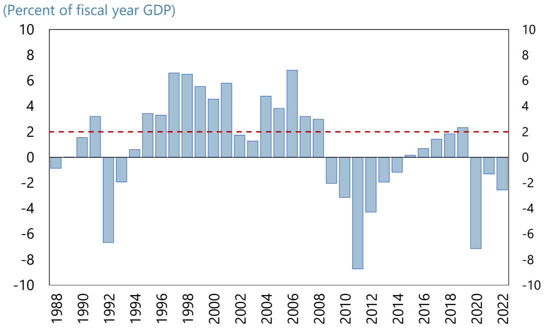
5. The debt ceiling rule is implemented to act as a backstop against a deficit bias. The net debt ceiling ensures that sufficient fiscal buffers are in place to address the potential costs of significant economic shocks or the occurrence of natural disasters. In the occurrence of such shocks, net debt may temporarily rise above the ceiling rule, but would be reduced over time below the debt ceiling through prudent spending and the return to operating surpluses.

6. In calibrating the first rule for New Zealand, Treasury calculated the approximate level of OBEGAL that ensures that it does not contribute to an increase net core Crown debt over time. Based on different parameters, an OBEGAL of -1.3 percent of GDP was found to not contribute to a rise in net debt-to-GDP. After accounting for the average cost contributions to the NZSF over time (estimated at approximately 0.3 percent of GDP) and allowing for significant macroeconomic shocks (which would roughly require an operating balance surplus of 1.5 percentage points of GDP to ensure that net debt does not rise), an OBEGAL surplus of 0.5 percent was found optimal.

7. Nonetheless, and to maximize prudence, two options were recommended for the OBEGAL rule. The first option specified that the OBEGAL should fall within the range of 0–2 percent of GDP over the 10-year period, with the target range providing the flexibility needed to manage cyclical and other fluctuations in the OBEGAL. The second option provided more flexibility and suggested a broader target of achieving "small surpluses," subject to economic and fiscal conditions, with less clarity on the definition of small surpluses.

Fiscal Operating Balances (OBEGAL)[1/]

(Percent of fiscal year GDP)



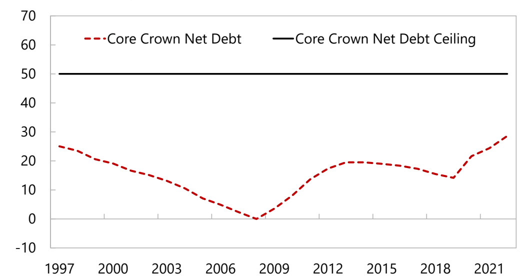
Source: New Zealand Treasury.

1/ OBEGAL: Operating Balance Excluding Gains and Losses.

8. To calibrate the net debt ceiling, Treasury considered the maximum level of net debt where it would still be plausible to stabilize and reduce net debt to GDP back to levels which restore fiscal buffers. For its calculations, Treasury took into consideration the maximum feasible primary balance that New Zealand could achieve based on historical performance (a primary surplus of 1-3 percent), conservative estimates of differentials between debt interest rates and GDP growth rates (with 3 percent being the most conservative based on historical evidence), and conservative fiscal buffers required for economic shocks (despite macroeconomic shocks averaging 10 percent of GDP historically, Treasury recommended an additional and more fiscally conservative of 40 percent of GDP to absorb medium or large shocks).

Core Crown Net Debt and New Debt Ceiling Since 2022

(Percent of fiscal year GDP)



Sources: New Zealand Treasury, Stats NZ.

Note: Core Crown net debt represents gross sovereign issued debt less financial assets (excluding financial assets held by the NZS Fund).

9. Assuming a maximum net debt level of 90 percent of GDP, a net debt ceiling between 40-60 percent of GDP was found prudent. As a result, Treasury recommended a net core crown debt ceiling of 50 percent of GDP (or 30 percent based on the new net debt indicator including the NZSF). This ceiling is expected to provide over 40 percent of fiscal buffers for shocks, provisional on running sustained primary surpluses over time. However, Treasury acknowledged that running primary surpluses would become more challenging over time, given rising costs associated with aging demographics.

10. The new fiscal framework marks a shift from previous Treasury advice. Relative to 2019's recommendation of a net debt target of 30 percent of GDP, the new net debt ceiling is less constraining, especially in the context of large infrastructure gaps given New Zealand's needs for greater capital investment in the years ahead.

