Treasury, 2010

NEW ZEALAND

Economic and Financial Overview

– 2010 –

Otago farmland, Rock and Pillar range in background. *Andris Apse*

ISSN: 1173-2334 (Print)
ISSN: 1178-749X (Online)

New Zealand Government

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Unless otherwise specified, all monetary units in this Overview are New Zealand dollars. The mid-point rate on 29 January 2010 was NZ$1 = US$0.7048.

The fiscal year of the Government of New Zealand ends on 30 June.

Spelling and punctuation conform to usage in New Zealand and have not been adjusted to conform to usage in the United States or any particular external market.

Where figures in tables have been rounded, totals listed may not equal the sum of the figures.

In tables, NA = Not Available.

This Overview is based on data available as at January 2010.

Introduction

New Zealand is a parliamentary democracy situated in the South Pacific. It has a population of around 4.3 million in a country similar in land area to Japan. New Zealand has a market economy with sizeable manufacturing and services sectors complementing a highly efficient export-oriented agricultural sector. New Zealand's high proportion of winter sunshine hours and considerable rainfall provide an ideal resource base for pastoral agriculture, forestry, horticulture and hydro-electricity generation. Hydro-electricity provides a relatively cheap source of energy and has allowed the development of energy-based industries such as aluminium refinement. New Zealand is also a popular overseas visitor destination and tourism is an important source of export income.

Economy

Over the last quarter of a century, the New Zealand economy has changed from being one of the most regulated in the Organisation for Economic Cooperation and Development (OECD) to one of the least regulated. The minority National Party government elected in November 2008 aims to lift the long-term performance of the economy through six key policy drivers: a growth-enhancing tax system; better public services; support for science, innovation and trade; better regulation, including regulation around natural resources; investment in infrastructure; and improved education and skills.

The New Zealand economy entered recession in early 2008, before the effects of the global financial crisis were felt later in the year. A drought over the 2007/08 summer led to lower production of dairy products in the first half of 2008. Domestic activity slowed sharply over 2008, as high fuel and food prices dampened private consumption, while high interest rates and falling house prices drove a rapid decline in residential investment. Economic activity fell sharply following the intensification of the global financial crisis in September 2008, contracting 0.9% in the December quarter 2008 and 0.8% in the March quarter 2009, with production GDP driven by reductions in manufacturing, construction, and wholesale and retail trade.

The combination of exceptionally low fixed mortgage interest rates and rapidly increasing net migration led to house prices rising in the June quarter 2009, after prices had declined 9.8% from the December 2007 peak. Renewed optimism in the economy drove consumer and business confidence higher, with activity recording modest growth of 0.2% in the June quarter 2009. This quarterly expansion marked the end of a five-quarter recession which began in March 2008, during which the New Zealand economy contracted a cumulative 3.3%. The relative shallowness of the recession compared favourably with other nations in the OECD, with New Zealand the seventh least affected out of the 30 member nations.

The economy recorded further positive growth in the September quarter 2009, with production and expenditure GDP both up 0.2% owing to strong primary production and private consumption. Annual average growth is expected to improve from the -2.2% recorded in the year to September 2009 to -0.4% in the year to March 2010, driven by a recovery in domestic demand. In addition to stronger residential investment resulting from the housing market recovery, stronger consumer confidence and a higher population base is expected to have a positive impact on private consumption in the near term. Further out, the strengthening global economy and a lower exchange rate are forecast to result in stronger export volumes driving economic growth.

The annual current account deficit narrowed from 8.7% of GDP in December 2008 to 3.1% of GDP in September 2009, reflecting a sharp reduction in imports, lower international interest payments and weaker profits for overseas-owned firms. As a proportion of GDP, the deficit is expected to rise gradually over the medium term, in line with increased demand for imported goods and higher interest rates

Annual Consumer Price Index (CPI) inflation fell to 2.0% in the year to September 2009 after reaching 5.1% one year earlier. This figure is expected to increase slightly over the medium term, but remain within the Reserve Bank's target band of 1% to 3%. The moderate outlook for inflation reflects higher tradables inflation (owing to an expected lower exchange rate), offset by lower non-tradables inflation (reflecting continuing spare capacity in the economy).

