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Supplement 1

CONTAINS CONFIDENTIAL
INFORMATION

July 19, 1994

To: Members of the Executive Board
From: The Acting Secretary
Subject: New Zealand - Staff Report for the 1994 Article IV Consultation

The attached supplement to the staff report for the 1994 Article IV consultation with New Zealand (SM/94/161, 6/28/94), has been prepared on the basis of additional information.

Mr. Cangiano (ext. 37330) or Mr. Callen (ext. 38873) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the GATT Secretariat and the Organisation for Economic Cooperation and Development (OECD), following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

NEW ZEALAND

Staff Report for the 1994 Article IV Consultation
Supplementary Information

Prepared by the Southeast Asia and Pacific Department

Approved by Kunio Saito and Jan van Houten

July 18, 1994

This supplement presents information that has become available since the staff report (SM/94/161, 6/28/94) was circulated to the Executive Board. The staff appraisal has not changed as a result of this new information.

1. Reserve Bank Monetary Policy Statement

In its latest semiannual Monetary Policy Statement, released on June 27, 1994, the Reserve Bank indicated that it believed the path of inflation, particularly in the short term, would be somewhat higher than expected at the time of its December 1993 Monetary Policy Statement and March 1994 economic forecasts. Headline inflation is now forecast to be 1.7 percent in the year to March 1995 (compared with 0.6 percent in the March forecasts), 1.9 percent in the year to March 1996 (previously 1.7 percent), and 1.8 percent in the year to March 1997 (previously 1.7 percent). The higher inflation outlook in the short term reflects stronger-than-expected wage pressures and the recent strengthening in international oil and some other commodity prices. Further, the Reserve Bank is now expecting a smaller exchange rate appreciation than previously anticipated. This deterioration in the inflation outlook, which puts forecast inflation toward the top of the 0-2 percent target range, leaves the Reserve Bank little margin for error if inflation pressures turn out to be stronger than anticipated. The Reserve Bank indicated that a somewhat higher exchange rate and interest rate profile than assumed in its forecasts would reduce the likelihood of inflation moving above the target range. This was interpreted by the financial markets as a desire on the part of the Bank for a tightening in monetary conditions. Short-term interest rates, which had already risen from a low of about 4 1/4 percent in January 1994 to 6 1/4 percent in the week before the June Statement, rose further to 7 percent following the Statement.

2. The 1994/95 budget

The 1994/95 budget was presented by Finance Minister Birch on June 30, 1994. The adjusted financial surplus in 1993/94 is now estimated at \$NZ 527 million (1/2 percent of GDP), compared to the \$NZ 422 million surplus reported in the staff report (Table 1 and Chart 1). The budget projects an adjusted financial surplus of \$NZ 730 million (3/4 percent of GDP) in 1994/95. No new revenue initiatives were announced, but the expected continuation of strong economic

Table 1. New Zealand: Summary of Central Government Budgets and Outcomes, 1989/90-1996/97 1/

