January 29, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/58-2

11:05 a.m., June 25, 2018

2. New Zealand—2018 Article IV Consultation

Documents: SM/18/145 and Correction 1; and Supplement 1; SM/18/146

Staff: Helbling, APD; Kostial, SPR

Length: 48 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	D. Mahlinza (AE)
	H. Razafindramanana (AF)
	E. Rojas Ulo (AG), Temporary
	G. Johnston (AP)
	B. Saraiva (BR)
	P. Sun (CC)
	A. Arevalo Arroyo (CE), Temporary
	D. Hart (CO), Temporary
	O. Bayar (EC)
	A. Castets (FF)
	K. Merk (GR)
	M. Siriwardana (IN)
	F. Spadafora (IT), Temporary
	Y. Saito (JA)
	M. Daïri (MD)
H. Beblawi (MI)	
	R. Doornbosch (NE)
T. Ostros (NO)	
	L. Palei (RU)
	R. Alkhareif (SA)
	E. Villa (ST)
M. Panek (SZ)	
	V. White (UK)
	D. Crane (US), Temporary

C. McDonald, Acting Secretary
S. Maxwell, Summing Up Officer
R. Smith Yee, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: A. Babii, O. Brekk, T. Helbling, I. Hussiada, E. Loukoianova, D. Muir, R. Nakatani, C. Rhee, Y. Wong. Communications Department: T. Yan. Legal Department: A. Yiadom. Strategy, Policy, and Review Department: V. Chensavasdijai, K. Kostial, M. Takebe. Alternate Executive Director: S. Geadah (MI). Senior Advisors to Executive Directors: M. Choueiri (MI), W. Kuhles (GR), R. N'Sonde (AF), G. Preston (AP),

A. Tivane (AE). Advisors to Executive Directors: P. Al-Riffai (MI), E. Amor (AP), E. Boukpessi (AF), S. David (AP), O. Haydon (UK), G. Khurelbaatar (AP), M. Kikiolo (AP), G. Kim (AP), M. Mehmedi (EC), A. Park (AP), C. Wehrle (SZ), K. Lok (CC).

2. NEW ZEALAND—2018 ARTICLE IV CONSULTATION

Mr. Johnston submitted the following statement:

The authorities broadly agree with the outlook presented in the staff report.

Economic growth in New Zealand has generally been in the range of 3 to 4 percent over the last three years, with key drivers including strong migration inflows, low interest rates and historically-high terms of trade. Employment growth has been strong and labor force participation is near a record-high 71 percent. However, wage and price pressures remain subdued and consumer price inflation is low. Low interest rates and high net inward migration have helped fuel demand for housing, with price-to-income ratios among the highest in the world.

The authorities' forecasts are for growth to average around 3 percent over the next few years, with the economy operating broadly at, or above, capacity. While some of the recent growth drivers will moderate, a lift in government spending and robust trading-partner growth are expected to provide support to the economy. The pace of employment growth is expected to be more than sufficient to employ new entrants to the labor market, despite high population growth, and unemployment is forecast to decline further towards 4 percent. Growth is expected to add to capacity pressures in the economy, contributing to inflation rising to the target mid-point of 2 percent. The current account deficit is forecast to widen slightly, to around 3 percent of GDP, but consistent with a stable net international investment position. These forecasts are subject to a number of upside and downside risks, with growing trade protectionism an important downside risk.

Fiscal Policy

A key anchor for fiscal policy is the government's intention to reduce net core Crown debt to 20 percent of GDP by 2021/22, subject to any significant shocks to the economy. Successive governments have considered a low level of public debt to be an important buffer given New Zealand's exposure to external shocks and natural disasters, and its relatively high private and external indebtedness. The government has also committed to keeping core expenditure within the recent historical range of spending—around 30 percent of GDP.

The fiscal outlook remains strong. The new government's first Budget, in May, increased operating and capital expenditure above their previous tracks but also showed a lift in expected tax revenue. Forecasts for the next four years show increasing operating and cash balances, and a declining debt ratio, consistent with the government's net debt objective. Fiscal policy is forecast to be stimulatory in the current fiscal year and the next, but contractionary after that. Increased spending has been directed to priority areas including meeting the needs of a growing population—particularly through the health and education systems—promoting economic development, taking action on child poverty and protecting New Zealand's natural resources. The government is increasing investment in social and transport infrastructure, and is gradually resuming contributions to the New Zealand Superannuation Fund, which prefunds a portion of future public pension costs. A Tax Working Group of external experts is looking at the structure, fairness and balance of New Zealand's tax system and will make its final recommendations early next year.

Monetary and Financial Sector Policies

Consumer price inflation remains below the 2 percent mid-point target, due in part to recent low food and import price inflation, and subdued wage pressures. The RBNZ has signalled that its policy rate will remain at 1.75 percent for some time to come. Ongoing stimulatory monetary policy is expected to result in increasing capacity pressures and consumer price inflation rising gradually to the 2 percent target. The RBNZ has also stated that the direction of its next move is equally balanced, up or down.

The monetary policy framework in New Zealand is being amended to add employment outcomes alongside price stability as a dual mandate for the RBNZ, and to create a formal committee to take monetary policy decisions. Legislation to effect these changes has yet to be introduced. In the interim, however, the Policy Targets Agreement with the Minister of Finance directs the Governor to "contribute to supporting maximum sustainable employment within the economy," which builds on the flexibility the RBNZ has been using for some time.

A broader review of the RBNZ's almost 30-year-old legislation is also underway. Key topics include: the institutional arrangements for prudential regulation and supervision; objectives, objective setting processes, and alignment with government policy and risk appetite; and role clarity for the Minister of Finance, Board and Governor, including the allocation and co-ordination of powers, functions, and tools. This review is likely to consider a number of the recommendations made in last year's FSSA, which the authorities are continuing to work through.

Structural Policy

The government has embarked on a broad program of structural reforms with an overall theme of building a productive, sustainable and inclusive economy. This includes initiatives to support skills, innovation, regional development and trade, alongside policies to improve family income support, raise the minimum wage and transition to a low-emission economy.

In the skills area, the government has begun to remove financial barriers to post-school education and training. The first year of study at a university, polytechnic or other tertiary provider is now fees-free, as is the first two years of industry training. The intention is to extend this to further years of study and training in the future. In the innovation space, the recent Budget contained a proposal for a new R&D tax incentive that would give eligible businesses 12.5 cents back for every dollar they spend on R&D. This is a contribution to the government's goal of lifting national investment in R&D from 1.3 percent to 2 percent of GDP within 10 years.

The Budget also formally established the $1 billion per year Provincial Growth Fund to support growth in regional New Zealand. The Fund aims to enhance economic development opportunities, create sustainable jobs, lift the productivity potential of regions, and help meet New Zealand's climate change targets. Investments are already planned in tree-planting and regional rail projects. New Zealand is a CPTPP member and is involved in several free trade negotiations, including those with the Pacific Alliance and as part of RCEP. Negotiations on a free trade agreement are due to begin soon with the EU—collectively New Zealand's third-largest trade partner.

Housing Market

New Zealand maintains a high degree of capital account openness and welcomes productive foreign investment that adds to the economy. However, it also faces challenges from declining home ownership and rapidly-increasing house prices. Home ownership plays an important role in New Zealanders' sense of wellbeing and security, and high house prices have fuelled concerns about globalization and increasing inequality around the world.

Addressing these challenges involves both supply-side and demand-side policies. In particular, the KiwiBuild program aims to deliver

100,000 affordable homes over 10 years for first home buyers through a combination of building on underutilized public land, purchasing or underwriting private developments off plan, and large-scale developments. A variety of housing-related tax measures have been introduced or are under consideration.

The government has also introduced legislation to generally prevent most overseas persons from acquiring residential land, except where that investment boosts New Zealand's housing supply, will result in a conversion of the use of that land (such as setting up a business), or the buyer is committed to living, and paying taxes, in New Zealand. This measure will ensure that house prices are shaped by New Zealanders and those that are committed to living in New Zealand, as they cannot be outbid by non-residents. As a demand-side policy—to complement supply-side measures—it will make some homes more affordable for buyers at some points in the property-market cycle. It will also help ensure that a greater proportion of foreign investment flows into the productive economy—where the benefits of free capital flows are greatest—rather than housing speculation. Furthermore, the government considers foreign capital will be better harnessed to reduce New Zealand's housing shortage through the incentives included in the new policy to support the supply of new housing, particularly large scale residential developments of at least twenty dwellings.

The government is committed to maintaining New Zealand as an open, outward-looking trading nation, with public support for liberal policy settings not just around trade but also more broadly across society. Its view is that, without the introduction of the proposed screening regime for residential land, public support for trade agreements like the recently-signed CPTPP would not be forthcoming and New Zealand would be unable to commit to the types of bilateral and multilateral trade deals that underpin a significant portion of the domestic economy. Such agreements are much more important to the long-term strength and resilience of New Zealand's economy and the wellbeing of its citizens than the introduction of a screening regime for residential property. The government considers that incorporating this broader perspective would improve the Fund's advice.

Finally, as there is no intention to manage aggregate capital flows, and it will have no material impact on the balance of payments, the authorities do not consider the policy on overseas purchases to be a capital flow management measure. The authorities also note that while foreign buyers may have played a smaller role in the housing market in 2017 (as noted in the staff report) their impact was likely to have been higher in the preceding years and, if this measure was not brought in, could be significant again in the future.

Mr. Daïri , Mr. Geadah, and Ms. Choueiri submitted the following joint statement:

We thank staff for the comprehensive papers and Mr. Johnston for the helpful buff statement. New Zealand's economy continued to enjoy solid growth, underpinned by robust construction activity, an accommodative monetary policy, high net migration, increasing services exports, and improved terms of trade. The unemployment rate declined to near the natural rate and the housing market cooled, but after increasing in the first half of 2017, inflation has recently weakened. We broadly concur with staff's analysis and recommendations and limit our comments to a few points.

Monetary and Fiscal Policies

We concur with staff that the current accommodative monetary policy stance is appropriate for addressing below-target inflation. A continued accommodative monetary policy stance has already contributed to stabilizing inflation expectations and will help the cyclical relationship between economic slack and prices to reemerge, after a long period of downward pressure on prices. It will also lower risks to demand from currency overvaluation. The strong fiscal position provides space to accommodate the needs from strong economic and population growth. We share staff's view that there is no need for faster debt reduction beyond that outlined in the FY2018/19 budget. We also welcome the Budget Responsibility Rules, which commit to reducing net public debt to around 20 percent of GDP two years later than in the previous budget, while preserving fiscal space and keeping expenditures at their historical average. Given the country's strong fiscal position, staff see merit in increased spending, notably in infrastructure where gaps remain, as outlined in the helpful selected issues paper (SIP). Can staff comment on the authorities' response to their suggestion to use stronger structural revenues to increase spending on infrastructure and other measures that would raise potential output?

Financial Policies

Macroprudential policies have contributed to reducing risks to financial stability, including from high household debt. We welcome the finding that bank and household balance sheets have become more resilient, with a lower share of loans with high LVRs. We note the authorities' view that any further easing of LVRs, following the January 2018 easing, would be gradual and contingent on the outlook. We also note that the macroprudential framework would be reconsidered in Phase Two of the Review of the Reserve Bank Act. In this connection, we encourage the authorities to take into consideration the 2017 FSAP suggestions, as outlined in paragraph 28.

Housing Policies

The authorities are taking bold measures to enhance housing affordability by strengthening supply and lowering tax distortions. We note the difference of views between staff and the authorities on whether proposed restrictions on nonresidents' real estate purchases—through an amendment to the Overseas Investment Act—can be correctly classified as a capital flow measure (CFM). The staff question the effectiveness of the restrictions as "available data suggest that foreign buyers appear to have played a minor role in New Zealand's residential real estate markets recently." They also consider that the restrictions constitute a CFM measure under the IMF's Institutional View (IV) on capital flows, as they would introduce discrimination based on residency. The authorities consider that the restrictions would enhance housing affordability by ensuring that housing prices will be shaped by domestic market forces. We sympathize with the authorities' view that the restrictions do not constitute CFMs under the IV, as there is no intention to manage aggregate capital flows and won't be a material impact on the balance of payments. The staff's views would be appreciated. We would also appreciate staff's views on the various points raised by the authorities in paragraph 35, notably on the fact that the ban must be assessed holistically, taking into account the broader social, economic and political context, as also conveyed in the buff statement. Such differences in views should be taken into consideration when assessing experience with the IV.

Structural Reforms

The SIP indicates that New Zealand's productivity growth has been relatively low compared to other advanced economies, despite pioneering structural reforms, which highlights remaining long-standing structural weaknesses. Against this background, the government's structural policy agenda appropriately seeks to support productive, sustainable, and inclusive growth. While the agenda is still under development, we concur with the authorities that important first steps have been made, notably on minimum wages, productivity (including research, development, and education), tax reform, regional development, and trade policy. In this connection, we welcome the government's intention to pursue deeper economic integration through international trade, with the signing of the CP-TPP which is an important step in this agenda, despite growing global trade tensions.

Mr. Saito and Mr. Ozaki submitted the following statement:

We thank staff for the comprehensive and informative papers and Mr. Johnston for his helpful buff statement. It is encouraging that New Zealand's economy has enjoyed a solid expansion since 2011. We positively take note that macroeconomic imbalances overall have narrowed, and banks continue to hold strong capital and liquidity buffers. Meanwhile, we note that some downside risks on both domestic and external side remain a concern in the medium term. As we broadly agree with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

We see that the expected fiscal policy stance would strike a right balance between the growing demands for government services and infrastructure from rapid population growth, and budget discipline. We commend the authorities' prudent fiscal management, including the commitment to budget discipline and the medium-term debt anchor, while the FY 2018/19 budget increased spending on infrastructure, housing, health, regional development and education. We observe that staff mention that the positive fiscal impulse is not expected to result in substantial upward price pressure, as some of the higher spending will also increase potential output. We would like to hear staff's view whether the area of increased spending in the FY 2018/19 Budget is efficient and effective enough to increase potential output.

