NEW ZEALAND COUNTRY REPORT 2019

MACROECONOMIC OUTLOOK

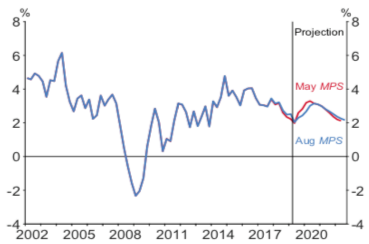
The New Zealand economic outlook has weakened over 2019 primarily as a result of economic and political uncertainty globally. Second quarter GDP grew at a modest rate of 0.5%, while the annual rate touched a five-year low of 2.1%. Headwinds remain for growth moving forward given the global landscape, lower domestic business confidence and household consumption. Business confidence has fallen to levels last seen ten years ago. Drivers are the global economic and political landscape, a fall in retail spending as households look to save rather than spend, and a construction sector that continues to suffer with ongoing insolvencies.

New Zealand's employment outlook has been positive to date with employment remaining at the maximum sustainable level and improving wage growth. New Zealand's CPI remains within the RBNZ's one to three percent target range, but below the two percent midpoint. The Labour led coalition continues to spend on public services such as health and education and has a large infrastructure program in place related to public transport, roading and housing.

The global landscape continues to be extremely uncertain given the economic and political uncertainty. US/China trade tensions are unresolved creating concerns about global growth and impacting global trade generally. This has led to lower demand for New Zealand goods and services. Likewise, Brexit and the political uncertainty in the UK is adding to the negative sentiment. As a result, Central Banks in advanced economies have reverted to adding monetary policy stimulus, via cuts in interest rates and, in some cases, increasing QE.

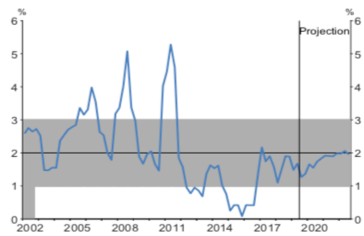
The RBNZ has responded to these events by initially cutting the OCR from 1.75% to 1.50% in May 2019. In August, the RBNZ took the unusual step of cutting the OCR by 50 basis points to 1.00%, an all-time low. Fifty basis point cuts in the OCR have previously be reserved for major crises such as the GFC. They also discussed the use of negative interest rates and/or QE in the future if needed. The Governor is presently on record as preferring negative interest rates. They noted that the low interest rates and ongoing Government spending would support the economy in the medium term. However, they also called on the Government to provide further fiscal stimulus and for households to spend. Market commentators expect the Central Bank was front loading rate cuts to provide insurance, although a larger than expected cut in the OCR may have had a negative impact on confidence for both business and households. At its most recent announcement, on 25 September, the RBNZ left the OCR unchanged noting new information since the August announcement did not warrant a significant change to the monetary policy outlook.

Figure 4.5
GDP growth
(annual)

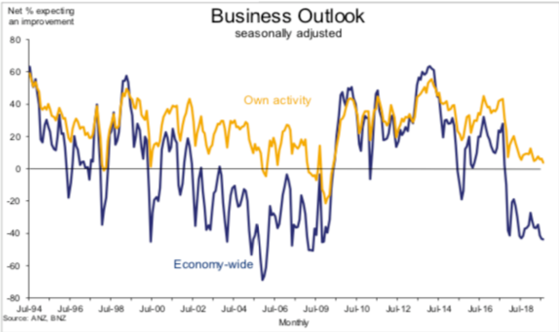


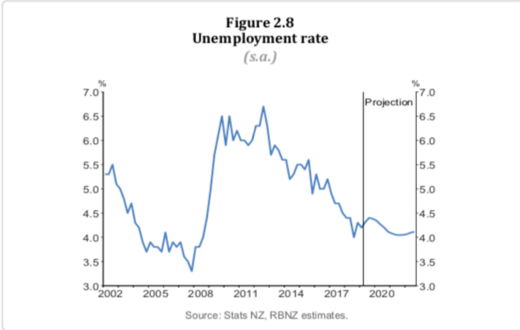
Source: Stats NZ, RBNZ estimates.

Figure 2.9
CPI inflation
(annual)



Source: Stats NZ, RBNZ estimates.