Annex VIII. Reviewing New Zealand's Monetary Policy Framework and Performance

The RBNZ launched two reviews related to monetary policy formulation and implementation in 2022.[1] *The first, the Review and Assessment of the Formulation and Implementation of Monetary Policy (RAFIMP), covered the period 2017-2022, was completed in November 2022. The second is the 5-yearly review of the Remit and Charter of the Monetary Policy Committee (MPC)—a statutory requirement under the Reserve Bank Act—which was completed in June 2023. The new Remit and Charter were adopted on June 27, 2023.*

A. Review and Assessment of the Formulation and Implementation of Monetary Policy

1. The RAFIMP examined all aspects of policy formulation and implementation, including forecasting and analysis; decision-making processes; communication; and the development and use of appropriate monetary policy tools. The assessment split the period under consideration into 3 parts: the below-target inflation period from 2017 until the onset of the pandemic; the initial pandemic response in 2020; and the post-pandemic period in 2021-22 characterized by the recovery, supply chain disruptions and the war in Ukraine. In preparing the RAFIMP, the RBNZ solicited inputs from a wide variety of internal and external stakeholders, including the RBNZ Board and members of the MPC. In addition, two external reviewers were commissioned to provide independent assessments.

2. The RAFIMP's key findings were:

- The formulation and implementation of monetary policy was consistent with the RBNZ's objectives.
- The MPC was agile and nimble in setting monetary policy in light of unprecedented shocks. In particular, the easing of monetary policy at the outset of the pandemic was warranted.
- But the interaction of monetary policy with fiscal policy, where policy actions were large and innovative, led to unexpected outcomes. Further work is needed to strengthen the MPC's understanding of these measures and their impact on monetary policy.
- The introduction of Additional Monetary Policy (AMP) tools such as the Large-scale Asset Purchase (LSAP) and Funding for Lending (FLP) programs restored functionality to the financial system but likely contributed to higher-than-expected activity and, by 2021, inflation. In particular, the FLP could have been designed more flexibly to allow the RBNZ to phase it out earlier as demand and price pressures were becoming evident.

[1] Details are available at https://www.rbnz.govt.nz/monetary-policy/about-monetary-policy/rafimp and https://www.rbnz.govt.nz/monetary-policy/about-monetary-policy/remit-review.

- The MPC's inflation and employment objectives were not in conflict over the review period.
- Macroprudential policies were the appropriate tools to limit financial stability risks from rising asset prices.
- Communicating the objectives of monetary policy and the RBNZ's actions was a challenge, particularly the MPC's commitment to ensure maximum sustainable employment.
- With hindsight, monetary policy should have been tightened earlier in 2021. But even if the MPC had acted more quickly, the inflationary impact stemming from supply shocks and the war Ukraine was unlikely to have been fully offset.

3. In light of these findings, the RAFIMP recommended the following:

- More work is needed to understand the implications of supply shocks on inflation, including due to pandemics, natural disasters and climate change.
- New data sources to facilitate better real-time monitoring of the economy are needed.
- Better estimates of neutral interest rates are needed to prevent the overly tight monetary policy that prevailed in the pre-pandemic period.
- There needs to be a better understanding of the role of fiscal policy and its interaction with monetary policy when used to manage economic shocks.
- The measure of maximum sustainable employment should be made more precise to facilitate policymaking and communication.
- The LSAP program is a useful and viable tool to address market dysfunction in the future, but more work is needed to improve the communication of monetary policy when the LSAP is part of the policy mix.
- Caution is needed in the provision of forward guidance given the experience with the FLP.

4. With regards to monetary policy implementation, the RAFIMP recommended that:

- The OCR should remain the preferred tool for setting monetary policy.
- AMP tools, including the possible deployment of a negative OCR, should be maintained given the risk of the OCR hitting its effective lower bound.

B. Review of the Remit and Charter of the Monetary Policy Committee

5. Where the RAFIMP was concerned about the formulation and implementation of policy, the Review of the MPC's Remit[2] and Charter[3] also covered the objectives of monetary policy and the MPC's accountability framework. In particular, the Review looked at the trade-offs in implementing the dual mandate, as well as other requirements placed on the MPC in formulating monetary policy. The Review was carried out by the RBNZ, which prepared a set of recommendations for the government, which formed the basis of adjustments to both.

6. The RBNZ undertook a 3-stage process in conducting the Review: The first stage, launched in June 2022, involved a public consultation on a variety of identified issues. After considering the comments, the RBNZ prepared a set of draft recommendations, which were released for a second round of public consultations at the end of November 2022. The feedback on the draft recommendations informed the final recommendations, which were delivered to the Minister of Finance in May 2023.