Monetary Policy

We welcome the current monetary policy is appropriately expansionary, while inflation has been either below or in the lower half of the inflation target range of the Reserve Bank of New Zealand. We see that low inflation, due to the low tradable prices and weak wage increases despite of the economy close to or at full employment, remains a monetary policy challenge. In this regard, we welcome that the authorities noted that monetary policy will be accommodative for a considerable period of time. At the same time, since the subdued inflation and low wage growth are the common phenomenon among advanced economies, we encourage staff's deeper analysis on this front to draw lessons for other counties.

The Role of Migration

We take note that net migration remained at recent record high levels. We also note that the output gap should turn positive with potential output growth slowing due to the slowdown of net migration. Against this background, we would appreciate it if staff could share their view on how New Zealand makes the most of net migration for boosting its potential growth.

Housing Market

Housing affordability is a pressing concern in major cities. In this regard, the new government's ambitious housing policy agenda focus on direct supply initiatives, tax policy changes, which broadly contributes to restoring housing affordability. That said, we are wondering whether restrictions on nonresident' real estate purchases are effective policy or not, regardless of the classification of capital flow management measure (CFM) (We are of the view that classification of CFM and appropriateness of the measures should be distinguished.) In this context, we take note of staff's view that foreign buyers appear to have played a minor role in New Zealand's residential real estate markets recently and the other broad housing policy agenda would address most of the potential problems. Against this background, could staff share their view that there is room for the authorities to introduce the restrictions on nonresident' real estate purchases if they have more detailed and persuading data to justify their policy?

We would also appreciate it if staff could tell us staff's view about incorporating the social context into the assessment of appropriateness of CFM, recognizing that the authorities emphasized that the measure must be assessed holistically, taking the broader social, economic and political context into account.

Ms. Pollard and Ms. Crane submitted the following statement:

We thank staff for the useful papers and Mr. Johnston for the helpful buff statement. New Zealand's economy is experiencing solid growth and is well-positioned to address risks in the housing and financial sectors and to reduce infrastructure gaps. We agree with staff that the current expansionary macroeconomic policy mix is appropriate, and offer a few points for emphasis.

We welcome the authorities' plans to use existing fiscal space to adopt a somewhat more expansionary fiscal policy stance over the coming several years, including higher social, housing and regional spending. We encourage the authorities to consider using any structural increase in revenues to increase inclusive infrastructure spending to boost potential growth, as recommended by staff.

New Zealand has opportunities to increase the resilience of its financial sector, in line with recommendations from the 2017 FSAP, as it moves into Phase 2 of its Review of the Reserve Bank Act. We encourage the authorities to give priority to enhancing its macroprudential toolkit with debt-to-income and debt-service-to-income instruments, and to adopt improvements to supervision as recommended in the FSAP. We also welcome the authorities' intention to consider ways to strengthen governance around financial and macroprudential policies.

On housing, we are encouraged by staff's views that risks around housing are beginning to ease. While we appreciated the detailed rationale for the housing CFM in Mr. Johnston's buff, we support staff's application of the Institutional View on Capital Flows which is well-explained in the staff report. We welcome the authorities' focus on boosting the supply of affordable housing and hope that the Build Kiwi program will be carefully implemented to avoid crowding out private construction.

Taking note that New Zealand has productivity among the lowest in OECD countries, we welcome the authorities' intentions to invest in infrastructure and implement an R&D tax credit. We appreciated the analysis on the productivity impacts of more inclusive infrastructure spending to address regional disparities in the selected issues paper. Do staff have views on other actions the authorities could take to boost productivity, beyond these planned measures?

Mr. Alkhareif and Mr. Rouai submitted the following statement:

We thank staff for the well-written set of reports and Mr. Johnston for his informative buff statement. New Zealand's economy continues to perform well, with strong growth underpinned by reconstruction spending, high net migration, and increasing services exports. We also welcome the favorable outlook, with growth hovering around 3 percent over the medium-term, and risks balanced in the near-term. Could staff elaborate on the recent data showing a slowing of growth in the first quarter of 2018 and indicate if this slowdown may affect growth forecast for the whole year?

The macroeconomic stance remains appropriate with an accommodative monetary policy to address below-target inflation, a strong fiscal position to respond to growing demand for government services, and proactive macroprudential policies to reduce risks to financial stability.

We commend the authorities for their continuous prudent fiscal policy and support their plan to strengthen fiscal buffers during the current favorable environment by reducing net public debt. However, we agree with staff that there is no need for faster debt reduction beyond that outlined in the FY2018/19 budget and support their recommendation to increase spending on infrastructure to close the infrastructure investment gap, particularly in regions outside of the main urban areas (Box 3), and strengthen the economy's growth potential.

We welcome the authorities' housing policy agenda to increase supply of affordable houses and developable land and change tax policy to reduce distortions. We take note of the reference in the staff report to the proposed restrictions on nonresidents' real estate purchases and of the conclusion that the proposed draft amendment would be a capital flow management measure (CFM) under the IMF's Institutional View. We understand that the government has recently amended its proposal to allow non-residents to own up to 60 percent of large, new apartment buildings and that there is no ban currently on foreign ownership of land, houses, or apartments. Could staff elaborate on these recent developments and indicate if the updated proposal would still be considered a CFM?

With these remarks, we wish the authorities continued success.

Mr. Razafindramanana, Mr. N'Sonde and Mrs. Boukpessi submitted the following statement:

We thank staff for a comprehensive set of papers and Mr. Johnston for the informative buff statement. New Zealand's economy continues to show solid growth and a broadly positive macroeconomic outlook underpinned by increased infrastructure investment, net migration wav and strong tourism-related services. The supportive monetary and fiscal policies are warranted on grounds of persistent disinflation pressures, the need to close infrastructure gaps notably in transport, telecommunications, electricity and water in parts of the country, and the existence of an adequate fiscal space to meet these needs.

However, while risks are balanced in the near horizon, medium-term risks remain tilted to the downside, including a possible housing market downturn and significant slowdown in a major trading partners. We are pleased that the authorities have the necessary monetary and fiscal policy space to counter the adverse effects on the economy if those risks came to materialize. Furthermore, we encourage the authorities to monitor closely the current fiscal expansion over the years and the still high pockets of macro-financial vulnerabilities, especially in the housing market. We agree that policy priorities going forward should focus on strengthening macro-financial resilience and taking full advantage of the robust economic and population growth while implementing the necessary structural measures to foster a more sustainable and inclusive growth.

We broadly agree with staff's appraisal and policy recommendations, and offer the following comments for emphasis.

We concur that the current macroeconomic policy mix is appropriate in supporting activity while maintaining macroeconomic stability. Despite alleviating infrastructure bottlenecks, the strong fiscal position provides adequate room to face social spending needs in a context of an economy with rapid population growth and pockets of poverty. Nevertheless, we encourage the authorities to remain vigilant and be ready to adjust the policy mix against an increasingly challenging external environment if needed.

We commend the Reserve Bank of New Zealand (RBNZ) for the progress made in strengthening the macroprudential framework and measures implemented to address vulnerabilities stemming from the housing market, notably the use of loan-to-value ratios (LVR). Going forward, we note that the authorities do not eliminate the possibility of a further and gradual LVR easing contingent on the outlook whereas staff do see neither justification nor need for a macroprudential relaxation even under the current cooling of the housing market. We would appreciate staff's elaboration on these diverging views? Following the updates provided during Phase One of the Review of the Reserve Bank Act, we look forward to Phase Two which should reassess the financial policy mandate of the RBNZ, strengthen its supervisory framework and consider more diverse macroprudential instruments.

The authorities' housing policy agenda that seek to tackle supply-side and affordability issues with notably the KiwiBuild program and the Urban

Growth Agenda is very much welcomed. Also, the ongoing reform on capital gain taxes on property sales and additional reforms in real estate investment and land as considered by the Tax Working Group should help reduce tax distortions, property speculation and improve housing affordability. However, while we recognize the significance, in political economy terms, of the proposed ban of residential real estate purchases by nonresidents in terms of political economy, we would encourage the authorities to ensure that any restrictive measure remains in line with the Fund's Institutional View on capital flows.

We welcome the fact that New Zealand's structural policy settings are considered best practices among OECD economies. We, nonetheless share the view that further structural measures remain critical to address the country's structural shortcomings and make growth more sustainable and inclusive. To this end, we welcome the government's initial measures aiming at boosting productivity and innovation, alleviating infrastructure bottlenecks, and improving regional development. Particularly, we welcome the setting up of the Provincial Growth Fund aiming at enhancing economic development opportunities, creating sustainable jobs, lifting the productivity potential of regions, and helping meet New Zealand's climate change targets as indicated in Mr. Johnston's buff statement. We look forward to the finalized agenda and would like to ask staff if an indicative deadline has been set up in that regard. Finally, we commend the New Zealand authorities for their commitment to deeper economic integration and international trade, with the recent signing of the CP-TPP.

Mr. Hurtado and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for the illustrative reports and Mr. Johnston for his helpful buff statement.

We welcome the strong fiscal position and agree with staff that there is scope for more flexibility to meet increasing spending needs in productive measures to boost growth potential, including infrastructure. We note the authorities' preference for a low level of public debt and welcome the Budget Responsibility Rules, that include the commitment to reduce net public debt to around 20 percent of GDP by 2021-2022. We believe authorities could consider diverse ways to finance the required expenditure to close the infrastructure investment gap.

We consider that the monetary policy stance is appropriate given low inflation and the flexible exchange regime. Does staff expect inflationary pressures may arise due to the minimum wage increase in the medium term?

Central banks currently face the need to update and refine their monetary policy frameworks given structural changes taking place in financial and labor markets. Clearly, central banks implement changes taking into consideration their own economic and institutional frameworks. We note that qualitative employment can be an adequate avenue to update governance of the RBNZ, considering the substantial risks to credibility from an inconsistent numerical objective. We thank staff for the very informative and useful SIPs, in particular regarding the review of the inflation targeting regime. The SIP indicates that monetary policy outcomes in countries with flexible inflation targeting are similar regardless of an implicit or explicit dual mandate. However, this addition is regarded as a refinement in the current practice of inflation targeting. Thus, staff comments on the gains of operationalizing the dual mandate are welcome.

We welcome authorities' efforts to address imbalances in the housing market and increase housing affordability, but challenges remain. The cooling of the housing market and slower credit growth to households are positive developments. The authorities' policies to address supply constraints such as the KiwiBuild program and the Urban Growth Agenda are welcome. However, it is unclear how the KiwiBuild program will redirect incentives. The staff's comments are welcome. Moreover, authorities should remain mindful of risks and distortions that could arise, such as crowding out private housing supply. Tax policy and a wider set of reforms to tax treatment of residential real estate investment are welcome. We are uncertain that a ban on residential real estate purchase by nonresident could have a positive impact on affordability, as it seems that in the case of New Zealand, non-residents have not played a relevant role in the real estate market. We note the difference of views regarding the Overseas Investment Act as a capital flow measure (CFM) under the IV.

Macroprudential tools have been useful to contain risks but increasing macrofinancial resilience should continue to be a priority. House debt vulnerabilities remain high and 60 percent of credit is exposed to residential mortgages. Loan-to-value ratios (LVRs) have contributed to added resilience of bank and household balance sheets. While we note the difference of views between the authorities and staff regarding LVRs, we agree with staff that easing of macroprudential policies is not yet warranted even though there is a modest cooling of the housing market.

Implementation of FSAP recommendations to strengthen the macroprudential framework shows mixed progress. The report highlights the resilience of the banking system but recommends several measures. The follow-up on key recommendations shows mixed implementation across measures. We would appreciate staff comments on the results of the public consultation on the macroprudential toolkit and the inclusion of debt-to-income instrument progress.

We welcome the structural reform agenda laid by the authorities to secure growth, make it more inclusive and increase productivity in the medium term. Boosting regional development, R&D incentives and other tax reforms are steps in the right direction. The staff's comments are welcome on other avenues to increase productivity in New Zealand.

Mr. Sun and Ms. Lok submitted the following statement:

We thank staff for the informative reports and Mr. Johnston for the helpful buff statement. We broadly agree with staff's appraisal and would like to offer the following comments for emphasis.

Sound macroeconomic policy management has contributed to solid economic expansion in New Zealand. The economy continues to perform well and is expected to maintain growth at around 3 percent in the coming few years. The current monetary stance is appropriately expansionary in the face of below-target inflation, and inflation expectations remain well anchored. With the economy expected to operate broadly at (or above) capacity on the one hand, and uncertainties surrounding the external environment on the other, it is important for the authorities to stand ready to adjust flexibility as needed. We take comfort from the Reserve Bank of New Zealand's (RBNZ) recent statement that the direction of its next move is equally balanced, up or down. The fiscal position remains strong, which has allowed room for increased spending on areas including health, education, and infrastructure to meet the needs of a growing population and support economic development. The staff has highlighted the potential gains from closing New Zealand's infrastructure investment gap. We support efforts in this regard, while maintaining fiscal prudence and focusing on investments that are most productive. Going forward, we trust that the authorities will continue to pursue an appropriate policy mix to strengthen the economy's resilience and promote growth.