Source: BNZ

Summary of economic projections
(annual percent change, unless specified otherwise)

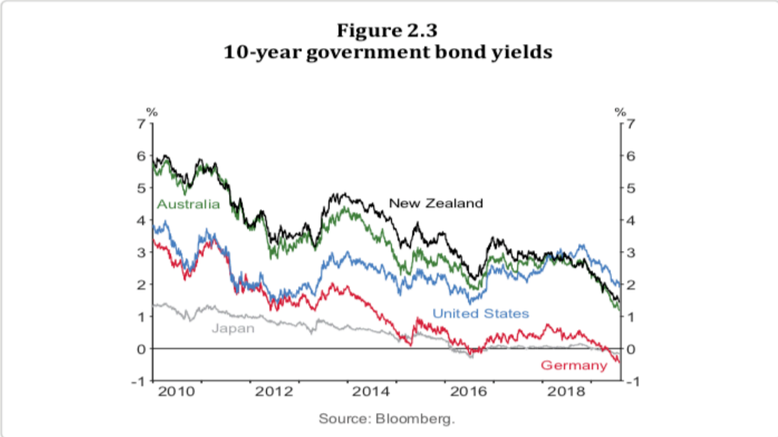
	Actuals								Projections		
March year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Price measures											
CPI	1.6	0.9	1.5	0.3	0.4	2.2	1.1	1.5	1.7	1.9	2.0
Labour costs	2.1	1.8	1.7	1.8	1.8	1.5	1.9	2.0	1.9	2.2	2.6
Export prices (in New Zealand dollars)	-2.6	-4.8	11.5	-9.2	-0.3	3.9	3.3	1.2	2.7	1.4	2.0
Import prices (in New Zealand dollars)	-1.7	-3.9	-3.0	-3.4	1.2	0.6	1.9	4.5	-1.3	0.5	1.0
Monetary conditions											
OCR (year average)	2.5	2.5	2.5	3.4	2.9	2.0	1.8	1.8	1.3	0.9	1.1
TWI (year average)	72.2	74.0	77.6	79.3	72.6	76.5	75.6	73.4	73.0	72.8	72.5
Output											
GDP (production, annual average % change)	2.3	2.2	2.6	3.7	3.6	3.7	3.1	2.7	2.4	3.1	2.6
Potential output (annual average % change)	1.7	2.1	2.5	2.9	3.1	3.1	3.1	2.9	2.7	2.6	2.5
Output gap (% of potential GDP, year average)	-1.6	-1.5	-1.4	-0.7	-0.2	0.3	0.4	0.3	-0.1	0.4	0.5
Labour market											
Total employment (seasonally adjusted)	0.6	0.2	3.7	3.1	1.8	5.4	2.7	1.3	1.7	1.8	1.4
Unemployment rate (March qtr, seasonally adjusted)	6.3	5.7	5.6	5.5	5.3	4.9	4.4	4.2	4.3	4.1	4.1
Trend labour productivity	1.0	0.9	0.8	0.8	0.7	0.7	0.7	0.8	1.0	1.1	1.2
Key balances											
Government operating balance (% of GDP, year to June)	-4.3	-2.0	-1.2	0.2	0.7	1.5	1.9	1.0	0.0	0.2	0.8
Current account balance (% of GDP)	-3.2	-3.7	-2.5	-3.5	-2.6	-2.6	-3.1	-3.6	-3.4	-2.9	-2.8
Terms of trade (SNA measure, annual average % change)	1.6	-4.3	11.7	-0.3	-3.0	2.7	4.6	-2.5	0.3	1.6	0.9
Household saving rate (% of disposable income)	2.3	0.4	0.3	-1.0	-0.6	0.1	-1.4	-1.8	-1.1	-0.5	0.4
World economy											
Trading-partner GDP (annual average % change)	3.4	3.3	3.5	3.7	3.4	3.4	3.8	3.5	3.3	3.3	3.3
Trading-partner CPI (TWI weighted)	2.7	2.3	2.3	1.0	1.2	1.9	1.9	1.4	2.2	2.0	2.3

Source: RBNZ

NEW ZEALAND CAPITAL MARKETS

Bond markets

Domestic bond yields have fallen this year to historically low levels, in line with global bonds yields. New Zealand government bond issuance totals NZ$70.4 billion. These debt levels are low by global comparison. The Government has committed to getting net Crown debt down to 20% of GDP by 2022, with a longer-term target of 15 to 25%. Offshore holdings of NZ Government securities continue to decline with ownership falling from 55% to 50% in the last twelve months. This reflects recent spread compression relative to G10 counterparts.