Response to International Credit Crisis

In response to the international credit crisis, the Reserve Bank began lowering the Official Cash Rate (OCR) in July 2008 and introduced a range of facilities designed to ensure that adequate liquidity was available to the banking sector. The government provided further support, introducing retail and wholesale bank guarantees, along with personal income tax cuts on 1 October 2008 and again on 1 April 2009. Other measures taken by the government include:

- an accelerated package of 'ready-to-roll' infrastructure projects spanning the housing, transport, education and energy sectors at an estimated cost of almost $500 million; and
- a relief package designed to assist small and medium-sized businesses (which make up the largest proportion of New Zealand firms) in order to reduce compliance costs and improve the business environment in the face of the crisis.

Macroeconomic Policy

In the area of macroeconomic policy, the Reserve Bank Act 1989 and the Public Finance Act 1989 (as amended in 2004) continue to set the framework. In June 2006, the New Zealand Treasury and the Reserve Bank of New Zealand co-hosted a Macroeconomic Policy Forum that brought together international and domestic experts to examine New Zealand's macroeconomic framework. The overall assessment of the invited speakers and participants was that the essential elements of New Zealand's macroeconomic policy institutions are sound and appropriate.

Further assessment of the macroeconomic policy framework was undertaken as part of an enquiry into the operation of monetary policy in New Zealand by Parliament's Finance and Expenditure Select Committee. The Committee's report presented to Parliament in September 2008 largely endorsed the current monetary policy framework, with recommendations to improve the information available to policy makers and to strengthen the institutional focus on increasing productivity growth.

Monetary Policy

The focus of monetary policy is on maintaining price stability. A Policy Targets Agreement between the Governor of the Reserve Bank of New Zealand and the Minister of Finance sets out the specific targets for maintaining price stability, while seeking to avoid unnecessary instability in output, interest rates and the exchange rate. The most recent Agreement was signed in December 2008 after the new government took office. There were no substantive changes to the Agreement. The policy target is to keep future CPI inflation outcomes between 1% and 3% on average over the medium term.

From 2004 until mid-2008, monetary policy was in a tightening phase with the Reserve Bank increasing the OCR by a total of 325 basis points from 5.0% in January 2004 to a peak of 8.25% in July 2007. The policy tightening reflected a prolonged period of strength in the domestic economy, which left productive resources stretched and led to a rise in non-tradable inflation. In line with moves by central banks around the world, the Reserve Bank commenced an easing cycle in response to the international financial crisis. The OCR was reduced by 150 basis points in December 2008 and again in January 2009 following smaller cuts at each of the previous three rate reviews. Further cuts at the next two reviews brought the OCR to 2.5% in April 2009. In January 2010, the OCR remained at 2.5%.

Recent statements from the Reserve Bank, the latest being in January 2010, suggest that rates may begin to tighten from the middle of 2010. The Bank noted that the current policy settings are consistent with inflation remaining within the target band over the medium term as both tradable and non-tradable inflation continue to be weak.

Fiscal Policy

On the fiscal front, the 1990s saw a consolidation of the country's fiscal position with the Fiscal Responsibility Act (now Part 2 of the Public Finance Act 1989) ensuring that fiscal policy is prudent and transparent. The government remains committed to maintaining a sound fiscal position.

In 2008/09, a deficit on the government operating balance of $10.5 billion was recorded. This compares with a surplus of $2.38 billion in 2007/08 and $8.02 billion in 2006/07. An operating deficit of $4.8 billion is forecast for 2009/10.