Significant efforts have been made by the authorities to tackle housing market challenges. Given the associated social implications, housing affordability should be an important policy priority. To this end, we welcome the efforts by the authorities to restore affordability through supply-side initiatives and housing-related tax measures. We also take positive note that macroprudential policies have contributed to mitigating financial stability risks associated with mortgage lending. With household debt still at elevated levels, continued close monitoring of developments in the housing sector is warranted. Regarding the proposed ban on residential real estate purchases by nonresidents, could staff comment on the authorities' view that the ban needs to be considered holistically, taking into account broader social, economic, and political context, and the need to incorporate this broader perspective into the Fund's advice?

We welcome Phase 1 of the Review of the Reserve Bank Act (the Review), which resulted in policy decisions to update New Zealand's monetary policy framework and the signing of a new Policy Targets Agreement (PTA) between the Minister of Finance and the RBNZ Governor in March 2018. While the previous framework has served New Zealand well, the amendments provide a constructive update to reflect the developments and changes in the economy and the conduct of monetary policy over the past 30 years. We look forward to Phase 2 of the Review, which will help strengthen the RBNZ's financial stability role and governance, and likely consider a number of last year's FSAP recommendations. We note that the Terms of Reference of Phase 2 were released on June 7. Could staff share further comments, if any, on the topics to be included in Phase 2?

We support the authorities' comprehensive program of structural reforms to facilitate productive, sustainable, and inclusive growth. Amid rising trade tensions in the current global environment, New Zealand's continued support of open trade and the multilateral trade framework is also welcomed. With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for a set of insightful papers and Mr. Johnston for informative buff statement. New Zealand's economy continues to perform well, with growth rates at around 3 percent and unemployment near the natural rate. The economic expansion is driven by accommodative monetary policy, solid net migration, improved service exports, and stronger terms of trade. The medium-term outlook is favorable notwithstanding significant external risks, including tighter global financial conditions and elevated trade tensions. The key challenges are associated with housing-related vulnerabilities and high household debt, and their potential interaction with negative external shocks. We broadly concur with the thrust of staff's appraisal.

According to staff, the macroeconomic policy mix is appropriate. We note that there is broad agreement between staff and the authorities on fiscal and monetary policy settings. On the fiscal side, the short-term expansionary fiscal measures should help mitigate potential implications from slowing residential investment and weaker agriculture exports. Higher infrastructure spending would help to sustain growth momentum, accommodate growing population needs, and address the infrastructure gaps. The staff's analysis in the SIP chapter proves substantial potential benefits in this area. Could staff also elaborate on public investment efficiency in New Zealand?

Since inflation remains below target, the current accommodative monetary policy stance is appropriate at this juncture. At the same time, while the economy is now broadly at capacity, the RBNZ should stand ready for an unexpected upshift in the inflation path. We note the formalization of an employment objective in the monetary policy framework and would highlight the importance of avoiding undue risks to operational monetary policy independence. We also agree with staff that phase two of the Review of the Reserve Bank Act should prioritize necessary reforms to complete the recent FSAP's recommendations.

Several developments indicate that the authorities' measures to address housing-related macro-financial risks and vulnerabilities are bearing fruit. The housing market is cooling and credit growth to households has slowed. The household debt-to-income ratio has stabilized, albeit at a still high level. The broad housing policy package consisting of supply initiatives, including the KiwiBuild program and changes in the tax system (paragraph 31) is rightly focused on improving housing affordability. On a proposed ban of residential real estate purchases by nonresidents, we tend to agree with staff's assessment that under the IMF's Institutional View this measure should be considered as a capital flow measure (CFM). Moreover, staff claim that this ban would not be in line with the IV. In this context, we encourage the authorities to consider alternative measures that do not have a discriminatory effect. We would also appreciate staff's comments on the various points raised by the authorities to justify this measure.

Structural reforms aimed at promoting innovation and competition, upgrading labor force skills, and advancing broad tax reform are needed to boost productivity and long-term growth. We welcome the authorities' plans to promote R&D, strengthen education, and enhance regional development. We also commend staff for their interesting analysis in the selectted issues paper of New Zealand's productivity performance from a firm-level perspective.

Mr. Leipold and Mr. Spadafora submitted the following statement:

We thank staff for a comprehensive set of papers and Mr. Johnston for his interesting buff statement. We broadly agree with the staff's assessment and policy recommendation and offer some comments for emphasis.

New Zealand's economic growth is expected to remain at a robust pace of around 3 percent this year and in the medium term, driven by private consumption and business investment in tradable services and an expansionary fiscal policy. Macroeconomic imbalances have narrowed and risks to growth are balanced overall in the near term. Net migration has been a key driver of growth and underpins an upward revision of potential growth.

Prolonged inflation undershooting calls for a continuation of the accommodative monetary policy, complemented by infrastructure spending and structural reforms to boost productivity. Renewed disinflation emerged in 2017-18 and wage and price pressures remain weak across the economy. A sufficiently expansionary stance is thus needed to address current, below-target inflation. In the medium term, inflation is expected to gradually increase toward the 2 percent midpoint of the target range, supported by an economy operating at close to full capacity and an output gap that is projected to turn positive.

Macroprudential policies have been effectively deployed to address housing-related macrofinancial vulnerabilities stemming from an increase of household debt ratios from already high levels. Recent indicators point to a moderation of house price increases and credit growth to households while the banking sector remains sound. However, we share the staff's view that high household debt ratios need to be closely monitored as they could amplify the impact of large negative shocks. We thus agree that a further relaxation of LVR restrictions is unwarranted at this juncture.

New Zealand continues to provide an interesting evolution in its monetary policy and central bank governance framework. Following Phase

One of the Review of its Act, the Reserve Bank now pursues a dual objective with “maximum sustainable employment” formally added to the price stability goal and with an update of the governance framework. The forthcoming Phase Two of the Review will consider financial stability and other policies with a view also to improving accountability. It will be important to ensure an appropriate governance arrangement between the new monetary policy committee and a possible financial stability committee.

Increased infrastructure and services needs resulting from strong economic and population growth can be accommodated by an enviable fiscal position—reinforced by a medium-term debt anchor—which allows the government to plan for higher social, housing and regional spending that will help close the infrastructure investment gap. We note staff’s call that, given the strong fiscal position, “there is no need for faster debt reduction beyond that outlined in the FY2018/19 budget,” but are unclear why staff felt it necessary to caution in that respect. Is such a faster pace of debt reduction indeed being considered?

The government’s goal of making growth more inclusive is commendable. The housing policy agenda is part of this effort by aiming at improving affordability, notably by fostering supply and lowering tax distortions. As in other countries, we note a difference of views as to whether a given measure (in this case a ban on residential real estate purchases by nonresidents) constitutes a Capital Flows Management measure (CFM) under the Fund’s Institutional View on capital flows. The introduction of a ban based on residency indeed points to the existence of a CFM, though Mr. Johnston’s buff provides useful context. In sum, we would reiterate the call made in other similar cases (notably Australia) that work be carried out to clarify the definition of CFMs in applying the Institutional View. The staff’s reactions would be appreciated.

Mr. Panek and Ms. Wehrle submitted the following statement:

We concur with staff’s assessment of New Zealand’s recent economic developments and prospects. The authorities should be commended for their well-designed fiscal, monetary and structural policies aimed at reducing remaining vulnerabilities. Growth is solid and overall macroeconomic imbalances are shrinking. We also welcome the authorities’ efforts to close infrastructure gaps and to carry out structural policies to help foster sustained and inclusive growth in the longer-term. We would like to highlight the following points:

We support staff's view that macroprudential policies have been successful in lowering risks to financial stability. These measures have helped cool the housing market, and the share of loans with high loan-to-value ratios has fallen significantly, making bank and household balance sheets more resilient. Nonetheless, we encourage the authorities to further strengthen the macroprudential framework and instruments, as recommended in the 2017 FSAP. The Phase Two of the Review of the Reserve Bank Act to clarify the RBNZ's financial policy mandate provides a good opportunity for this. We also agree with staff that the loan-to-value ratio tightening measures implemented before 2018 should not be reversed for some time to come, in order to mitigate risks from high household debt. Given that household debt is still elevated, we view the January 2018 relaxation of the loan-to-value restrictions as a little premature.

We welcome the authorities' initiatives to improve housing affordability, which has become a fundamental issue in New Zealand. The efforts to address supply constraints with the Urban Growth Agenda are very useful in this respect. The tax policy changes aimed at curbing property speculation also seem sensible. While we understand that the authorities assess the impact of the Urban Growth Agenda as insufficient to fully stave off affordability concerns and have thus launched the KiwiBuild program, we note that the latter comes with the risks of crowding out private housing supply and creating general market distortions.

Ms. Horsman and Ms. Zorn submitted the following statement:

Consistently prudent policy actions have enabled robust economic growth, mitigation of financial system vulnerabilities, a build-up of sizable policy buffers, and a favorable macroeconomic outlook for New Zealand. As outlined in Mr. Johnston's helpful buff statement, the authorities are appropriately focused on meeting the needs of a growing population, while overcoming structural headwinds to potential growth over the longer term. We thank staff for a very interesting set of reports, and agree with the thrust of their assessment.

The planned shift in the macroeconomic policy mix appears well calibrated to the outlook for inflation, output, and debt dynamics. Wage and price pressures have been minimal, and inflation has remained below target for some time, in spite of the closed output gap. However, as expectations remain well-anchored and given policy-related risks, we agree with staff that the current monetary stance seems appropriate. Going forward, careful assessment and communication by the RBNZ of maximum sustainable employment will be important. On the fiscal side, the authorities deserve recognition for crafting a careful balance between growth-oriented and socially-responsive increases in government spending, while respecting the Budget Responsibility Rules that will help to create buffers for external shocks and natural disasters. We concur with staff that stronger-than-expected revenues should be oriented towards measures that increase potential growth rather than a faster pace of debt reduction.

A comprehensive structural policy agenda with broad reach is key for propelling strong, sustainable, and inclusive growth. With labor supply growth projected to decline along with net migration beyond the medium term, the authorities are rightly focused on infrastructure and innovation as a means for boosting productivity. This will be especially important to support competitiveness as wages increase in response to legislated higher minimums. We will be interested to see New Zealand's full agenda for motivating greater business investment and for increasing R&D spending to 2 percent of GDP.

Macroprudential policy actions and tighter lending standards have helped to slow the growth in house prices and household credit. At the same time, banks remain well capitalized, and their liquidity and funding positions have improved. We suggest that the authorities fully assess the effects of the most recent changes in LVRs before contemplating additional macroprudential actions aimed at housing-related risks. Looking ahead, the government's policy agenda seems appropriately positioned to engineer a soft landing in housing markets and increase the supply of affordable homes. While we can understand the authorities' concerns about non-resident real estate purchases, we also agree with staff that the ban on foreign purchases likely will have only limited effect on affordability.

Mr. Saraiva, Ms. Hennings and Mr. Pinheiro de Melo submitted the following statement:

We thank staff for the reports and Mr. Johnston for his buff. Underpinned by sound macroeconomic policies, the New Zealand`s economy continues to enjoy mostly favorable developments. Although cooling down compared to the buoyant 2014–2016 period, growth in 2017 is estimated to have been close to three percent and is expected to remain near to potential in the coming years. While moving upwards in the first half of the year, inflation has moderated since and is hovering just above the floor of the Reserve Bank of New Zealand (RBNZ)—partially reflecting significant downward pressures from tradable goods prices and services. In this context, fiscal policy has been slightly expansionary—consistent with budget discipline—and the monetary policy stance has remained broadly accommodative.

Despite buffers and an overall positive outlook, New Zealand's small and open economy could be affected by adverse global economic developments. The international environment has been favorable and the country has benefited from positive terms of trade and a generally strong growth in its main trade partners. While the forward scenario indicates increasingly tighter global financial conditions, New Zealand's external balance sheet is solid and the fiscal position provides ample buffers. However, New Zealand's economy strongly relies on trade and foreign capital, which makes it vulnerable to a global protectionist retrenchment. Tackling domestic vulnerabilities—such as high household indebtedness—and stimulating the internal demand by investing in infrastructure and housing, would increase even more the country's resilience against external shocks.

Active macroprudential policies have been instrumental to ease pressures in the housing market and to contain undue financial stability risks. Measures have also been taken to curb prices and to support housing affordability, especially for first home buyers, and a soft landing in the housing market is expected to proceed. The lower share of loans with large loan-to-value ratios (LTV) also indicates that banks and household balance sheets have strengthened. Nevertheless, with household debt to income still at considerably high levels, we concur that the RBNZ should carefully assess risks of further relaxing LTV restrictions. Moreover, adding new elements to the macroprudential toolkit, such as debt-to-income (DTI) or debt-service-to-income (DSTI) instruments, could provide the authorities more leverage to deal with unfavorable developments in a housing market that is still not completely free of pressures.

Many years after pioneering implementing an inflation targeting (IT) regime, an ongoing review of the Reserve Bank Act is expected to update RBNZ's governance framework. RBNZ has been in the forefront of independent and credible monetary policy making. The Phase One of the Review has delegated decision-making to a monetary policy committee (MPC) and added a "maximum sustainable employment" objective. The staff regards the changes so far to be consistent with needed operational independence and substantial changes in monetary policy outcomes are not expected—the qualitative employment objective would not affect RBNZ's operational independence according to a selected issues paper. However, central banks usually have a limited set of instruments and policy objectives must remain consistent with such a constrained toolkit. Considering that

RBNZ has operated a very successful IT regime, which also implies de facto output and employment stabilization, we wonder if the new objective adds significant value for monetary policy conducting—in the short term such dual objectives could even create conflicting signs. Could staff elaborate on this issue and bring more information on how the new MPC has been structured and how it is operating?