	Outcome 1989/90	Outcome 1990/91	Outcome 1991/92	Outcome 1992/93	Budget	Est. 2/ 1993/94	Outcome	Budget Proj. 1994/95	Budget Proj. 1995/96	Budget Proj. 1996/97
<u>(In millions of New Zealand dollars)</u>										
Total revenue	28,351	29,008	27,635	27,629	28,112	29,875	29,561	31,901	32,990	34,788
Total tax revenue	26,198	25,797	24,843	25,980	26,486	28,106	28,120	29,878	31,417	33,093
Direct taxation	17,165	16,622	15,508	16,186	16,456	17,890	17,901	19,263	20,431	21,654
Indirect taxation	9,033	9,175	9,335	9,794	10,030	10,216	10,219	10,615	10,986	11,439
Nontax revenue	2,153	3,211	2,792	1,649	1,626	1,769	1,441	2,023	1,573	1,695
Net financial expenditure	29,506	30,298	29,174	29,418	30,390	29,453	29,371	30,803	30,496	30,257
Of which:										
Social services	10,320	11,005	10,620	10,697	10,831	10,573	10,578	10,868	10,925	11,002
Debt-service payments	4,725	4,624	4,147	3,899	3,971	3,591	3,555	3,791	3,521	3,185
Financial balance 3/	-1,155	-1,290	-1,539	-1,789	-2,278	422	190	1,098	2,494	4,531
Adjusted financial balance 4/	-1,131	-2,560	-2,449	-1,823	-2,278	422	527	730	2,494	4,531
<u>(In percent of GDP)</u>										
Total revenue	39.7	39.4	37.7	35.9	34.6	36.3	35.9	36.2	35.0	35.4
Tax revenue	36.7	35.0	33.9	33.7	32.6	34.1	34.2	33.9	33.4	33.7
Direct taxes	24.0	22.6	21.1	21.0	20.2	21.7	21.7	21.9	21.7	22.0
Indirect taxes	12.6	12.5	12.7	12.7	12.3	12.4	12.4	12.0	11.7	11.6
Nontax revenue	3.0	4.4	3.8	2.1	2.0	2.1	1.8	2.3	1.7	1.7
Net financial expenditure	41.3	41.2	39.8	38.2	37.4	35.8	35.7	34.9	32.4	30.8
Of which:										
Social services	14.4	15.0	14.5	13.9	13.3	12.8	12.8	12.3	11.6	11.2
Debt-service payments	6.6	6.3	5.7	5.1	4.9	4.4	4.3	4.3	3.7	3.2
Financial balance 3/	-1.6	-1.8	-2.1	-2.3	-2.8	0.5	0.2	1.2	2.6	4.6
Adjusted financial balance 4/	-1.6	-3.5	-3.3	-2.4	-2.8	0.5	0.6	0.8	2.6	4.6
Memorandum items:										
Primary balance										
(millions of New Zealand dollars)	2,954	1,484	1,161	1,617	1,208	3,456	3,504	4,343	5,507	7,265
(percent of GDP)	4.1	2.0	1.6	2.1	1.5	4.2	4.3	4.9	5.8	7.4

Sources: New Zealand Treasury, Budget, various issues; and May Fiscal Update, May 1994.

1/ Fiscal years ended June.

2/ As presented in the Staff Report (SM/94/161), Table 2, page 5.