7. In the consultations, there was strong public support for maintaining the primacy of the inflation objective, with many respondents favoring giving it a larger weight relative to the employment objective. Respondents showed less interest in other considerations (house prices, climate change, distributional effects of monetary policy) being included in the monetary policy mandate. There was also support for maintaining the current target (range of 1-3 percent, with a focus on the mid-point over the medium term) and the current flexible inflation targeting approach. There was less consensus on the price measure to be targeted, with concerns the CPI understated some aspects of the cost of living such as house prices. On the employment objective, there was a sense the objective could be more precisely defined but less so on the actual measures that could be targeted.

8. Based on these, and in response to comments received in the second round of public consultations, the RBNZ provided its recommendations on the Remit, which were largely accepted by the Minister in June 2023:

- There was a strong sense that current operational framework for monetary policy (flexible inflation targeting) rather than alternatives, such as price level targeting, remained appropriate and thus was retained. The RBNZ also recommended that the new Remit clarify the primacy of the inflation objective, with a preference for an ordering of its monetary policy objectives, with a priority on inflation and the commitment to support maximum sustainable employment a secondary target but this was not changed. In line with the RBNZ Act, and recognizing that

[2] The Remit sets out how the MPC goes about meeting its economic objectives of price stability and maximum sustainable employment over the medium term and covers matters such as choice of the intermediate targets and choice of instruments. The Remit is set solely by the Minister of Finance, based on the advice of the RBNZ.

[3] The Charter provides guidance on the process by which the MPC makes decisions and communicates these, and how it is held accountable for the outcomes. This includes setting out the frequency of MPC meetings, process by which decisions are made, and communications with the public and accountability to Parliament. Unlike the Remit, the Charter is jointly agreed between the Minister of Finance and the MPC.

inflation is currently above target, the Remit now specifies the MPC must "achieve and maintain" inflation within the target range.

- The Remit clarifies that the MPC is required to "seek to understand and communicate material interactions between monetary policy and other government objectives" due to monetary policy decisions (ex post), rather than assessing the effect of monetary policy decisions on them (ex ante). This includes the earlier requirement to give due regard to house prices, alongside the obligation to examine the interactions between monetary and fiscal policies, understand the implications of monetary policy decisions on financial stability, examine the impact of the choice of monetary policy instruments on the RBNZ's financial risks, and support information-sharing between the monetary and fiscal authorities. In making its monetary policy decisions, the requirements on the MPC have been streamlined to:
    - Have regard to the importance of protecting financial stability; and
    - Seek to avoid unnecessary instability in output, interest rates and exchange rates.
- The flexibility inherent in the current framework with regard to the time horizon and the definition of maximum sustainable employment works well and gives the MPC sufficient scope to meet its objectives.
- The current inflation target (the 1-3 percent range and the 2 percent mid-point) is consistent with the RBNZ Act's definition of price stability and ensures low and stable inflation consistent with sustainable growth. While consideration could be given to a higher target due to the implications of getting close to the zero lower bound on the policy rate, the existing target achieves a balance between the costs and benefits of positive inflation, which argues against a change.
- The All Groups Consumer Price Index remains the best measure of prices and is the appropriate target in the pursuit of price stability. That said, the RBNZ considered it would be a significant improvement to produce a monthly series rather than the current quarterly schedule.

Additionally, the Charter was also reviewed based on the RBNZ's recommendations and in consultation with members of the MPC, with the following changes:

- The Charter remains largely appropriate in guiding the functioning of the MPC. The revised Charter clarifies the requirements for MPC members, including external members, to communicate both the consensus and their own views of the MPC's policy strategy and decisions, the balance of risks and the economic outlook . While MPC members have been able to communicate independently in the past, the authorities hope the new clarifications will facilitate more wide-ranging public communication by members going forward.
- The requirements to formalize the process for assessing and reporting the interaction between monetary and fiscal and other policies, such as house price sustainability, as well as risks to financial stability and impact of the choice of monetary policy tools on the RBNZ's financial position in MPC meetings have been adjusted in light of the change in the Remit.

Annex IX. Fiscal Implications of Large-Scale Asset Purchases by the RBNZ[1]

1. **It is well understood that conventional monetary easing has a favorable impact on the fiscal position**. This is because easier monetary conditions reduce debt servicing costs, boost aggregate demand, and increase tax revenues. In contrast, fiscal implications of large-scale asset purchases (LSAP) are less clear as they may adversely affect central bank profits. This can be particularly true if the monetary authority ends up normalizing policy earlier than expected when launching LSAP.

2. **These considerations are highly relevant for countries like New Zealand, which joined many other economies in relying heavily on LSAPs to mitigate adverse macroeconomic effects of the Covid-19 recession.** The monetary easing by RBNZ involved cuts in the policy rate and purchases of assets worth around 16 percent of annual GDP. A faster post-pandemic recovery and spike in energy prices due to Russia's invasion of Ukraine called for faster monetary normalization, with the policy rate quickly rising above 4 percent.