The next phase of the Reserve Bank Act review has a welcome focus on better defining RBNZ's mandate and objectives on financial stability issues. We concur that emphasis should be given to priority areas in need of reform, in special those recommended in the last Financial Sector Assessment Program (FSAP). Besides the need for strengthening the macroprudential framework, we consider that RBNZ could be given more latitude to take macroprudential actions whenever necessary. The current process—where the central bank is required first to advise the Minister of Finance before a subsequent agreement and launching of measures—seems a little cumbersome. Such mechanism might not be as flexible as needed during moments of stress. It is possible, and maybe desirable, to add more agility to the RBNZ while preserving decision making transparency and accountability.

Mr. Ostros and Ms. Mannefred submitted the following statement:

We thank staff for the report and informative selected issues papers and Mr. Johnston for his insightful buff statement. The New Zealand economy is healthy, the outlook for growth is stable over the near term, and risks are broadly balanced. We agree with staff's assessment and recommendations and offer a few comments for emphasis.

New Zealand has a strong fiscal position and we commend the government's commitment to budget discipline and the medium-term debt anchor. We welcome that increased spending is directed towards areas of priory to address both social and structural issues such as the needs to adjust to a growing population and to address infrastructure shortages, also taking into account regional imbalances.

As a small open economy New Zealand is sensitive to external factors where, in this particular case, tightening global financial conditions, a slowdown in China—its major trading partner, and an increase in protectionist and trade-unfriendly policies pose the largest risks. The country is also exposed to shocks stemming from natural disasters. In this regard, we support the authorities' commitment to maintain low levels of public debt as a buffer. We also strongly support New Zealand's commitment and openness to international trade and congratulate the signing of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP). We also welcome the negotiations of a free trade agreement with the European Union.

We positively note that the housing market has calmed and that macroprudential policies have contributed to reducing financial stability risks through for example lowering banks' exposure to loans with high loan-to-value (LTV) ratios. Nevertheless, household debt vulnerabilities remain high and we agree with staff's assessment that a relaxation in LTV restrictions is not appropriate in the near term.

We share staff's view that macroprudential policies are aimed at addressing systemic financial risks and are not the primary tools to be used to make housing more affordable. Addressing housing affordability is better done with measures focusing on the supply side and on removing tax distortions. We note that comprehensive plans under the Kiwi Build program and the Urban Growth Agenda are underway to address housing affordability problems. These are welcome initiatives. However, we support staff's assessment that the recently imposed legislation banning non-residents to from real estate purchases in New Zealand should be considered a CFM under the IV.

Mr. de Villeroché, Mr. Castets and Mr. Sode submitted the following statement:

We thank staff for the quality of their documents and Mr. Johnston for his insightful buff statement. We commend New Zealand authorities for effectively leveraging the benign environment and sustained good economic performances, as well as their commitment to reforms fostering inclusive growth. We agree with staff analysis regarding the main impediments to New Zealand's growth—infrastructure gap, housing supply, relatively low total factor productivity growth—and we support the recommendations made to address these challenges, notably mobilizing the existing fiscal space to finance growing infrastructure needs. With this general comment in mind, we would like to offer the following comments:

Given the importance of net migration as an engine of growth for New Zealand, could staff elaborate on the drivers of current migration in New Zealand (immigrant's countries of origin and determinants of inflows and outflows) as well as on potential scenarios for net migration levels in the future?

We commend staff for the attention dedicated to inclusive growth, which is also a priority of the authorities, and encourage further work on inequality, social mobility and poverty in New Zealand in future article IV reports. The relatively high level of inequality in New Zealand and wide regional disparities could be macro-critical for the country and be one source explaining the weak productivity performance highlighted in staff report. A stronger focus on New Zealand social policies (from the existing social safety nets to education policy) would be useful.

We also encourage staff to better assess New Zealand climate change policies and the country engagement to reduce to net zero emissions by 2050.

We thank staff for the insightful selected issues paper on the revamping of New Zealand's inflation targeting regime. New Zealand is to be commended for widely-acknowledged state-of-the-art monetary policy framework and has a long tradition of being a precursor in terms of monetary reform. The most recent decision to formally adopt a dual mandate of price stability and full employment is thus particularly interesting. However, staff final assessment of the gains to be expected from this change (if any) remain somewhat unclear. We are also surprised by the qualification of the euro area as not having an inflation targeting regime. The staff's comments are welcome.

Finally, we take note on the divergence of views between the authorities and staff as regards the qualification of a measure aiming at banning real estate purchasing by non-residents under certain conditions. Since a discrimination based on residency is one of the main criteria to identify a CFM according to the institutional view on capital flows, our view is that the debate should focus on the rationale for adopting such a CFM, taking into consideration the arguments developed by Mr Johnston in his buff. As already stated when reviewing Australia's and Canada's Article IV reports, we look forward to having an in-depth discussion on how the IV apply in the specific cases of measures aiming mostly at ensuring housing affordability.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for their well-written reports and Mr. Johnston for his informative buff statement.

New Zealand has maintained strong growth since 2011 and the economy operates broadly at, or above, capacity. Growth has been supported by accommodative monetary policy, construction, increasing terms of trade, strong external demand from Asia and historically high net migration. Inflation remains well contained and employment has picked up strongly. We view the macroeconomic policy mix as appropriate. Macro-financial vulnerabilities related to rapid house price increase is a key challenge to the economy. We broadly concur with the staff appraisal and wish to make following remarks for emphasis.

We commend the authorities for taking proactive measures to address housing-related macro-financial vulnerabilities. The financing constraints from LTV restrictions have cooled down the housing market and reduced the risks to financial stability. They have also strengthened bank balance sheets. Of course, continuous vigilance is needed to strengthen this improvement further. Household debt remains high, raising affordability concerns. Household debt has increased to 168 percent of household disposable income in 2017. These could potentially raise settlement risks and increase NPLs. The house price-to-income ratio in New Zealand is the highest in OECD countries. Given this situation, we commend the government's ambitious policy agenda to restore housing affordability appropriately by focusing on strengthening supply and lowering tax distortions. Meanwhile, we note the divergence between staff and authorities on whether or not the ban on residential real estate purchases by nonresidents is a capital flow management measure (CFM). Given the sharp increase in house prices and large deterioration in housing affordability for New Zealanders, we would appreciate further comments by staff on the institutional view (IV) on this measure.

The current accommodative monetary policy stance of RBNZ, supported by sound fiscal policies, appears appropriate helping to anchor inflation expectations. The inflation has been either below or in the lower half of the target range. However, inflation could increase given that the economy is operating at its potential and capacity pressures are increasing. The RBNZ has signaled that current policy rate will remain for some time to come. Appropriate timing in adjusting monetary policy stance in either direction is important to prevent risk of subsequent sharper adjustments. The staff's comments are welcome on the impact of the ongoing normalization of U.S. monetary policy on New Zealand.

The changes in the Inflation Targeting (IT) framework reflect an important milestone in the evolution in IT regime in New Zealand. We note that, after 30 years, the Reserve Bank Act (RBA) is being revised. Under Phase One of the RBA review process, an employment objective will be added to the price stability objective, aiming at maximizing employment alongside price stability, while maintaining the flexible inflation targeting regime. This new move is expected to provide the RBNZ with more flexibility in monetary policy making. In this context, we would appreciate staff comments on the possible impact of the new change (dual mandate) on the conduct and communication of monetary policy in New Zealand.

The financial system is generally sound and operating effectively but measures are required to strengthen it further. We note that Phase Two of the RBA review will give an opportunity to reconsider financial policy mandate of the RBNZ. In this context, we encourage the authorities to strengthen macroprudential framework by broadening the toolkit to include debt-to-income ratio or debt-service-to-income, and supervisory pillar of banking regulation, in line with the 2017 FSAP recommendations. The intention to develop a Risk Statement by the government, similar to the overarching monetary policy objectives, is an important initiative, as it will formally frame RBNZ's financial policy mandate.

The fiscal position remains robust with strong buffers, supported by solid growth. Consequently, the country will be able to accommodate a wide range of shocks and hence, no immediate need for fiscal consolidation efforts is observed. We commend the higher infrastructure and social spending coupled with growth-friendly measures while taking advantage of the strong fiscal position. Closing the infrastructure gap will enhance productivity and generate positive economy-wide spillovers, as indicated in the SIP. The authorities have rightly emphasized regional development, particularly through the new Provincial Growth Fund. We welcome the continued commitment of the authorities to budget discipline and a medium-term debt anchor.

Addressing structural issues is needed to enhance growth potential. In particular, sustaining growth will be challenging due to the stagnant capital intensity of the economy and relatively weak business fixed investment growth. We welcome the introduction of productivity enhancing tax reforms to shift incentives to broader business investment given the closed output gap and increasing capacity pressures. The emphasis on research and development, improving education and labor skills and increasing interconnectedness with other countries will help further diversify the economy. We note that New Zealand is involved in several free trade negotiations. The staff's comments on the growing trade protectionism against New Zealand economy are welcome. The proposed minimum wage increase by 2020 and ongoing measures to enhance regional development will help easing income and regional inequality. Could staff comment on the impact of increasing minimum wages on employment growth, international competitiveness, and labor productivity?

Mr. Mahlinza and Mr. Tivane submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Johnston for his helpful buff statement.

New Zealand has continued to show a strong growth momentum underpinned by reconstruction spending, an accommodative monetary policy, high net migration, improved services exports, and strong terms of trade. The above trend growth in employment, has helped absorb the migration-induced increase in the labor force. The growth outlook remains positive, however, medium term risks are skewed to the downside, including tighter global financial conditions and growing trade protectionism. Going forward, priority should be placed on strengthening macrofinancial resilience and productivity growth. We broadly concur with the thrust of staff's appraisal and add the following points for emphasis.

Sound macroeconomic management including a strong fiscal position has helped absorb climate-related shocks and accommodate growing spending needs on infrastructure, social and human capital development, as well as regional development. The authorities' commitment to the Budget Responsibility Rules, which entails curbing net debt to nearly 20 percent of GDP by FY2021/22 provides a robust fiscal anchor against risks related to the country's exposure to external shocks. We welcome the authorities' decisive response to address the demand-supply imbalance in the housing market and lowering tax distortions. In the same vein, we see merit in deploying policy measures to improve housing affordability, including the promotion of competition in the land market through the Urban Growth Agenda and the KiwiBuild program. Considering staff's views that a ban on residential real estate purchases by non-residents, would be a CFM under the IV, we would appreciate staff comments on the impact of these measures on BOP.

The accommodative monetary policy stance has contributed to stabilizing inflation expectations. The Reserve Bank of New Zealand (RBNZ)' readiness to adjust its policy rate, if warranted by market conditions, is welcome. Further, macroprudential policies have played a critical role to accelerating household deleverage and addressing related risks to financial stability. We note that after three rounds of tightening of loan-to-value (LVR) restrictions, the banks and household balance sheets have become more resilient. We support staff's view that additional macroeconomic prudential policies should be considered in the second phase of the Review of the RBNZ Act. In addition, we support the revisions to the monetary policy framework to include employment outcomes alongside price stability as well as the creating of a monetary policy committee in charge of decisions. We encourage the authorities to continue the structural enhancements to the crisis resolution framework in line with the recommendations of the 2017 FSAP.

Finally, we welcome the frontloading of macrostructural reforms to address the country's productivity growth challenges, and promote sustainable and inclusive growth. We welcome the emphasis on minimum wages, productivity, research and development (RD) and education. Similarly, we see merit in sustaining efforts to deepen economic integration through international trade, and welcome the signing of the CP-TPP agreement which is a key step to strengthen resilience of the New Zealand's economy in the long run.

Ms. Erbenova, Mr. Bayar and Mr. Mehmedi submitted the following statement:

We thank staff for their comprehensive set of reports, including the selected issues paper on infrastructure investment, housing affordability, and the policy response; and Mr. Johnston for his insightful buff statement. We commend the authorities for the prudent macroeconomic policies and robust economic growth. Considering the projected slowdown of potential output over the medium term and the downside risks, the steadfast implementation of reforms is needed aimed at reducing housing market vulnerabilities, incentivizing broader business investment, and boosting labor force productivity. We broadly concur with the thrust of staff's appraisal and would like to flag some issues for emphasis.

A short-term positive fiscal impulse consistent with reducing net debt in the medium-term is a warranted shift in the overall policy mix. We note that the economic expansion in recent years has helped the authorities maintain a strong fiscal position with robust revenue growth, while prudent expenditure restraints have been employed. In view of New Zealand's high infrastructure gap, we see merit in increasing productivity-enhancing spending—including in infrastructure, health, and education—to accommodate the higher population growth, as well as to boost potential growth and regional development. In this regard, we agree with the authorities' intention to relax the fiscal adjustment path, allowing for a slower debt reduction. Considering that inflation is still below its target, and wage and price pressures minimal, we agree that monetary policy should remain accommodative.

We welcome the authorities' efforts in modernizing the inflation-targeting regime. While the Reserve Bank of New Zealand (RBNZ) now has an explicit dual mandate, we note that this does not represent a fundamental change to the monetary policy regime, as the framework already embodied de facto output and employment stabilization objectives. Going forward, as part of Phase Two of the Review of the Reserve Bank Act, the authorities should clarify the responsibilities of the Treasury and the central bank in financial sector issues, and reinforce the RBNZ's role and autonomy as prudential regulator and supervisor, in line with the 2017 Financial Sector Assessment Program (FSAP) recommendations. At the same time, broadening the macroprudential policy toolkit is necessary. The staff's comments on the scope of the Phase Two of the Review, which is expected to start in the second half of this year, are welcome.