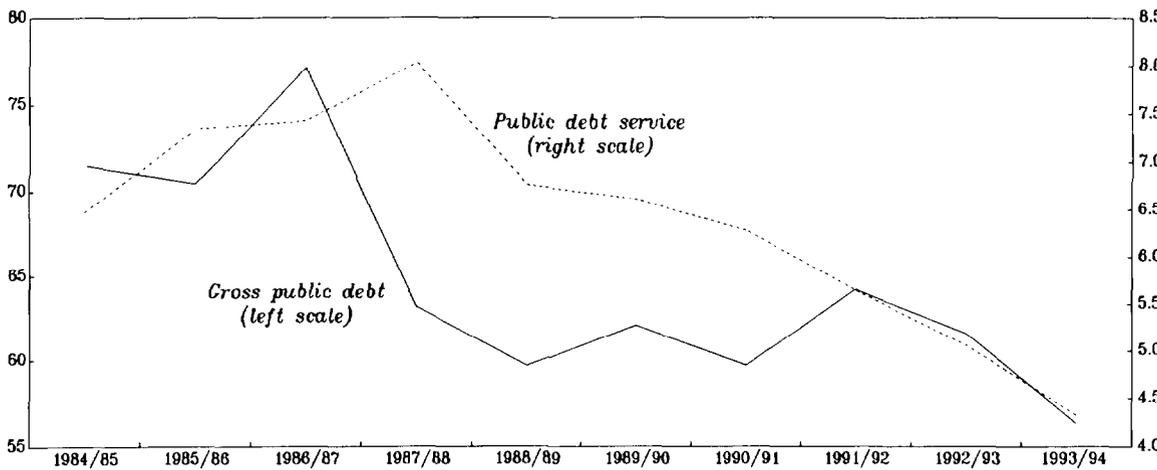
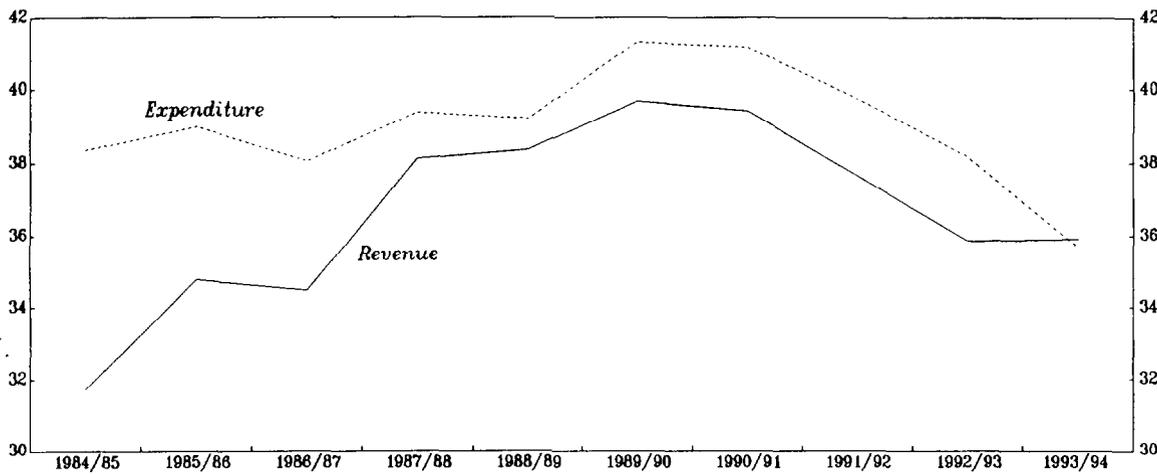
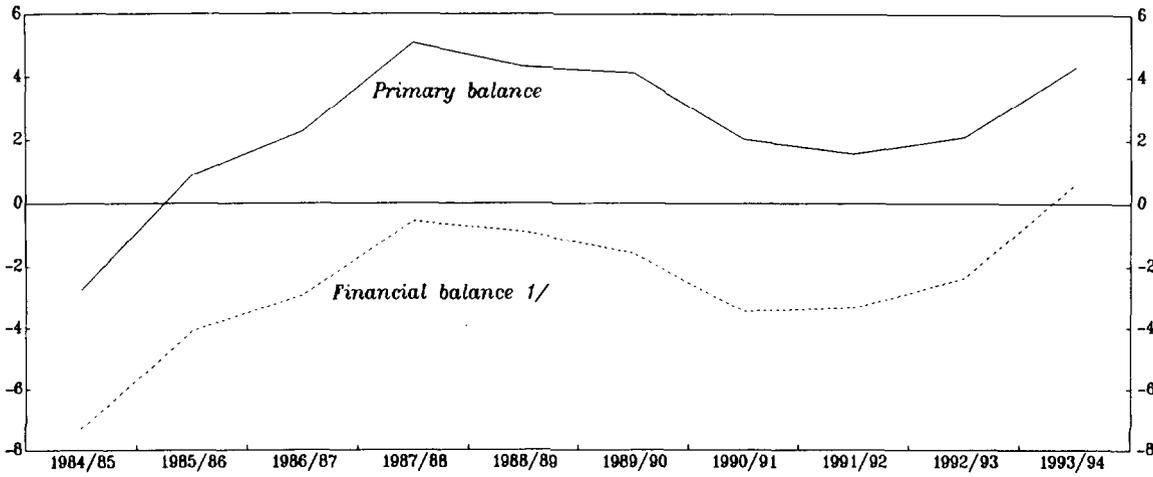
3/ The financial balance excludes net lending and repayments which include the proceeds from the sale of state-owned enterprises.