3. **To assess the fiscal effects of LSAP by RBNZ, a two-country New Keynesian model with bond market segmentation is used**.[2] The model is augmented to include a rich account of fiscal policy and government debt dynamics, and is calibrated to reflect the key features, initial conditions, and recent developments of the New Zealand economy. A large, negative demand shock to simulate a severe fall in the global economic activity is used, which drives the RBNZ policy rate to its effective lower bound. Next the model is used to assess macroeconomic developments depending on whether RBNZ undertook LSAPs or not.

4. **By lowering long-term rates, LSAPs helped mitigate the contraction in economic activity and deflationary pressures, and created room for an earlier policy lift-off (see Figure IX.1).** Had the economic recovery proceeded as forecasted at the time of the purchases, the impact of LSAP on the fiscal stance would be clearly favorable, implying a reduction in government debt by more than 2 percent of annual GDP in the 8-year horizon. This positive fiscal outcome is mainly due to increased tax revenues and lower debt service costs, which more than offset the effect of lower central bank profits that cumulate to less than 1 percent of annual GDP.

5. **However, LSAPs make the central bank balance sheet more vulnerable to earlier policy normalization.** Indeed, this risk materialized as the RBNZ policy rate needed to be increased much earlier and more drastically than projected at the onset of the Covid-19 crisis. This scenario is simulated in the model by assuming that, about 1.5 years after the LSAPs, positive demand and negative supply shocks trigger a faster global recovery. These shocks are aimed to capture the post-pandemic recovery and sharp increase in energy prices, both contributing to a sharp rise in inflation.

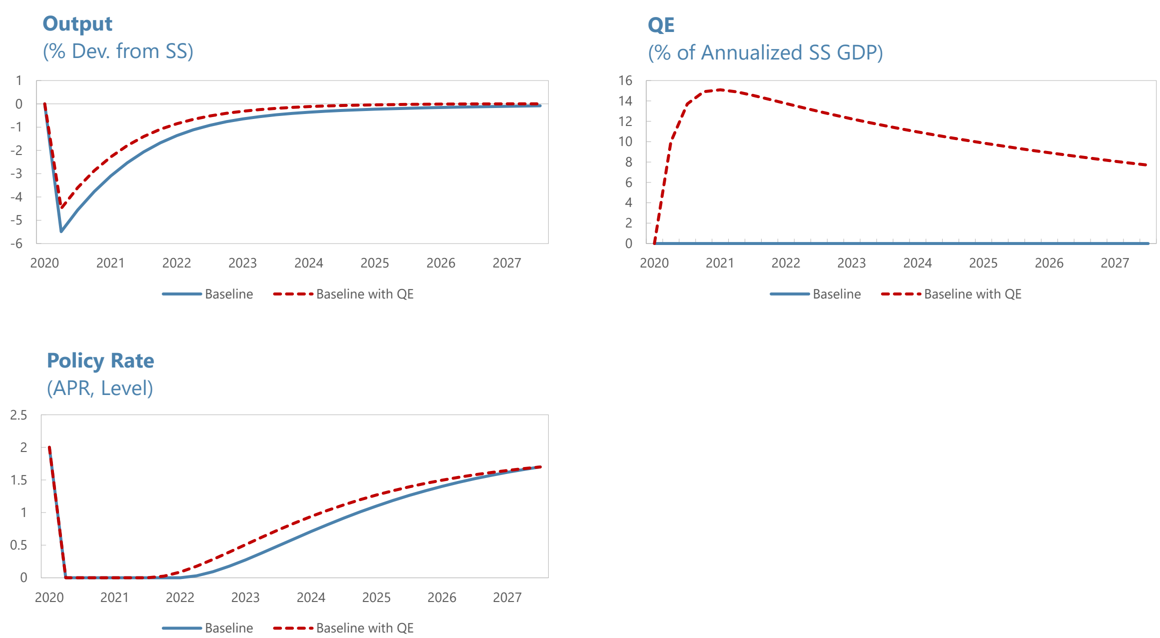
[1] Prepared by Marcin Kolasa, Jesper Linde and Pawel Zabczyk.

[2] Erceg, C., Kolasa, M., Linde, J., and P. Zabczyk (2023). Central Bank Exit Strategies: Domestic Transmission and International Spillovers. IMF Working Paper (forthcoming).

6. In this scenario with earlier monetary tightening, the cumulative decrease in central bank profits due to LSAPs amounted to about 2.5 percent of annual GDP (see Figure IX.2). In consequence, ex post fiscal gains from LSAPs were significantly reduced. Even so, the overall impact of this unconventional policy on the medium-run level of public debt is still likely to remain favorable, though small.