We encourage the authorities to move forward with the reforms aimed at enhancing financial stability and financial sector resilience, in line with the FSAP recommendations. While the banking sector is well-capitalized and profitable, it remains significantly exposed to the real estate sector and relies on wholesale offshore funding. Although the recent cooling of the housing market is a welcome development, persistently elevated housing prices and low housing affordability remain a source of concern. We commend the authorities for implementing the housing policy agenda, including the Kiwi Build program, which appropriately focuses on closing key gaps on the supply side and in the tax system. The macroprudential measures taken so far have proven successful, but we caution that the loan-to-value ratio restrictions should not be eased prematurely. We note Mr. Johnston's comment in his buff statement that the ban of residential real estate purchases by non-residents is not aimed at managing aggregate capital flows and will not have a material impact on the balance of payments. Nonetheless, we agree with staff that this policy measure is unlikely to be temporary or targeted and will, by its design, limit capital flows. The staff's comments on how the ban on home sales to foreigners may impact foreign direct investment going forward are welcome.

Concrete measures should focus on boosting productivity and investment, and making growth more broad-based and inclusive. Productivity growth has been relatively low compared to other advanced economies. In this context, the structural reform agenda should focus on boosting human capital, improving education, increasing research and development spending, and creating incentives to attract more high-quality foreign business investment.

Ms. Villa and Mr. Machmud submitted the following statement:

We thank staff for a comprehensive set of reports and Mr. Johnston for his informative buff statement.

New Zealand's economy has experienced solid expansion since 2011, driven by construction sector and supported by accommodative monetary policy, a net migration wave, and relatively favorable terms of trade. Nevertheless, productivity growth remains lackluster reflecting lingering structural weaknesses in the economy. Going forward, we agree that the policy focus should be on structural reforms to support higher productivity and inclusive growth, while maintaining macroeconomic and financial stability.

An appropriate macroeconomic policy mix is crucial in maintaining macroeconomic stability. We agree that the maintenance of an accommodative monetary policy stance will help facilitate the recovery of inflation toward the two percent target. We welcome the active efforts to review and update the mandates of the Reserve Bank of New Zealand (RBNZ), and positively note the completion of Phase One of the review. On the fiscal front, given the strong fiscal position and rapid population growth, we welcome the authorities' plan in 2018/19 Budget to increase spending on infrastructure, housing, health, education, and regional development. We also commend the authorities' commitment to reduce net public debt to around 20 percent of GDP by FY2021/2022, which would help build fiscal buffers in light of New Zealands' exposure to external shocks and natural disasters.

Macroprudential measures have helped to contain housing market vulnerabilities, but vigilance remains necessary. We note positively that successive rounds of macroprudential tightening have contributed to a gradual cooling of the housing market, and in particular a significant decline in the share of outstanding residential mortgage with LVRs above 80 percent. Given that household debt remains elevated, we tend to agree with staff that a more cautious approach toward relaxing the LVR may be warranted. However, we note that housing affordability remains a challenge for first-time home buyers and wonder whether an LVR relaxation might help to facilitate home ownership?

More broadly on the housing market, we support the emphasis on the supply side response in the authorities' housing policy agenda. With regard to demand-side measures, we have sympathy for the authorities' reasoning that continued political support for deeper global integration might require measures to reassure New Zealanders that their prospects for home ownership are not being threatened by foreign speculation. Nonetheless, a ban on foreign acquisitions of residential real estate seems a rather absolute response and we would be interested to hear if the authorities had considered any other less emphatic measures to discourage nonresident speculation. Could staff also elaborate on their assessment that foreign buyers are playing only a minor role in the residential real estate markets? Further, like Messrs. Saito and Ozaki, we would be interested to hear views on how social and political economy considerations should be taken into consideration when assessing the appropriateness of measures under the Institutional View.

Advancing structural reforms will be important to boost productivity and innovation and support more inclusive growth. We commend the authorities' structural reform initiatives. We take positive note that to deepen skills and innovation, the authorities have started to provide free tertiary-level education and training for at least one year and proposed a new R&D tax incentive to support innovation spending in the business sector. On the minimum wage, we tend to agree with staff that minimum wage increases should be implemented judiciously given the potential impact on competitiveness relative to other OECD members.

Mr. Merk and Ms. Kuhles submitted the following statement:

We thank staff for the insightful set of reports and Mr. Johnston for his informative buff statement. We mostly agree with staff's assessment and policy recommendations. We welcome New Zealand's solid economic expansion, which has been underpinned by sound macroeconomic policies. The economic outlook appears favorable with broadly balanced near-term risks to growth. Medium-term risks, however, remain tilted to the downside, in particular risks related to the still high household debt and external risks such as a retreat from cross-border integration.

We concur with staff that the current macroeconomic policy stance appears broadly appropriate. We commend the authorities for their prudent and growth-friendly fiscal policy and their commitment to budget discipline and the medium-term fiscal anchor, which also helps to balance the macroeconomic policy mix in an economy with a closed output gap. As regards monetary policy, we agree with staff that the current policy stance is sufficiently accommodative to address below-target inflation and lower risks from currency overvaluation. Going forward, we trust that the authorities will remain vigilant and stand ready to adjust their policies, if warranted.

We welcome that the authorities' ambitious housing policy agenda focuses on increasing housing supply and reducing speculation-incentivizing tax distortions to address the supply-demand imbalances in the housing market. In this context, we take positive note that the macroprudential measures undertaken so far have contributed to cooling the housing market and reducing related financial stability risks. Nevertheless, household debt ratios remain high, which would argue for caution when considering an easing of LVR restrictions.

As regards the government's structural policy agenda, we particularly welcome measures aimed at enhancing business investment and innovation. The envisaged R&D tax credit and tax reform, if well designed, could be helpful instruments in enhancing innovation in the business sector and shifting incentives towards broader business investment. We are looking forward to the authorities' final agenda in this regard. Finally, we welcome the authorities' continued commitment to open trade and the multilateral trade framework.

Mr. Armas and Mr. Corvalan Mendoza submitted the following statement:

We thank staff for the report and Mr. Johnston for his comprehensive buff statement. Solid growth performance and a strong economic policy framework are safeguarding the country from numerous domestic and external shocks. Medium-term challenges, like the expansion of infrastructure and public services for the rapidly growing population, are on the government agenda. Short-term challenges, which are focalized on the financial sector, are also being addressed.

The accommodative stance for the monetary policy is helping the economy, taking into consideration that inflation dynamics are still muted. Persistent net migration has helped this outcome, as stated in Box 2; and labor productivity growth was higher than anticipated. Given these new GDP figures and the latest upward revision for the potential output, we would like to ask staff for more clarification on the potential link between the migration wave and supply-driven expansion of the economy.

We welcome the authorities' intention to focus on the Budget Responsibility Rules, and their willingness to reduce net debt to around 20 percent of GDP by FY 2021/2022. It is a prudent view for the country to maintain a low level of public debt, given New Zealand's exposure to external shocks and natural disasters, and its relatively high private and external indebtedness.

Preserving fiscal space and keeping expenditures in check served the country well. The fiscal room to maneuver becomes a real asset for economic policy and the new coalition government will use some of it to accommodate higher demands for infrastructure and public services, such as education, health, regional development, housing, etc. From what we have learned in Annex III, the new coalition government's fiscal and structural agenda is ambitious. We would appreciate further details from staff on implementation plans to move ahead with the agenda, and if possible, a deeper analysis on the deployment of the Provincial Growth Fund.

Macroprudential measures (MPM) applied by RBNZ proved to work as planned. Credit growth moderated in line with nominal income growth and house prices are cooling. Further tightening of LVR since 2016 moderated the exuberance in the real estate market. It is also a welcome step that banks' funding needs are shifting away from wholesale funding to domestic deposits. On a less positive note, the household debt-to-income ratio is around 168 percent, which is considered high. The saving concentration on the housing sector (due to tax incentives), and increased offshore funding (in the search of yields) might all have played an important role in creating the demand-supply imbalance in the housing sector. However, as we see it, with the new coalition government plans to increase the supply for houses and to rearrange tax incentives, these potential risks for the financial sector might dissipate faster than expected.

Finally, regarding the capital flow management to be introduced, we support staff's view that such a movement to restrict nonresidents' real estate purchases should be reconsidered by the authorities. In the understanding that there is a housing policy agenda in motion, and assuming it will be fully implemented, there might not be the need to set in place a discriminatory measure as envisaged in the Overseas Investment Act.

With these comments, we would like to wish New Zealand and its people all the best in their future endeavors.

Mr. Saito made the following statement:

We thank the staff for the set of papers and Mr. Johnston for his buff statement. As we have issued a gray statement, we would like to provide two comments for emphasis.

First, on managing housing market imbalances, we broadly agree with the staff's view that the housing policy agenda appropriately focuses on closing key gaps on the supply side and in the tax system. Among the measures, we take note of the divergence of views between the staff and the authorities about the ban of residential real estate purchases by non-residents when it comes to applying Fund's Institutional View. We thank the staff again for the detailed responses to the Board's questions on this issue.

Regarding the labeling of these measures, there is no doubt that the measure is classified as a capital flow management measure (CFM) according to the Institutional View because it would introduce discrimination based on residency. Based on this understanding, we raised a question in our gray statement about incorporating the social context into the assessment of the appropriateness of the CFM. Again, we support the staff's response on the question. The staff rightly recognized that rising housing prices and declining housing affordability are a major concern from a social and political perspective, and it took account of these perspectives when assessing the appropriateness of the housing ban.

Furthermore, the staff noted that there might be some room to introduce the housing ban if the measure is in line with the Institutional View. For this specific case, after considering these elements, the staff concludes that the ban is in line with the Institutional View. We are of the view that the staff's assessment is reasonable and appropriate.

We note that the staff is accumulating takeaways from several Article IV cases and is preparing a paper to be shared with the Board in July. We encourage the staff to incorporate the case of New Zealand in the paper; particularly with regard to how the staff takes into account the social and political factors in assessing the appropriateness of the housing ban.

Second, on monetary policy, we welcome the revisions to the monetary policy framework under phase one of the review, which includes the maximum employment objectives. We take note of the staff's view that, due to the amendments, the dual mandates, the staff does not expect material changes to monetary policy conduct in the current environment. At the same time, we assume that the explicit dual mandate will require enhanced communication of the central bank's monetary policy conduct, especially when responding to the supply shocks. We hope that the Reserve Bank of New Zealand will fulfill its mandate well.

Finally, regarding the question by Mr. de Villeroché on the classification of the European Central Bank's (ECB) monetary policy framework, the staff responded that the euro area has an inflation targeting regime but not inflation-focused targeting or a flexible inflation-targeting regime. We ask the staff to elaborate more on the difference between the two regimes and how Japan's monetary policy framework is classified.

Ms. Villa made the following statement:

We thank the staff for the comprehensive report and answers to our technical questions. We also appreciate the pointed buff statement from Mr. Johnston that has led to some useful clarification in staff's application of the Institutional View on CFM issues and housing affordability, and risks to trade and openness.

We issued a gray statement, wherein we noted New Zealand's solid growth and prudent policies, and broadly supported the staff's recommendations, including the need for advancing structural reforms to boost productivity and for beefing up supply-side responses in their housing policy agenda while encouraging authorities to be mindful of the sustainability and fiscal implications of such supply-side responses. We just wish to make two points again on the CFM.

First, the back and forth between authorities and staff again brings to the fore the usefulness of a healthy discussion on the different dimensions of an issue. For our authorities, labeling that a measure is a CFM or not will always fall short of its objective. We believe merely labeling does not improve the traction of policy advice. It must always be accompanied by concrete alternative recommendations.

In response to our question, No. 32, on less emphatic measures to discourage non-resident speculation, the staff noted measures that the authorities already had put in place in previous years, which were not necessarily discriminatory.

For New Zealand, and as intimated by Mr. Johnston in his buff statement, we realize that their policy decisions are more complex. At this time, the issues cover more than housing affordability. We trust that the authorities will be able to find the appropriate policy mix that would address these concerns; but more generally, and as also cited by Mr. Saito this morning, given that housing is a special case that has social and political economy implications, we continue to encourage the staff to consider the underlying motivations for the authorities' choice of policy measures when implementing the Institutional View.

Second, we are heartened by the staff's answer to question 29. We look forward to the discussion of the paper on the Institutional View in practice in July and the taxonomy in the fall, which the staff mentioned in its response. We trust this will further clarify the application of the Institutional View. As both the staff and the authorities draw lessons from cross-country experiences, we hope that this would further guide the staff in their engagement with the authorities and help policymakers in their goal of further strengthening their own policy toolkits.

Ms. Crane made the following statement:

We thank the staff for the paper and the answers to our technical questions and Mr. Johnston for the informative buff statement. We would like to highlight a few points from our gray statement.

First, we welcome the staff's analysis of fiscal space and concur with the recommendation to use available space to boost investment in ways that can lift potential growth over time. We appreciated the description in the buff statement of the authorities' plans to pursue an expansionary fiscal policy in the near term, including plans to invest in the health care and education systems, as well as social and transport infrastructure. We encourage them to take the staff's advice to use any structural increase in revenues to increase spending to boost potential growth.

Second, regarding the housing CFM, the measure is being pursued for political economy reasons that have been well explained in the buff statement. That being said, we do not believe it is appropriate to look to the Fund to blast this measure on economic grounds. The Fund needs to apply the Institutional View in a consistent and evenhanded manner, as it has done in this case. The staff has also pointed to other more effective means of addressing the economics of the housing affordability issue, many of which the authorities are already pursuing.

Finally, on the financial sector, we welcome that a number of the recommendations from the recent Financial Sector Assessment Program (FSAP) will be taken up as part of phase two at the review of the Reserve Bank Act. We encourage the authorities to consider the priorities for reform put forward in the staff report.

Ms. White made the following statement:

We thank the staff for the well-reasoned papers and the answers to technical questions, which we find useful. We also thank Mr. Johnston for his clear and informative buff statement. We commend New Zealand for its solid and importantly inclusive growth over the last few years and generally agree with the staff's outlook.