Direct Public Debt

At 30 June 2009, New Zealand's gross direct public debt was $41.3 billion, or 28.1% of estimated GDP. At the same date, public sector foreign-currency debt was $4.2 billion, and interest charges on foreign-currency debt were $48 million. The government has no net foreign-currency debt.

Statistical Data

	2005	2006	2007	2008	2009
		(dollar amounts in millions)			
Gross Domestic Product at Current Prices (1)(2)	151,701	160,273	168,328	181,259	84,802
Annual average % change in Real GDP (1)(2)(3)	3.7	3.2	0.9	2.9	(1.4)
Population (thousands) (4)	4,134	4,185	4,228	4,269	4,316
Unemployment Rate (5)	3.8	3.7	3.7	4.0	6.0
Change in Consumer Price Index (6)	2.8	4.0	2.0	4.0	1.9
Exchange Rate (7)	0.7085	0.6190	0.7559	0.7607	0.6374
90-Day Bank Bill Rate (8)	7.03	7.47	8.32	8.68	2.78
10 Year Government Loan Stock Rate (8)	5.71	5.84	6.72	6.42	5.98
Terms of Trade Index (2)(9)	1,091	1,097	1,122	1,242	1,185
Current Account Deficit as a % of GDP (1)(2)	(6.7%)	(9.0%)	(8.0%)	(7.8%)	(7.9%)

Government Finance(10)

Year ended 30 June	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**2009/10(11)**
			(dollar amounts in millions)			
Total Revenue	65,367	71,425	74,589	81,479	79,928	75,972
Total Expenses	58,292	64,334	68,729	75,842	83,821	83,437
OBEGAL (12)	7,075	7,091	5,860	5,637	(3,893)	(7,465)
Gains/(Losses)	(1,144)	2,451	2,162	(3,253)	(6,612)	2,671
Operating Balance	5,931	9,542	8,022	2,384	(10,505)	(4,794)
% of GDP	3.9%	6.1%	4.8%	1.3%	(5.8%)	(2.6%)
Net Worth	54,240	83,971	96,827	105,514	99,515	94,809
Net Direct Domestic Borrowing	(662)	(1,221)	(3,917)	1,721	8,454	-
Net Direct Overseas Borrowing	559	(16)	312	(1,296)	717	-

Direct Public Debt

Internal Funded Debt	26,555.3	25,346.9	26,860.4	28,210.4	29,614.5	-
Internal Floating Debt	5,595.0	5,057.0	2,303.4	1,655.0	7,505.0	-
External Debt	3,931.3	5,116.4	2,048.0	2,048.5	4,718.7	-
Total Direct Public Debt	36,081.6	35,520.3	31,211.4	31,913.9	41,298.2	-

(1) Year ended 31 March.

(2) 2009 data provisional. Prior years' data revised.

(3) Production based – chain volume series expressed in 1995/96 prices.

(4) June year resident population estimate.

(5) June quarter, seasonally adjusted.

(6) Annual percentage change, June quarter.

(7) US$ per NZ$ monthly average for June.

(8) June monthly average.

(9) Year ended 30 June. Base: June quarter 2002 = 1,000.

(10) This table is prepared in accordance with New Zealand Generally Accepted Accounting Practice (GAAP).

(11) Half-Year Economic and Fiscal Update published 17 December 2009.

(12) Operating Balance Excluding Gains and Losses. The OBEGAL is the operating balance excluding gains and losses on assets and liabilities of institutions such as the Accident Compensation Corporation, Earthquake Commission and the Government Superannuation Fund.


NORTH
WEST
EAST
SOUTH
WHANGAREI
AUCKLAND
TAURANGA
HAMILTON
ROTORUA
TAUPO
GISBORNE
NEW PLYMOUTH
NAPIER
HASTINGS
WANGANUI
PALMERSTON NORTH
MASTERTON
NELSON
BLENHEIM
WELLINGTON
GREYMOUTH
CHRISTCHURCH
TIMARU
OAMARU
QUEENSTOWN
DUNEDIN
INVERCARGILL

NEW ZEALAND

The Economy of New Zealand: Overview

Introduction

New Zealand has a small open economy which operates on free market principles. It has sizable manufacturing and service sectors complementing a highly efficient agricultural sector. New Zealand is highly dependent on the primary sector with commodities accounting for around half of total goods exports. Exports of goods and services account for around one third of real expenditure GDP.