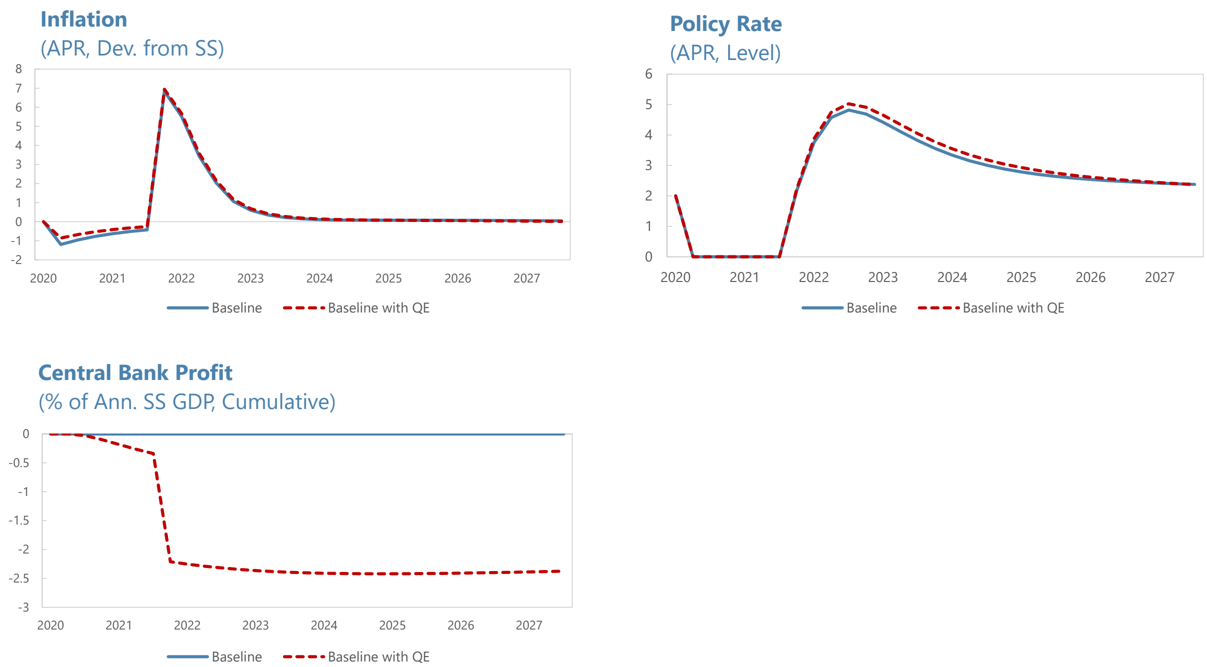
7. Overall, LSAP by RBNZ had favorable effects on the fiscal stance, even if the earlier than expected monetary policy normalization is taken into account. These outcomes can be contrasted with the consequences of a fiscal stimulus which, if used to provide a similar boost to economic activity to that achieved with LSAP, would clearly increase the medium-run level of government debt, at least for realistic values of fiscal multipliers.

Annex IX. Figure 1. Covid-19 Recession with and without LSAP



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

Annex IX. Figure 2. Covid-19 Recession with Earlier Policy Tightening



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

INTERNATIONAL MONETARY FUND

NEW ZEALAND

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 14, 2023

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of June 30, 2023)

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	887.85	70.91
Reserve position in Fund	364.68	29.13
Lending to the Fund		
New Arrangements to Borrow	1.94	

SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	2,053.84	100.00
Holdings	2,165.69	105.45

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) [1/]

	Forthcoming				
	2023	2024	2025	2026	2027
Principal					
Charges/Interest		0.03	0.03	0.03	0.03
Total		**0.03**	**0.03**	**0.03**	**0.03**

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

Exchange Rate Arrangement:

The New Zealand dollar has floated independently since March 1985. The de facto exchange rate arrangement is floating, and the de jure exchange rate arrangement is free floating. New Zealand accepted the obligations under Article VIII, Sections 2a, 3, and 4 of the IMF's Articles of Agreement on August 5, 1982 and maintains an exchange system that is free of multiple currency practices and 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 2022 Article IV consultation was concluded by the Executive Board on May 13, 2022.