I want to make a brief intervention this morning to focus on the housing issue, which has been the thematic piece through everyone's gray statements.

It is clear that the proposed housing measure has exposed, once again, the potential for differing views on the categorization of these policies. This chair remains a strong supporter of the Institutional View and welcomes the efforts on the part of the staff to better explain its application. Equally, we welcome the additional insights that Mr. Johnston provided in his statement as to the role homeownership plays in New Zealand society and his authorities' commitment to maintaining New Zealand as an open and outward-looking trading nation.

Clearly, it is important that the Board discusses these measures, but we thought that Mr. de Villeroché and his colleagues articulated the issue at hand very well in his gray statement, where he argued that the debate should focus on the rationale for implementing such a measure, particularly in the context of the social policy effects associated with housing affordability.

This chair has made similar points in other Article IV discussions, where the authorities and the staff have disagreed; notably, the Australian and Malaysian cases. But it seems that the New Zealand example amplifies again the case for the staff to provide some broader analysis on housing affordability and what could be done to mitigate the pressures being felt in many advanced economies without running contrary to the Institutional View. We echo Ms. Villa's request this morning and look forward to this work in due course.

Mr. Castets made the following statement:

I thank the staff for the set of good reports and Mr. Johnston for his insightful buff statement. I also would like to congratulate Mr. Johnston on the birth of the new Prime Minister's baby. I learned that it is only the second time that a female head of state has given birth while being in office. It sets a good example also for this institution, which is working increasingly on female labor participation.

I would like to add three short points to our gray statement. First, like Ms. Crane, we would like to support the staff's encouragement to use the existing fiscal space to support potential growth, notably by supporting spending on training.

My second point regards the call that we made last year to integrate further climate change and inequality into Article IV reports for New Zealand.

My third and final point regards the discussion that took place this morning on the ban on real estate purchasing by non-residents. Ms. White recalled the position we articulated in our gray statement. We are also a strong supporter of the Institutional View as it is; but we definitely see a need for more in-depth engagement. Like Mr. Saito, we encourage the staff to integrate New Zealand's case into the report to be presented in July. We are also keen on having a broader discussion about housing affordability.

Mr. Saraiva made the following statement:

I thank the staff for the papers and for the answers to the technical questions. I thank Mr. Johnston for his informative and clear buff statement.

We issued a gray statement, and I will touch briefly on two points that have been touched upon here also, including by Mr. Saito.

The first is regarding the housing market. I believe that the authorities' approach has been the right one—focusing on the supply side, trying to remove the bottlenecks for housing supply in order to enhance affordability, but also being mindful of financial stability issues, using a high loan-to-value (LTV) ratio, which should remain high while it is warranted. Eventually, the authorities should consider using other macroprudential tools.

The other instrument that has been used on the demand side is the regulation on housing purchased by non-residents, which has been classified by the staff as a CFM. I am not too concerned about that. There are reasons to classify it as a CFM according to the Institutional View, but I am not too concerned about the perfect application of the Institutional View's strictures. We should go into the content of the measure, of what we are seeing there. As Mr. Johnston said, the measure does not materially affect balance of payment flows. It does not affect in the least the open character of New Zealand's economy, so that should be clearly stated. Even if it just complements the other measures that have been taken to cope with the housing issue, it may be valid. In the end, the Institutional View does not rule out CFMs, and it is not prescriptive. It is more like a recommendation. The authorities have been managing New Zealand's economy in a skillful way and should continue to do so.

The other point I would like to mention regards the review of the Reserve Bank of New Zealand Act, which has gone through the first phase and is going into the second phase. We would like to raise the question of the new objective for the central bank's mandate. We do understand that it gives more flexibility and we believe it is important to keep it as a qualitative objective, not to put too much stress into the core issue of maintaining inflation within the target.

But there was another aspect in our question that was not answered by the staff, which concerns the new composition of the monetary policy committee, and if there is any information about how it will work.

Mr. Ostros made the following statement:

I thank the staff for a good set of reports and Mr. Johnston for a well-written buff statement.

We tend to follow New Zealand because there are some interesting similarities with countries in my constituency, not least my own country, with high household debt, rising house prices, and the use of macroprudential measures to try to deal with that situation. I commend the authorities for having implemented macroprudential measures in a good way.

I would like to agree with the staff when it comes to being careful in not taking away macroprudential measures at this stage. I would like to underline that message from the staff, directed to the New Zealand authorities. I will continue to follow developments closely because many countries are learning from each other in this case.

When it comes to the implementation of or the interpretation of the Institutional View, I tend to agree with the staff that the measures banning non-residents from real estate purchases in New Zealand should be considered as a CFM under the Institutional View. I tend to think it will be a bit difficult to differentiate between asset classes when we are using the Institutional View because we could also consider many other instances where we could argue that the Institutional View should not be implemented.

It is hard to believe that the ban from real estate purchases is the most effective way of dealing with non-affordability when it comes to housing. It tends to be often in specific parts of the housing market, where there is this is a foreign demand. It might be a politically convenient measure to take and a popular measure, but I do not think, from an economic point of view, that it is the most efficient measure. I would encourage the staff to continue with this assessment but would also look forward to a deeper discussion on how we implement the Institutional View going forward.

Mr. Palei remarked that his chair's position on the Institutional View was similar to the one expressed by Mr. Ostros. He believed that the staff was appropriately applying the Institutional View, and agreed with the recommendations in the staff report.

Mr. Mahlinza noted that he had been satisfied with the staff's response to his question on the CFM, but that he was looking forward to the forthcoming discussion of the Institutional View in July. He asked that the case of New Zealand be incorporated into that paper.

The staff representative from the Asia Pacific Department (Mr. Helbling), in response to questions and comments from Executive Directors, made the following statement:[1]

On the CFM, I will defer to Ms. Kostial. From our point of view, there is nothing to add.

On housing, as in many other cases, we would point to supply-side issues. Many cities in the world have had problems with coping with recent, unexpectedly strong increases in activity, population, and labor force. Ultimately, what this has shown is that there were supply side problems in accommodating the surprise. There are issues when demand-side measures are needed to support supply-side policies, but these issues have been discussed.

There were issues on monetary policy. At the moment—with New Zealand being back on the recovery to full employment, and in the absence of a supply shock and far away from the zero lower bound—the employment

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[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

mandate, which is appropriately qualitative, should not make a big difference in policy conduct.

The new employment mandate will require additional communication, and the Reserve Bank has already started. Traditionally, it has only commented on the output gap and focused less on full employment, partly because of structural change in the labor market. It has thus been difficult to establish a stable non-accelerating inflation rate of unemployment (NAIRU). For this reason, the most recent monetary policy statement, the Reserve Bank evaluated eight measures of full employment, and on this basis, drew a conclusion of how close the economy was to full employment. In line with the staff report, the economy is broadly at full employment at this point.

Regarding the classification into inflation forecast targeting or flexible inflation targeting, when it comes to Japan and the euro area, there is the aspect of the forecast targeting, both the European Central Bank and the Bank of Japan target inflation. In that sense, they are inflation targeting, but they do not use the forecast of inflation as an intermediate target. Also, in both cases, they do not have an endogenous policy interest rate that they communicate with their inflation forecast.

We have to admit that both central banks operate under conditions of quantitative easing, and this is a slightly rhetorical distinction and may not apply at the moment.

Finally, on the Monetary Policy Committee, enabling legislation will be put in place. It is expected that the Monetary Policy Committee will be established early next year. The New Zealand authorities envisage five to seven members. The majority of members will be internal: the Governor, the Deputy Governor, and, possibly, the Assistant Governors. The Committee will be chaired by the Governor. On mission, the Minister of Finance told us that in the first go, the Monetary Policy Committee will have seven members: four internal ones and three external ones. The central bank's expertise will, therefore, be prominently represented. While benefitting from the experience of the Reserve Bank, the main novelty of the MPC-based decision-making is that outside perspectives will also play a role in monetary policy deliberations.

The Deputy Director of the Strategy, Policy, and Review Department (Ms. Kostial), in response to questions and comments from Executive Directors, made the following statement:

Since several Directors raised issues on the Institutional View, I wanted to provide some additional clarification. One important point about the Institutional View is that it is not about labeling. What is at the heart of the Institutional View is finding the right policies for a country in its specific circumstances.

In terms of the definition of what is a CFM and what is not a CFM, the Institutional View is quite clear. The criteria for making that assessment are not the intent or motivation. These two criteria do not enter the consideration of whether a measure is a CFM or not.

The case for New Zealand is relatively clear because any measure that discriminates between a resident and non-resident per its design and its nature is a CFM, as it affects cross-border financial activity.

I would also like to discuss how we come to our assessment of what we think are the appropriate policies. This is not just about economics. For staff, when we look at rising housing prices, when we look at the declining housing affordability, these are important political and social considerations. There is no question about that. But then the question is: What are the right policies?

If there is a capital flow measure involved, the Institutional View provides guidance in terms of asking staff to look into what is the right policy option. From our side, we believe that in terms of macro and macroprudential policies, we do not see scope for further adjusting them to address the issue of the housing imbalances.

In terms of how to restore housing affordability, we believe that the broad-based policy which addresses supply-side constraints, a policy which addresses tax distortions—and that is exactly what the authorities are also planning to do—that is the right policy, and that is also a more effective policy than establishing a CFM. That is because this broad housing policy would address the root cause, because the root cause of the issue of housing affordability is not that there are large inflows from the outside.

Mr. Saraiva correctly said that the Institutional View does allow for CFMs. In certain circumstances—such as a large capital flow surge—

introducing CFMs that do not substitute for macro adjustment can be useful as long as they follow the three "Ts" outlined in the Institutional View. That they are transparent, temporary, and targeted.

Directors raise a fair point that we probably have not done a good enough job in explaining the application of the Institutional View. A meeting like today's is useful in understanding where Directors see issues. We will follow what we have been doing before. We have had seminars at the Spring and Annual Meetings. The next step is that in July, we will issue a note, and that note will look into the application of the Institutional View. It will also look into the housing sector and how the Institutional View is applied there.

Later this year, Directors will get a taxonomy of the Institutional View which will show that since the Institutional View has been in place since 2012, which countries have imposed which measures and how we have been assessing these in terms of appropriateness.

Mr. Johnston made the following concluding statement:

It is always interesting seeing how other people view your own country. I find most of the time in America that it is about Lord of the Rings. I also was just noticing that on my water bottle, on the logo of the Fund, New Zealand does not actually appear on it. It seems to have been air brushed out or replaced by some big long crease that goes along the side of Australia.

New Zealand is a small and remote country. That does explain part of one of the mysteries of New Zealand—that an open country with high-quality institutions and policy settings, is somewhat lagging many of its peers in terms of per capita income and productivity. I believe that size and distance explains quite a bit of that.

I did not actually want to talk about CFMs much today, but everyone has goaded me into it.

In terms of fiscal policy in New Zealand, the government is required by law to get public debt to a prudent level. Successive governments have taken "prudent" to mean low. The current government has maintained its predecessor's target of reducing net debt to 20 percent of GDP, which is low, as a buffer against New Zealand's relatively high private and external indebtedness and exposure to shocks. We do not tend to use fiscal policy as a stabilization tool. That was the case even during the global financial crisis.

In terms of infrastructure, it would be fair to say the authorities are skeptical about using high-level cross-country measures, like those of the Global Infrastructure Hub, as an assessment of the state of New Zealand's infrastructure. Infrastructure investments are based on rigorous cost-benefit calculations within a framework that focuses on what services and outcomes the government wants to achieve in the future, rather than the assets that are used to deliver them.

In terms of monetary policy, New Zealand, as people have noted, has been a pioneer of inflation targeting. The new government wants to maintain that focus on price stability, but it also wants to highlight the human face of monetary policy by explicitly recognizing its role and supporting sustainable employment.

Another key policy of the government is this restriction on house purchases by non-residents. I will not go into the rationale because I addressed it in the buff statement, and people have discussed it today.

One point about CFMs in this case is that mission teams should look at domestic policy issues that are macro relevant, and they should certainly express their views on them. In return, the authorities get to express their views as well. I do not believe they are looking to the Fund to bless these particular measures, but having that debate is absolutely fine. Directors can have a view on it, too.

As Mr. Ostros was saying, we can have a discussion about whether we think some domestic policy measures are helpful or not helpful. I guess the question is whether these things should be described as CFMs and what that labeling actually achieves. I would politely disagree with Ms. Kostial, that it is not about labeling because I believe it really is. It is about the Fund telling the world that a country is effectively employing capital controls. I do not believe countries like that if they do not need it.

In terms of CFMs more generally beyond New Zealand, this chair supports the Institutional View that the Board agreed to in 2012, which is a focus on managing surges of inflows and disruptive outflows and explicitly says measures would be discussed in Article IV consultations when they are "having a significant impact on a member's domestic or balance of payment stability." We agree with that. But yet this is the third country in our constituency to have the CFM label applied to it in the last six months.
In none of those cases is there any indication of a significant impact on the balance of payments. In terms of effectiveness, nor have the countries

changed what they are doing because of the CFM label. They have just been bemused and/or annoyed by it. It has had zero traction. This gets to the difference between the Institutional View, as agreed to by the Board, and the implementation of the Institutional view, which has been formed in the Staff Discussion Note that we did not agree to and in subsequent staff guidance. It would be good if we could have a proper discussion about all this, rather than doing it on the sidelines of countries' Article IV consultations, to be honest.

On that cheery note, I thank Directors again for their attention to New Zealand and for the thought that they put into their gray statements and their remarks. I thank the mission chief, Mr. Helbling, and his team for the excellent and helpful work they put into this Article IV consultation.