4/ Adjusted to exclude the proceeds from the sale of Crown forestry assets and unrealized foreign exchange gains and losses.

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CHART 1

NEW ZEALAND
FISCAL DEVELOPMENTS, 1984/85-1993/94
(In percent of GDP)



Source: New Zealand Treasury, *Budget*, various issues.
1/ Financial balance excludes lending minus repayments and unrealized foreign exchange gains and losses.

growth results in a 6 1/4 percent rise in tax receipts in 1994/95, implying a fractional increase in total revenues as a share of GDP. New spending initiatives announced in the budget amount to about \$NZ 770 million over three years, of which \$NZ 415 million will occur in 1994/95. The additional expenditure is mainly in the areas of health, education and training, science and research, support for low-income families, and road improvements. As a result of these spending measures, as well as the carryover of some deferred expenditure from 1993/94, expenditure is forecast to rise by 5 percent in 1994/95. However, as a share of GDP, it is expected to decline from 35 3/4 percent in 1993/94 to 35 percent in 1994/95.

3. Medium-term budget targets

The Fiscal Responsibility Bill, which was under discussion in Parliament when the staff report was circulated, was passed and came into effect on July 1, 1994. The Act establishes five principles of responsible fiscal management and requires the Government to state its long-term fiscal policy objectives, its short-term intentions (over the next three years), and the consistency of these objectives and intentions with the principles of responsible fiscal management as set out in the Act. The five principles of responsible fiscal management established in the Act are as follows: (i) fiscal surpluses should be run until public debt has been reduced to a prudent level; (ii) once a prudent level of public debt has been achieved, it should be maintained by ensuring that, over time, the fiscal position remains in balance; (iii) a level of government net worth should be achieved and maintained that provides a buffer against adverse shocks; (iv) fiscal risks facing the Government should be prudently managed; and (v) policies should be pursued that are consistent with a reasonable degree of certainty about the level and stability of tax rates in future years.

In the budget papers, the Government set out its long-term fiscal policy objectives as follows: to reduce net public sector debt to between 20 and 30 percent of GDP; to restore the net worth of the Government to positive levels; to reduce expenditure to below 30 percent of GDP; to refrain from increasing statutory rates of income tax and the goods and services tax; to maintain the integrity of the tax base; and to prudently manage the fiscal risks facing the Government. The Government intends to reduce net public debt to below 30 percent of GDP (it is currently 42 percent of GDP) on a sustainable basis by 1997/98 and to below 20 percent by 2003/04. To achieve this, fiscal surpluses of between zero percent and 3 percent of GDP will be run over the economic cycle. When debt has been reduced to 20 percent of GDP on a sustainable basis, small reductions in debt may continue to be made. This would imply running surpluses of between zero and 1 percent of GDP over the cycle. The adjusted financial surplus is expected to reach \$NZ 2.5 billion (2 1/2 percent of GDP) in 1995/96 and \$NZ 4.5 billion (4 1/2 percent of GDP) in 1996/97. Revenues as a proportion of GDP are expected to decline slightly (to 35 1/2 percent in 1996/97) while expenditures are forecast to decline quite sharply to 30 3/4 percent of GDP in 1996/97 as nominal expenditure actually falls in both 1995/96 and 1996/97. Net debt is expected to have declined to 28 3/4 percent of GDP by 1996/97. The forecasts suggest that the surplus likely to be generated in 1996/97 will exceed that required to meet the Government's long-term fiscal objectives, and serious thought will be given to implementing tax cuts worth \$NZ 1.5 billion in that year.