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 May 26, 2023)

I. Assessment of Data Adequacy for Surveillance
General. Data provision is adequate for surveillance. The authorities are continuing to enhance data quality and expand the range of data available and are making progress towards subscribing to the IMF's Special Data Dissemination Standard (SDDS).
Real Sector. Annual estimates of GDP are compiled for production, expenditure and income, in nominal and chained volume terms. Estimates are fully reconciled via supply and use tables and make use of annual enterprise and household surveys to update benchmarks. The authorities compile quarterly estimates of GDP 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.
Fiscal Sector. Stats NZ provides annual data (operating statement, balance sheet, government expenses by function, taxation revenue and non-financial assets reconciliation) on the general government and its central and local government subsectors following the *Government Finance Statistics Manual 2014* (*GFSM 2014*) recommendations for data beginning from 2009 on a fiscal year (July-June) basis. It is published roughly five months following the fiscal year end, preceded by data on a provisional basis at the time of the budget (usually in May). The authorities also report detailed central government debt data to the IMF / World Bank Quarterly Public Sector Debt Database. The Treasury also provides data on a timely basis for the central government that complies with New Zealand equivalents of the GAAP Public Sector Public Benefit Entity (PBE) Standards from 2005 onwards. They are provided on a monthly basis (with a one-month lag), with an annual statement published within 4 months of the fiscal year end. The provided data enable adequate assessment of the impact of fiscal policy measures on New Zealand's economic performance.
Monetary and Financial Sectors. The Reserve Bank of New Zealand (RBNZ) publishes monthly and quarterly data on a broad range of monetary and financial variables. Monetary statistics compiled by the RBNZ are consistent with the methodology of the *2016 Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG)*. New Zealand reports high quality monetary

statistics regularly to STA for publication in *International Financial Statistics*. There is room for improving the timeliness of the data for other financial corporations. RBNZ also reports some data and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
Financial Sector Surveillance: New Zealand currently does not report Financial Soundness Indicators (FSIs) for dissemination on the Fund website. The authorities should develop an action plan to submit the FSI data and metadata to the IMF for posting.
External Sector. Stats NZ provides timely information on the balance of payments and the international investment position (IIP) on a quarterly frequency. The data are released around 11 weeks after the close of the reference quarter. The IIP and international financial assets and liabilities measures of New Zealand's international balance sheet position are complemented with data on 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 and in the Data Template on International Reserves and Foreign Currency Liquidity. Stats NZ also participates in the Coordinated Direct Investment and Portfolio Investment Surveys conducted by the IMF's Statistics Department.

New Zealand: Table of Common Indicators Required for Surveillance

(As of May 26, 2023)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	5/25/2023	5/25/2023	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/2023	5/25/2023	M	M	M
Reserve/Base Money	3/2023	4/27/2023	M	M	M
Broad Money	3/2023	4/27/2023	M	M	M
Central Bank Balance Sheet	3/2023	4/27/2023	M	M	M
Consolidated Balance Sheet of the Banking System	3/2023	4/27/2023	M	M	M
Interest Rates[2]	5/24/2023	5/24/2023	D	D	D
Consumer Price Index	Q1 2023	4/19/2023	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2022/23	14/5/2023	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[4]	2022/23	14/5/2023	A	A	A
External Current Account Balance	Q4 2022	3/14/2023	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2022	3/14/2023	Q	Q	Q
GDP/GNP	Q4 2022	3/15/2023	Q	Q	Q
Gross External Debt	Q4 2022	3/14/2023	Q	Q	Q
International Investment Position[5]	Q4 2022	3/14/2023	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic non-bank financing.

[4] Including currency and maturity composition.

[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by Oscar Parkyn, Alternate Executive Director for New Zealand
August 23, 2023

The New Zealand authorities appreciate the constructive and engaging consultation with the IMF mission team and broadly concur with the staff appraisal.

New Zealand's economy rebounded strongly from the pandemic, supported by a strong public health and economic policy response. The level of real GDP is 7% above its prepandemic level and the unemployment rate is below its pre-pandemic level. Economic growth has slowed, as anticipated, following this strong recovery. The authorities project real GDP growth to slow to around 1% in the June 2024 year and then average 2.7% thereafter. Continued strength in tourism, stronger growth in net migration, and rebuild activity associated with the North Island weather events will help to offset slowing demand in other parts of the economy.

Inflation is too high, although has reduced as demand softens and supply constraints ease. Annual consumer price inflation peaked at 7.3% in June 2022, driven by global and domestic factors. Annual inflation has now reduced to 6.0% with the CPI increasing at an annualized rate of 4.3% in the June 2023 quarter. However, with broad-based inflationary pressures and measures of core inflation proving persistent, monetary policy is appropriately maintaining a restrictive stance.

The housing market is stabilizing with macro-financial risks well contained. Nominal house prices were broadly stable over the June 2023 quarter, following a significant downward correction in nominal and real terms. A sooner-than-expected stabilization in house prices is anticipated to support domestic demand. Strong growth in net migration is a factor supporting housing demand. Prudential policies have contributed to significant resilience in the financial system, which has been evident as house price declines have not been associated with widespread impacts on financial stability.