The Acting Chair (Mr. Zhang) noted that New Zealand is an Article VIII member and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for prudent macroeconomic policies leading to New Zealand's continued solid economic growth. While the outlook remains favorable and near-term risks are broadly balanced, medium-term risks are tilted to the downside including tighter-than-expected global financial conditions and growing protectionist policies in other countries. Against this background, Directors encouraged continued sound policy implementation and reforms to support inclusive growth.

Directors agreed that current macroeconomic policy settings are broadly appropriate and welcomed the authorities' readiness to adjust the policy mix if needed. They viewed the monetary policy stance as sufficiently expansionary to address current, below-target inflation and to lower risks to demand from currency overvaluation. Directors concurred that the strong fiscal position provides space to accommodate the needs from robust population growth, while the pace of debt reduction envisaged in the FY2018/19 budget is appropriately ambitious. They encouraged using stronger structural revenues to increase spending on infrastructure, human capital development, and other public services that would raise potential output.

Directors noted that macroprudential policies have contributed to reducing risks to financial stability and should continue to mitigate risks from high household debt. Bank and household balance sheets have become more resilient with a lower share of loans with high loan-to-value ratios (LVRs). With household debt still elevated, Directors generally did not see further relaxation of LVR restrictions as appropriate in the near term.

Directors welcomed the Review of the Reserve Bank Act. Regarding Phase One of the review, they encouraged maintenance of the employment objective as the updated framework is legislated and fully implemented. Directors saw Phase Two of the Review, focused on financial stability and other policies, as an opportunity to better define the mandate and objectives for the Reserve Bank of New Zealand in this domain. They encouraged the authorities to give emphasis to priority areas in need of reform, such as the macroprudential toolkit and the supervisory pillar suggested in the 2017 Financial Sector Assessment Program.

Directors concurred that the ambitious housing policy agenda centered on strengthening supply and lowering tax distortions will help to restore broad-based housing affordability. They emphasized that the success of the agenda will depend on well-coordinated progress of the *KiwiBuild* program and the *Urban Growth Agenda* across the public sector. Many Directors noted the proposed ban of residential real estate purchases by nonresidents, which is assessed as a capital flow management measure under the Fund's Institutional View, and encouraged the authorities to reconsider the measure. They considered that this measure would be unlikely to improve housing affordability, while the broad housing policy agenda, if fully implemented, would likely address most of the potential problems associated with foreign buyers on a non-discriminatory basis. A number of Directors, however, saw merit in taking into account the social and political economy considerations in the assessment, or did not think that the proposed ban would have a material impact on the balance of payments.

Directors welcomed the government's structural policy agenda, which seeks to support productive, sustainable, and inclusive growth. They noted that an R&D tax credit, if well designed, could be an efficient instrument to support innovation in the business sector, while tax reform could play an important role in shifting incentives toward broader business investment. Directors welcomed the authorities' ongoing commitment to open, multilateral trade integration.

It is expected that the next Article IV consultation with New Zealand will be held on the standard 12-month cycle.

APPROVAL: February 5, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. ***Could the staff elaborate on the recent data showing a slowing of growth in the first quarter of 2018 and indicate if this slowdown may affect growth forecast for the whole year?***

- The slowdown of growth in the first quarter of 2018 stems from weaker than expected private consumption. According to the StatsNZ press release, "household spending on services was held back by reduced spending on second-hand vehicles, petrol, and clothing. The discovery of stink bugs in car shipments during the quarter has reduced the volume of cars available for sale." So, if the major deceleration of household consumption was due to spending on vehicles, this can be treated as a temporary factor and we will likely see a rebound in consumption in the second quarter. Having said that, more recent data on retail sales confirms some moderation in spending. Consequently, the growth forecast for this year might be slightly lower than previously thought.

2. ***We take note that net migration remained at recent record high levels. We also note that the output gap should turn positive with potential output growth slowing due to the slowdown of net migration. How can New Zealand make the most of net migration for boosting its potential growth?***

- Net migration is encouraged through a merit system, and balancing needs to fill in parts of the labor force that are unable to meet domestic demands, to bolster a skilled labor force. By encouraging the role of market forces shape migration patterns, the economy benefits more than using direct intervention which it can be hard to identify and understand the underlying economic forces in labor demand, especially in the short term.

3. ***Given the importance of net migration as an engine of growth for New Zealand, could staff elaborate on the drivers of current migration in New Zealand (immigrant's countries of origin and determinants of inflows and outflows) as well as on potential scenarios for net migration levels in the future?***

- Strong net migration in recent years is driven by two factors: stronger immigration inflows and smaller outflows of New Zealand citizens. The government visa schemes have increased the global inflows of migrant workers, while the strong New Zealand economy has encouraged New Zealanders to remain in the country. The authorities' Budget 2018 assumes that net migration will fall from 68,000 in the year to March 2018 to 25,000 in the year ending in June 2022. The forecasts underpinning the staff report are closely in line with these numbers. Given the performance of migration in the past several years (where the level that has occurred has exceeded that forecasted the year before), and continued strength of the economy, there remains an upside risk to the level of migration going forward.

4. ***Persistent net migration has helped this outcome, as stated in Box 2; and labor productivity growth was higher than anticipated. Given these new GDP figures and the latest upward revision for the potential output, we would like to ask staff for more clarification on the potential link between the migration wave and supply-driven expansion of the economy.***

- The strong net migration wave has contributed to raising supply-side capacity by boosting the labor input in the economy, thereby leading to higher potential output, which also has encouraged private business investment to further capital deepening and maximize the productivity of that labor. Given the labor input has had a strong working-age component, this has contributed to the steady rise in New Zealand's rising participation rates (both male and female). Moreover, it has spurred the authorities to reorient its priorities over the past decade to provide more infrastructure and services to expand the economy's productive capacity, to meet the needs of a rapidly expanding population. It is worth noting that record-high net migration of recent years also increased aggregate demand in the economy.

Fiscal Policy

5. ***Could the staff comment on the authorities' response to their suggestion to use stronger structural revenues to increase spending on infrastructure and other measures that would raise potential output?***

- The government has appropriately moved forward on a variety of policy measures, related to infrastructure (direct spending, and the Provincial Growth Fund) and through increased measures related to human capital (through health and education spending) and productivity (by starting to work with the R&D tax regime). They have indicated that these priorities will continue to receive more funding, if available and consistent with the Budget Responsibility Rules, which staff welcomes.

6. ***What is the staff's view on whether the area of increased spending in the FY 2018/19 Budget is efficient and effective enough to increase potential output?***

- Given the focus on diversifying sources of growth through providing improved foundations (infrastructure spending, the Provincial Growth Fund, encouraging human capital formation through more health and education spending) and encouraging innovation (with reforms on R&D tax policy), there is a strong emphasis on efficient and proven channels. The minimum wage increase can also be helpful, especially on the grounds of easing inequality in the short term, along with better education outcomes in the long term.

7. ***Higher infrastructure spending would help to sustain growth momentum, accommodate growing population needs, and address the infrastructure gaps. The staff's analysis in the SIP chapter proves substantial potential benefits in this area. Could staff also elaborate on public investment efficiency in New Zealand?***

- Public investment is relatively efficient in New Zealand. It has strong institutions (including a National Infrastructure Unit in the Treasury) and processes for public investment (with a 30-year Infrastructure Plan that was developed in 2015, and strong ministerial supervision, mostly by the Ministry of Business, Innovation, and Employment), and a framework for PPPs (public private partnerships) that is geared towards achieving efficient outcomes for spending undertaken rather than focusing on shifting spending burdens off of the government onto the private sector.

8. ***We note staff's call that, given the strong fiscal position, "there is no need for faster debt reduction beyond that outlined in the FY2018/19 budget," but are unclear why staff felt it necessary to caution in that respect. Is such a faster pace of debt reduction indeed being considered?***

- No, a faster pace is not being considered by the government. This is just part of the argument that if there are structural improvements revenue collection or spending, that it would be best to devote it to infrastructure and other measures to strengthen potential output further.

9. ***We would appreciate further details from staff on implementation plans to move ahead with the agenda, and if possible, a deeper analysis on the deployment of the Provincial Growth Fund.***

- Structural policies are included in various government initiatives, including the initial 100-Day Plan (which was completed on time by the end of February, 2018), minimum wage policy (with a timetable for annual increases on April 1st, out to 2020), the Provincial Growth Fund (NZ$1bn each year for three years, already being disbursed), R&D policy (which is just at starting stages, as outlined in the staff report), and so on. Not all policies have concrete timetables at this time, but progress is being made on all fronts, in line with Budget 2018.

- The 2018 disbursement of the Provincial Growth Fund (PGF) is well underway. There are three tiers—projects under NZ$1mn, are signed off under departmental systems; NZ$1mn-NZ$20mn projects are signed off by an established advisory board; projects over NZ$20mn need to be signed off by the Cabinet. The PGF services new projects, and also acts as an umbrella for other projects that would have fallen under other portfolios (mentioned below).

- The PGF will have a focus on six regions (but this does not preclude other regions from accessing the PGF): Tairawhiti/East Coast, Hawke's Bay, Northland, Bay of Plenty, West Coast and Manawatu-Whanganui. These regions historically have had developmental issues, related to relative isolation, poverty and lack of investment (business and infrastructure), and weak population and economic growth in general.

- According to Budget 2018, this year's NZ$1bn will be disbursed as follows:

- NZ$536mn of operating funding and NZ$236mn of capital funding for part of the One Billion Trees programme, and investment-ready initiatives for the current year that meet the criteria for the Fund, and funding for administration.

- $148m of existing operating funding that includes $75.0 million from the Tourism Infrastructure Fund and $13.0 million for One Billion Trees from the Budget 2017 Between-Budget contingency; plus NZ$80mn that includes a portion of KiwiRail's (national rail operator) capital injection.'

- Projects also include reviving regional rail (i.e. the Whanganui rail line), and assistance to local businesses and initiatives.

Monetary Policy

10. ***We consider that the monetary policy stance is appropriate given low inflation and the flexible exchange regime. Does the staff expect inflationary pressures may arise due to the minimum wage increase in the medium term?***

- The minimum wage increases are expected to raise overall wage inflation to some extent, considering that around one fifth of employees have wages close to the minimum wage. However, it is unlikely that the minimum wage increase will substantially increase overall CPI inflation. The main reason driver behind low inflation over the past years has been relatively low tradable inflation, primarily from imports—a trend that is expected to continue for some time.

- At this point, the minimum wage increases will support monetary policy and contribute to the gradual rise in inflation towards the mid-point of the target range.

11. ***The SIP indicates that monetary policy outcomes in countries with flexible inflation targeting are similar regardless of an implicit or explicit dual mandate. However, this addition is regarded as a refinement in the current practice of inflation targeting. Could the staff comment on the gains of operationalizing the dual mandate?***

- The operationalization of the dual mandate increases the transparency of the RBNZ, as the goals are clearer than with an implicit dual mandate. In addition, it also requires the RBNZ to express its view on the maximum sustainable employment, which will also increase monetary policy transparency.

- The increased transparency from the dual mandate will be most relevant with supply shocks, which may lead to trade-offs between output and inflation. The dual mandate will both allow and require the RBNZ to take an explicit stance on how it will resolve the tradeoff.

12. ***The RBNZ has signaled that current policy rate will remain for some time to come. Appropriate timing in adjusting monetary policy stance in either direction is important to prevent risk of subsequent sharper adjustments. Could the staff comment on the impact of the ongoing normalization of U.S. monetary policy on New Zealand?***

- The Reserve Bank of New Zealand (RBNZ)'s announced path for interest rates already takes into account U.S. monetary policy normalization. The RBNZ recognizes that U.S. monetary policy normalization will increase bank funding costs in wholesale markets, which will contribute to tighter domestic financial conditions in New Zealand.

- This tightening will likely be partly offset through currency depreciation, given the expected divergence in the policy rate path.

Financial Sector

13. ***We note that the authorities do not eliminate the possibility of a further and gradual LVR easing contingent on the outlook whereas staff do see neither justification nor need for a macroprudential relaxation even under the current cooling of the housing market. Could the staff elaborate on these diverging views?***

- The staff see no need for further relaxation to prevent a destabilizing market correction under the baseline. Maintaining the growth limit on high LVRs loan is also prudent as household debt vulnerabilities remain high.

14. ***Given that household debt remains elevated, we tend to agree with staff that a more cautious approach toward relaxing the LVR may be warranted. However, we note that housing affordability remains a challenge for first-time home buyers and wonder whether an LVR relaxation might help to facilitate home ownership?***

- A relaxation of LVRs, a macroprudential measure, is not an appropriate instrument to address housing affordability. Macroprudential policies aim to manage financial system risk by increasing the resilience of bank balance and, indirectly, household balance sheets topotential shocks; and by reducing the likelihood of dampening a credit-driven credit and asset price cycles and, ultimately, output swings. In this context, maintaining a relatively high LVR might make credit less accessible, but should also help housing affordability, as it will reduce the amplitude of house price fluctuations.

15. ***Could the staff comment on the results of the public consultation on the macroprudential toolkit and the inclusion of debt-to-income instrument progress?***

- This process has been folded into Phase 2 of the Review of the Reserve Bank Act, which is about to begin, staff has no further comments at this point.

Review of Reserve Bank Act

16. ***The Phase One of the Review has delegated decision-making to a monetary policy committee (MPC) and added a "maximum sustainable employment" objective... However, central banks usually have a limited set of instruments and policy objectives must remain consistent with such a constrained toolkit. Considering that RBNZ has operated a very successful IT regime, which also implies de facto output and employment stabilization, we wonder if the new objective adds significant value for monetary policy conducting—in the short term such dual objectives could even create conflicting signs. Could staff elaborate on this issue and bring more information on how the new MPC has been structured and how it is operating?***

- The value arises primarily from the increased transparency. The benefit from a dual mandate mainly arises in the case of supply shocks, as discussed in the answer to question 11. It may also provide the RBNZ with the needed flexibility to focus on employment stabilization should it ever be in a situation in which the policy rate reaches the effective lower bound.