4. Economic developments and forecasts

Real GDP (production measure) rose by 1 1/2 percent in the March quarter and by 5 1/4 percent in the year ending March 1994, in line with the short-term projections presented in the staff report (see table in the Annex). The forecasts presented in the 1994/95 budget reflect the favorable economic developments that have taken place since the last official forecasts were made in October 1993 and are broadly in line with the medium-term scenario presented in the staff report. Real GDP is expected to grow by 4 1/2 percent in 1994/95, before moderating to 3 1/2 percent in 1995/96 and 1996/97. Growth for 1994/95 is somewhat stronger than the staff's projections, but follows a similar profile thereafter. The official forecasts also continue to show a somewhat more rapid improvement in the external current account balance than envisaged by the staff.

New Zealand: Basic Data, 1989/90-1993/94 1/

Area	267.8 thousand sq. km.
Population (1993)	3.49 million
Annual rate of population growth (1987-92)	0.8 percent
Life expectancy at birth (1992)	75.7 years
Gross domestic product (1992/93)	US\$41.4 billion
GDP per capita (1992/93)	US\$11,862

	1989/90	1990/91	1991/92	1992/93	Est. 1993/94
<u>Output and prices</u> (change in percent)					
Real GDP (expenditure)	-1.0	0.2	-2.9	0.8	5.2
Real GDP (production)	1.5	-0.5	-1.2	2.3	5.2
Domestic demand	5.4	-1.6	-6.4	3.8	6.1
CPI (average annual rate)	6.4	5.5	1.7	1.1	1.6
Unemployment rate (labor force survey; end-of-period, seasonally adjusted)	7.3	9.9	11.1	10.2	9.1
<u>Public finance</u> (in percent of GDP) <u>2/</u>					
Adjusted financial balance <u>3/</u>	-1.6	-3.5	-3.3	-2.4	0.6
Revenue	39.7	39.4	37.7	35.9	35.9
Expenditure	41.3	41.2	39.8	38.2	35.7
<u>Money and credit</u> (in percent)					
Private sector credit (year on year)	9.7	11.1	5.9	8.8	10.7 <u>4/</u>
Broad money (year on year)	1.4	12.8	11.3	8.4	5.2 <u>4/</u>
Interest rates					
Bank bills (90 days)	13.7	11.9	7.3	7.2	5.4 <u>5/</u>
Government bonds (5 years)	12.1	11.4	8.6	7.2	6.0 <u>5/</u>
<u>Balance of payments</u> (in percent of GDP)					
Trade account	1.9	2.1	4.9	4.5	3.4
Exports	20.8	21.0	22.9	24.3	23.7
Imports	19.0	18.9	18.0	19.7	20.2
Current account	-3.4	-2.1	-2.1	-1.5	-1.7
Reserves (\$NZ bn.)	5.6	6.6	5.8	6.2	6.9
<u>External debt</u> (in percent of GDP, end of period)					
Official debt	28.1	27.4	27.3	30.5	25.6
Total debt	74.3	83.5	84.5	86.4	78.4
Debt-service ratio	12.3	12.2	13.7	13.2	11.7
<u>Exchange rate</u> (calendar year average)					
U.S. dollar/New Zealand dollar	0.60	0.60	0.58	0.54	0.57 <u>5/</u>
Trade-weighted index (June 1979=100)	60.6	60.4	57.6	53.7	55.4 <u>5/</u>
Nominal effective exchange rate (1980=100)	68.7	66.2	64.1	58.9	65.1 <u>5/</u>
Real effective exchange rate (1980=100)	112.7	109.5	104.3	94.3	101.8 <u>5/</u>
<u>Quota</u> (SDR mn.) = 650.1					
Memorandum item (\$NZ mn.):					
Nominal GDP (expenditure)	71,435	73,601	73,378	77,067	82,327

Sources: Data provided by Statistics New Zealand; New Zealand Treasury; Reserve Bank of New Zealand; World Bank, Social Indicators Data Base; IMF, Information Notice System; and staff estimates.

- 1/ Fiscal years ending March except where noted otherwise.
2/ Fiscal years ending June.
3/ Excluding lending minus repayments plus, since 1991, the proceeds from the sale of Crown forestry assets and unrealized foreign exchange gains.
4/ March-to-February percentage change.
5/ March 1994.