Recent Economic Performance and Outlook

Between 2000 and 2007, the New Zealand economy expanded by an average of 3.5% each year as private consumption and residential investment grew strongly. Annual inflation averaged 2.6%, comfortably within the Reserve Bank's 1% to 3% target range, while the current account deficit averaged 5.8% of GDP over this period.

The New Zealand economy entered recession in early 2008, before the effects of the global financial crisis set in later in the year. A drought over the 2007/08 summer led to lower production of dairy products in the first half of 2008. Domestic activity slowed sharply over 2008 as high fuel and food prices dampened domestic consumption while high interest rates and falling house prices drove a rapid decline in residential investment.

The outlook for the New Zealand economy deteriorated sharply following the intensification of the global financial crisis in September 2008. Similar to experiences across advanced economies, business and consumer confidence plummeted as uncertainty dominated the global financial and economic environment. In addition, local banks' access to funding in overseas markets was temporarily curtailed at the height of the crisis. Economic activity contracted 0.9% in the December quarter 2008, with production GDP affected by a reduction in manufacturing, construction and wholesale and retail trade. On the expenditure side, investment fell sharply while the extent of uncertainty in the global economy was evident in large declines for both services and goods exports. Overseas importers ran down stocks in the face of the uncertainty, while inbound tourism continued to weaken as fears around job security and declining incomes weighed on decisions to travel.

The government and the Reserve Bank responded to the crisis with a range of measures designed to alleviate its effects. The Reserve Bank lowered the OCR from its level of 8.25% over the year to July 2008 to a low of 2.5% at the end of April 2009. The Reserve Bank also introduced a range of facilities to ensure that adequate liquidity was available to the banking sector. The government introduced retail and wholesale bank guarantees aimed at restoring confidence in the banking sector and providing banks with improved access to wholesale funding. The Labour-led government proceeded with personal income tax cuts on 1 October 2008 and the new National-led government, which came to power in November 2008, introduced further tax reductions effective from 1 April 2009.

Other measures were also taken by the new government in December 2008 aimed more directly at alleviating the effects of the downturn, including:

- an accelerated package of 'ready-to-roll' infrastructure projects spanning the housing, transport, education and energy sectors at an estimated cost of almost $500 million; and
- a temporary relief package designed to assist small and medium-sized businesses (which make up the largest proportion of New Zealand businesses) in order to reduce compliance costs and improve the business environment in the face of the crisis.

Global uncertainty intensified in the March quarter 2009, as the global crisis extended and the New Zealand economy fell a further 0.8% from the previous quarter, resulting in a 1.4% decline in annual average terms. As in the December quarter 2008, manufacturing fell sharply, along with wholesale and retail trade. New Zealand's manufacturing and export sectors were affected less by the global financial crisis than many other countries, partly because of the country's dependence on primary commodity exports, which remained in demand even though world prices fell in most cases, and because the main market for manufactured exports, Australia, was also less affected by the global financial crisis. On the expenditure side, private consumption fell 1.2% - the largest quarterly decline since 1991 – while weak domestic demand was reflected in a third consecutive fall in both goods and services imports, with total imports down 20% from their peak in June 2008.

Mid-March 2009 marked a turning point in global sentiment, as equity markets around the world rallied from exceptionally low levels and risk aversion began to wane. The Reserve Bank made its seventh consecutive reduction in the OCR in April 2009, lowering official rates to 2.5%, 575 basis points lower than the July 2008 peak. Borrowing rates fell in line with reductions in official rates, with fixed mortgage interest rates reaching historic lows in early 2009. At the same time, net