17. ***We note that, after 30 years, the Reserve Bank Act (RBA) is being revised. Under Phase One of the RBA review process, an employment objective will be added to the price stability objective, aiming at maximizing employment alongside price stability, while maintaining the flexible inflation targeting regime. This new move is expected to provide the RBNZ with more flexibility in monetary policy making. Could the staff comment on the possible impact of the new change (dual mandate) on the conduct and communication of monetary policy in New Zealand?***

- We do not expect material changes to monetary policy conduct in the current environment. However, in the future, when monetary policy is constrained (e.g. at the effective lower bound of the interest rate after a large negative shock) or in the case of supply shocks, the explicit dual mandate will provide the RBNZ with a transparent mandate to focus more on employment rather than inflation.

18. ***The most recent decision to formally adopt a dual mandate of price stability and full employment is thus particularly interesting. However, staff final assessment of the gains to be expected from this change (if any) remain somewhat unclear. We are also surprised by the qualification of the euro area as not having an inflation targeting regime. Could the staff comment?***

- The euro area has an inflation targeting regime but not an inflation forecast targeting (or flexible inflation targeting regime), as the ECB does not publish endogenous policy rate path. In addition, the ECB also has a monetary objective.

- As mentioned in the SR, we do not expect in a material change to the policy in the current environment. In some specific instances, the explicit dual mandate would require other policy settings than under a stricter inflation targeting regime and would potentially lower the likelihood of "dark corners," when monetary policy faces a large negative shock and is constrained.

19. ***We look forward to Phase 2 of the Review, which will help strengthen the RBNZ's financial stability role and governance, and likely consider a number of last year's FSAP recommendations. The terms of reference of Phase 2 were released on June 7. Could the staff further comments on the topics to be included in Phase 2?***

- Phase 2 of the Review, focused on financial stability, is ambitious in scope. The staff take note from the recently released Terms of Reference for this phase that the Review will cover the FSAP recommendations centering around strengthening the macroprudential framework, including broadening the tool kit; the supervisory pillar of banking regulation; and the crisis resolution regime. The FSAP identified an urgent need for reform in the first two areas. It also called for a strengthening of the RBNZ's operational independence in financial policy decision making. Emphasis should be given to priority areas in need of reform.

20. ***Could the staff comments on the scope of the Phase Two of the Review, which is expected to start in the second half of this year?***

- Please refer to the answer to question 19 above.

Housing Policy

21. ***The authorities consider that the restrictions on nonresidents' real estate purchases would enhance housing affordability by ensuring that housing prices will be shaped by domestic market forces. We sympathize with the authorities' view that the restrictions do not constitute CFMs under the IV, as there is no intention to manage aggregate capital flows and won't be a material impact on the balance of payments. Could the staff comment?***

- CFMs refer to measures that are designed to limit capital flows according to the Fund's Institutional View on capital flows (IV). Measures that discriminate between residents and non-residents limit capital flows by virtue of their design. Therefore, residency-based measures are always considered as CFMs regardless of the stated intent or motivation behind the adoption of the measure. In other words, the stated intent is not a criterion to be assessed for the CFM classification under the IV. In the case of New Zealand, the ban of residential real estate purchases by nonresidents falls into this category of residency-based CFMs.

- On macro-criticality of CFMs, it is important to note that the application of the IV calls for an assessment of whether the context in which CFMs are applied is macro-critical, not necessarily the material macroeconomic impact of the individual CFMs themselves. Also, macro-criticality points not only to the impact on BOP stability but also domestic economic stability. In the case of New Zealand, staff considers that the housing sector is a key macro policy concern because house prices remain higher than the level consistent with fundamentals along with other housing market imbalances.

22. ***What are the staff's views on the various points raised by the authorities in paragraph 35, notably on the fact that the ban must be assessed holistically, taking into account the broader social, economic and political context, as also conveyed in the buff statement?***

- From the economic perspective, it is clear that the housing sector is macro critical. Going beyond the economics, staff recognizes that the rising house prices and declining housing affordability are a major concern from social and political perspectives and took consideration of these perspectives when assessing the appropriateness of the housing ban (please note that residency-based measures such as the ban on housing is always classified as a CFM).

- The staff considers that macro and macroprudential policy settings are broadly appropriate. To restore broad-based housing affordability, staff considers that a broad housing policy agenda focusing on strengthening supply and lowering tax distortions would be more effective than a residency-based ban. The recommendation to reconsider the ban is in line with the IV, which states that CFMs on capital inflows should be the least discriminatory to the extent possible (in addition to being transparent, targeted, and temporary).

23. ***We take note of staff's view that foreign buyers appear to have played a minor role in New Zealand's residential real estate markets recently and the other broad housing policy agenda would address most of the potential problems. Could staff share their view that there is room for the authorities to introduce the restrictions on nonresident' real estate purchases if they have more detailed and persuading data to justify their policy?***

- If more detailed data suggested that foreign buyers had played a more significant role in driving the housing market boom (i.e., there were substantial capital inflows) and there were no other less discriminatory policies immediately available (which is not the case as staff assesses that the other elements of the housing policy, if fully implemented, would address most of the potential problems associated with foreign buyers on a non-discriminatory basis), staff could support a targeted and temporary CFM that does not substitute for warranted macroeconomic adjustment, in line with the IV. In the case of New Zealand, the "if" clauses do not apply. Moreover, staff would not support the ban on residential real estate purchases by nonresidents because the measure is not targeted and not temporary by design based on the IV.

24. ***What is the staff's view about incorporating the social context into the assessment of appropriateness of CFM, recognizing that the authorities emphasized that the measure must be assessed holistically, taking the broader social, economic and political context into account?***

- Please refer to the answer to question 22 above.

25. ***Further, … we would be interested to hear views on how social and political economy considerations should be taken into consideration when assessing the appropriateness of measures under the Institutional View?***

- Please refer to the answer to question 22 above.

26. ***Regarding the proposed ban on residential real estate purchases by nonresidents, could staff comment on the authorities' view that the ban needs to be considered holistically, taking into account broader social, economic, and political context, and the need to incorporate this broader perspective into the Fund's advice?***

- Please refer to the answer to question 22 above.

27. ***On a proposed ban of residential real estate purchases by nonresidents, we tend to agree with staff's assessment that under the IMF's Institutional View this measure should be considered as a capital flow measure (CFM). Moreover, staff claim that this ban would not be in line with the IV. In this context, we encourage the authorities to consider alternative measures that do not have a discriminatory effect. Could the staff comment on the various points raised by the authorities to justify this measure?***

- Please refer to the answer to question 22 above.

28. ***We understand that the government has recently amended its proposal to allow non-residents to own up to 60 percent of large, new apartment buildings and that there is no ban currently on foreign ownership of land, houses, or apartments. Could staff elaborate on these recent developments and indicate if the updated proposal would still be considered a CFM?***

- Despite the amendment (which provides for some exemptions from the ban), the ban still discriminates between residents and nonresidents and therefore is classified as a CFM.

29. ***The introduction of a ban based on residency indeed points to the existence of a CFM, though Mr. Johnston's buff provides useful context. In sum, we would reiterate the call made in other similar cases (notably Australia) that work be carried out to clarify the definition of CFMs in applying the Institutional View. Could staff comment?***

- To deepen the understanding of the IV, staff has stepped up efforts to explain its key elements and how it is consistently applied in practice. In this context, staff held workshops on the IV to discuss such issues with country authorities at the 2017 Annual Meetings and the 2018 Spring Meetings. The staff is also planning to share the paper on the IV in Practice in July with the Board in mid-July and publish a CFM taxonomy in the Fall to further clarify the application of the IV. In the case of New

Zealand, the classification is clear as residency-based measures are a CFM by virtue of their design regardless of the policy intent for which they are introduced.

30. ***We note the divergence between staff and authorities on whether or not the ban on residential real estate purchases by nonresidents is a capital flow management measure (CFM). Given the sharp increase in house prices and large deterioration in housing affordability for New Zealanders, could the staff further comment on the institutional view (IV) on this measure?***

- Please refer to the answer to question 21 above.

31. ***Considering staff's views that a ban on residential real estate purchases by non-residents, would be a CFM under the IV, could the staff comment on the impact of these measures on BOP?***

- Available data suggest that foreign investment inflow appeared to be relatively small in the residential real estate sector. Therefore, the impact of the ban on BOP is likely to not be significant.

32. ***A ban on foreign acquisitions of residential real estate seems a rather absolute response. Did the authorities consider any other less emphatic measures to discourage nonresident speculation?***

- To discourage property speculation, the bright-line test on residential property sales introduced in October 1, 2015 has been extended from two years such that any residential properties other than main home acquired after March 29, 2018 will be subject to tax if disposed of within five years of acquisition. The government has also proposed to limit negative gearing from rental properties, such that the deductibility of net losses from property investment from other taxable income would be eliminated. These measures should, in principle also affect foreign buyers, depending on their tax residency status.

33. ***Could the staff elaborate on their assessment that foreign buyers are playing only a minor role in the residential real estate markets?***

- Data on the role of foreign buyers in residential real estate markets are very limited. The main source is data on property transfers and tax residency collected under the Land Transfer Amendment Act from Oct 1, 2015, which suggest that about 3 percent of all buyers nationwide and 5 percent of buyers in Auckland had overseas tax residency in 2017.

34. ***Could the staff comment on how the ban on home sales to foreigners may impact***

foreign direct investment going forward?

- As available data suggest that foreign investment inflows appeared to be relatively small in the residential real estate sector, the ban on home sales to foreigners is unlikely to significantly change the magnitude of inward foreign direct investment.

35. ***The authorities' policies to address supply constraints such as the KiwiBuild program and the Urban Growth Agenda are welcome. However, it is unclear how the KiwiBuild program will redirect incentives. The staff's comments are welcome.***

- The KiwiBuild program will increase developers' incentives to shift activities to building more homes guaranteed at affordable prices. Related policies aim at augmentation the inflow of skilled labor and easier bank financing should also help to redirect incentives.

Structural Reforms

36. ***We welcome the authorities' intentions to invest in infrastructure and implement an R&D tax credit. We appreciated the analysis on the productivity impacts of more inclusive infrastructure spending to address regional disparities in the selected issues paper. Do staff have views on other actions the authorities could take to boost productivity, beyond these planned measures?***

- At this point, staff has made its recommendations as outlined in the staff report, and agrees with the still-developing efforts of the authorities. The staff will follow up on the subject in next year's Article IV cycle.

37. ***We welcome the structural reform agenda laid by the authorities to secure growth, make it more inclusive and increase productivity in the medium term. Boosting regional development, R&D incentives and other tax reforms are steps in the right direction. Are there other avenues to increase productivity in New Zealand?***

- At this point, staff has made its recommendations as outlined in the staff report, and agrees with the still-developing efforts of the authorities. The staff will follow up on the subject in next year's Article IV cycle.

38. ***We look forward to the finalized structural policy agenda and would like to ask staff if an indicative deadline has been set up in that regard.***

- Structural policies are included in various government initiatives, including the the initial 100 Day Plan (which was completed on time by the end of February, 2018), minimum wage policy (with a timetable for annual increases on April 1st, out to 2020), the Provincial Growth Fund (NZ$1 bn each year for three years, already being disbursed), R&D policy (which is just at starting stages, as outlined in the staff report), and so on. Not all policies have concrete timetables at this time, and there is no generalized summary yet available.

39. However, for the deadlines related to carbon emissions, the membership of the interim Climate Change Commission was announced in April 2018, with provisional goals of a net zero emissions economy by 2050, and 100-percent renewable electricity generation by 2035. Terms of reference has been proposed, with: a proposal for a report on agriculture and renewable electricity due by end-2019Q2; a "Zero Carbon Bill" enacted by start-2019Q2 to set up a permanent Climate Change Commission and specify the carbon emissions goals more precisely; the permanent Commission established end-2019Q2; and further amendments related to other sectors (like forestry) by end-2019Q4. This timetable is only indicative, and contingent on the legislative program and priorities of the government. [2]

40. ***We note that New Zealand is involved in several free trade negotiations. Could the staff comment on the growing trade protectionism against New Zealand economy?***

- At this point, there is no explicit protectionism directly against New Zealand, although as the global situation is volatile. From a cost-benefit perspective, it is in New Zealand's best interests to continue to engage in free trade, and to lead by example. To change course could only harm New Zealand, and staff commends the authorities for maintaining its commitment on this front.

41. ***The proposed minimum wage increase by 2020 and ongoing measures to enhance regional development will help easing income and regional inequality. Could the staff comment on the impact of increasing minimum wages on employment growth, international competitiveness, and labor productivity?***

- In the current strong growth environment, and given recent strong labor supply growth, the negative impact of higher minimum wages on employment growth, international competitiveness, and labor productivity is likely to be minimal. However, in a small open economy, higher minimum wages can pose risks to competitiveness, especially if the minimum wage is close to the median wage, as in the case of New Zealand. That said, most minimum wage jobs appear to be in the non-tradable sectors, suggesting that wages in the tradable sectors are higher and only indirectly affected by the minimum wage settings. Minimum wages could increase

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- [2]http://www.mfe.govt.nz/sites/default/files/media/Legislation/Cabinet%20paper/interim-climate-change-committee-tor.pdf.

incentives for productivity improvements if wage costs were to constrain profitability and competitiveness.