Severe weather events have materially impacted the economic outlook and policy priorities. Large-scale flooding in Auckland was soon followed by Cyclone Gabrielle in early 2023. The weather events caused widespread damage to property, businesses and infrastructure across multiple regions with large impacts on the affected communities. As climate change has increased the frequency and severity of such extreme weather events, the authorities have accelerated their plans to adapt to climate change and build more resilient infrastructure.

The widening of the current account deficit largely reflects cyclical and temporary COVID-related effects. The current account deficit widened to 9% of GDP owing to cyclical overheating and the lingering effects of the pandemic, notably affecting tourism and international education exports and transportation costs. The authorities expect the current account deficit to narrow to sustainable levels as demand cools and services exports recover. While the current account deficit is large, a considerable external rebalancing since the Global Financial Crisis has been associated with an improvement in the net international investment position from -84% of GDP in 2009 to -49% in 2023. Moreover, external resilience is supported by the economy's sound macroeconomic fundamentals and institutions, including the freely floating exchange rate, and characteristics of the external balance sheet, including the maturity profile and currency denomination of external debt.

Monetary policy remains appropriately restrictive. The RBNZ began increasing the policy interest rate in October 2021, which was earlier than most central banks in advanced economies. The policy interest rate has increased by a cumulative 525 basis points. There are clear signs that this tightening is having its intended effect of reducing the imbalance between aggregate demand and supply. Indicators of inflation expectations have also fallen toward the target, underpinning confidence that long-term expectations remain wellanchored. The RBNZ remains data dependent and firmly focused on its mandate to bring future inflation back to target. The RBNZ is also steadily implementing its well-signaled plan to unwind its balance sheet measures.

The monetary framework has worked effectively following modernization in 2019. While governance and decision-making processes have been modernized, the longstanding pillars of New Zealand's sound approach to monetary policy remain: an operationally independent central bank, flexible inflation targeting and a freely floating exchange rate. The Monetary Policy Committee's Remit and Charter were updated in June 2023, in accordance with the legislative requirements. The remit remains focused on achieving a medium-term inflation target of 1-3%, with a focus on the 2% midpoint, and supporting maximum sustainable employment. The RBNZ continues to draw lessons from recent experience. It is implementing a program of work, including a revamped research agenda, in response to recommendations in its recent Review and Assessment of the Formulation and

Implementation of Monetary Policy. The authorities also welcome staff's attention on the topic of large-scale asset purchases (Annex IX) and encourage further analysis tailored to the specific country circumstances, noting that there are significant uncertainties in modelling the effects of alternative monetary policies.

The Government's fiscal strategy prudently balances a range of considerations. A gradual fiscal consolidation planned over the medium term will ensure fiscal sustainability and support monetary policy by helping to alleviate inflationary pressures. Within this strategy, the Government continues to make long-term investments in accordance with the priorities of its successive Wellbeing Budgets. This approach is informed by the New Zealand Treasury's Living Standards Framework that considers a broad range of factors that matter for the quality of life. The 2023 Budget focused on delivering core public services well, responding to the North Island weather events and investing in infrastructure. The new National Resilience Plan will focus initially on rebuilding from Cyclone Gabrielle and then on closing a long-term infrastructure deficit. While the Budget includes targeted support to alleviate households' cost of living pressures, broad fiscal support measures, put in place in response to COVID-19 and the energy price shock, have been unwound.

The fiscal stance is contractionary over the authorities' four-year forecast horizon. This is supported by a significant decline in real government consumption expenditure. The fiscal stance was less contractionary than earlier planned owing to the impact of the recent North Island weather events and cost pressures in the public sector. While the fiscal impulse is estimated to be positive in the current fiscal year, the authorities note that near-term fiscal impulse forecasts are highly uncertain. There has been material volatility in recent years, mainly owing to variability in the timing of revenue collection, capital budget execution and cyclical adjustments.

The fiscal rules support fiscal sustainability while providing space for long-term investments. The primary fiscal rule is to return the operating balance to surplus and maintain small surpluses thereafter, with the intention to achieve this within the Treasury's forecast period ending 2026/27. A net public debt ceiling of 30% of GDP complements the operating balance target while providing space for high-quality public investment. Net public debt currently sits at around 18% of GDP. Maintaining a strong public sector balance sheet provides an important fiscal buffer for future shocks, including future economic downturns, pandemics, natural disasters and climate-related events. The Government's fiscal plan supports a commitment of NZ$71 billion for infrastructure investment over the next five years, while keeping central government net debt well below the 30% of GDP ceiling.

Innovations in fiscal transparency will also support a more integrated fiscal framework to address future challenges. In addition to the regular *Economic and Fiscal Updates*, *Investment Statement* and *Statement on the Long-term Fiscal Position,* innovations in reporting will support policymakers to further integrate considerations related to climate, digitalization, inclusion and demographic transition. The *Wellbeing Report,* first published in

2022, was added to the suite of reporting required by the Public Finance Act. In addition, the Treasury and Ministry for the Environment released a *Climate Economic and Fiscal Assessment (CEFA)* in 2023. Along with a focus on climate change and natural disaster risks in recent Long-term Fiscal and Investment Statements, the CEFA will support the integration of climate considerations into the fiscal framework. The 2023 Budget continued to include Wellbeing Objectives and the Child Poverty Report, while also incorporating gender budgeting for the first time.

New Zealand's financial system is sound and resilient. The banking system's capital and liquidity positions are strong, with profitability and asset quality remaining high. The RBNZ is closely monitoring pressures among households and business sectors from the tighter financial conditions. While borrowers are facing increased debt servicing costs, there have been limited signs of distress in banks' lending portfolios to date, with only a small share of borrowers falling behind on their payments. While the financial system has been resilient to the effects of the North Island weather events, it underscores the ongoing need to enhance understanding and management of the financial system's exposure to climate risk.

The authorities are implementing a major overhaul of the regulatory framework to support financial stability. The authorities have progressed a wide-ranging reform agenda building on the recommendations contained in the 2017 FSAP. A major milestone was reached with the enactment of the Deposit Takers Act in 2023. This legislation modernizes the regulatory framework to provide a single, coherent regulatory regime for all bank and non-bank deposit takers. It will enhance regulation and supervision, management and resolution of any deposit taker in financial distress and introduces a new deposit insurance scheme.

The authorities continue to explore potential solutions to the withdrawal of correspondent banking relationships (CBRs) among Pacific Island countries. The drivers of withdrawal are complex, involving banks' commercial decisions, including the compliance burden and reputational risks associated with AML/CFT regulation, and the scale of impact differs across the Pacific. The Ministry of Foreign Affairs and Trade, the Treasury and the RBNZ are working with international partners to identify possible solutions, such as through targeting the drivers of withdrawal or exploring alternative mechanisms for crossborder transactions.

The structural policy agenda works toward a more productive, sustainable and inclusive economy. Easing global supply bottlenecks is supporting potential growth, while policy reforms will also work to reduce domestic supply constraints. There is a broad policy agenda to upgrade infrastructure, improve the investment environment through resource management reform and address skills gaps through education, training and migration policy. New Zealand continues to be a strong advocate for a rules-based, international trading system through the WTO, while actively expanding its network of high-quality trade agreements. It has recently concluded a Free Trade Agreement with the European Union. Nevertheless, the authorities recognize that further efforts are needed to materially improve New Zealand's productivity performance, support the climate transition and lift social inclusion, including addressing gender inequities and improving opportunities for Māori and Pacific peoples.

Housing affordability remains a major structural challenge. A lack of affordable housing has been a long-standing policy concern due to its adverse impacts on economic and social outcomes. The authorities are progressing reforms to ease regulatory, planning and infrastructure constraints on housing supply, including a requirement that local government permit greater density in urban areas. A significant expansion in housing supply is underway, particularly in medium-to-high density housing types. The number of consents issued for new residential dwellings appears to be stabilizing, currently around pre-pandemic levels, after reaching a historic 28-year peak in March 2022. Further implementation of reforms to ease land use constraints is needed to achieve greater housing affordability.

The Government is committed to a just transition to a climate-resilient, sustainable and low-emissions economy. New Zealand has built a strong institutional framework to address climate change, including the Zero Carbon Act and five-yearly emissions budgets with an independent Climate Change Commission that monitors progress against these commitments. The authorities have made further progress with the release of the first Emissions Reduction and National Adaptation Plans in 2022, and implementation of these Plans is being supported by funding from the Climate Emergency Response Fund. The Emissions Trading Scheme (ETS), the centerpiece of mitigation policy, is an effective and efficient instrument for achieving emissions reduction commitments. The ETS is being reviewed to consider whether any design refinements would improve its functioning and contribution to mitigation goals. The authorities remain committed to pricing agricultural greenhouse gas emissions and have been working with the sector to find workable mechanisms.

New Zealand actively supports international cooperation to address climate change. New Zealand recognizes it is essential to lift ambition to meet the Paris Agreement's goal to limit warming to 1.5 degrees. New Zealand has committed NZ$1.3 billion in grant-based climate finance for developing economies between 2022 and 2025. At least half of this climate finance commitment will support Pacific Island countries and at least 50% will target adaptation, a key priority for the Pacific.