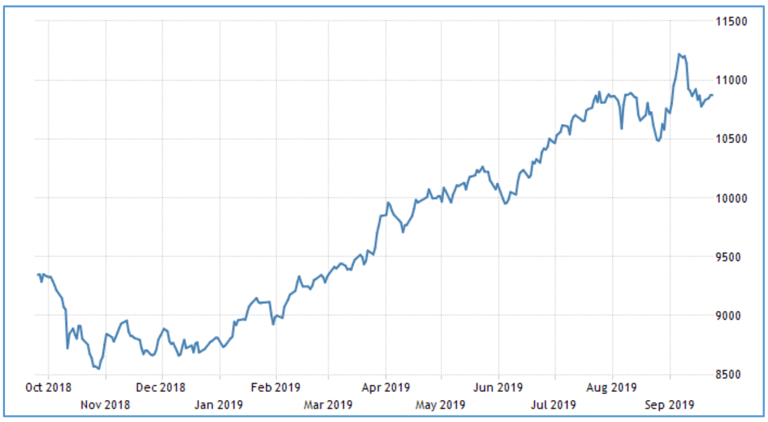
Despite this The Treasury continue to see good demand at their regular auctions and syndications. A recent syndication of a new 15 May 2031 nominal bond had an initial book build of NZ$3 billion. The Treasury were able to issue the plan volume of NZ$2 billion and pricing was within the expected range.

The issuance of NZ dollar Supranational/Agency bonds, or Kauri bonds, has remained stable during 2019, with total issuance at NZ$26 billion. Non-resident holdings have declined at a similar rate to that seen for NZ Government securities, falling from 46% to 37% over the last twelve months.

NEW ZEALAND EQUITY MARKETS

To date, the NZX50 has had another strong year growing 24% in the first nine months of 2019, reaching an all-time high of 11,222, and is one of the best performing indexes globally. Continued strong performance of international bourses in a low interest rate environment, along with good investor demand (especially from international investors) have all supported this growth.

NZSE50



Source: Trading economics

ISSUES CURRENTLY UNDER CONSIDERATION BY THE NZFMA

Fall-back Benchmark Interest Rate

Following market consultation, the NZFMA has selected the RBNZ policy rate, the OCR, as the fall-back benchmark interest rate for New Zealand. The OCR is an overnight risk-free rate. The fall-back has been ratified by the NZFMA's Benchmark Oversight Committee and Board, and by the Reserve Bank of New Zealand. We are currently awaiting ISDA to initiate any consultation they may require and the subsequent updating of documentation.

This fall-back benchmark is intended to be used under two different scenarios. The first being in the event that the current interbank offer rate (IBOR), BKBM, ceases to be published for any reason. This may be due to BKBM no longer being deemed fit for purpose by the regulator or the benchmark administrator becomes insolvent. The second scenario is where that benchmark is chosen by the market to be used as a `risk free benchmark rate' (RFR) to settle a selected instrument. With other currency markets moving to use RFRs instead of IBORs, it is important that we offer a benchmark that shares a similar basis.

EU Benchmark Regulation

New Zealand is well down the path of seeking equivalency to meet EU BMR due to the large derivative exposures NZ banks have with European entities. Legislation was recently passed to introduce an opt-in licensing regime for benchmark administrators in New Zealand. Government agencies are in regular contact with the European Commission regarding our equivalency application. It is hoped the licensing regime will be implemented in the first half of 2020 and equivalency will be obtained later in that calendar year.

NZFMA Review of Governance for New Zealand's Interest Rate Benchmarks

The project scope will focus on the current benchmark administration process with the NZFMA as benchmark administrator (BA) and identify the conflicts that currently exist operating that model. Once this assessment has been completed and the conflicts identified, we will also conduct a strengths and weakness assessment of that model identifying the most practical conflict mitigation processes.

The next step involves an inward-looking assessment, the project will then focus on alternative BA models that operate around the world and, in each case, we will conduct a strengths and weaknesses assessment. Given that most alternative models have been established to address conflicts that previously existed, it is not deemed necessary to conduct a conflict assessment.

To ensure that we have an appropriate level of assurance that our assumptions, structural analysis, conflict management and conclusions are sound and fit within the regulatory confines of the New Zealand Financial Markets, we will employ a legal resource with significant experience in this area to assist our efforts.

Subsequent to this detailed model assessment, the NZFMA will propose its preference and seek assurance from our external benchmark auditor that our preferred model meets IOSCO benchmark principles and mitigates any conflicts identified.

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Margin on uncleared derivatives

The legislation noted above, under EU BMR, also included changes to margining rules in New Zealand. This will ensure New Zealand's margining requirements reduce systemic counterparty risk and are aligned to the margining requirements in other countries.

Australian Regulatory Issues – Impact for NZ

1. **ASIC Consultation - Foreign financial service providers licensing regime**

ASIC is intent on strengthening the licensing regime for wholesale financial service providers. Previously NZ banks were given an exemption under a limited connection relief. This exemption will be removed on the 31st of March 2020 meaning that NZ banks offering wholesale services into Australia will have to have an Australian Financial Services License. We believe that this move by ASIC fails to recognize the existence of the NZ regulatory environment as well as hindering our economic and regulatory cooperation agreements. In addition, the licensing regime is onerous and expensive.

We have made various submissions on the subject to ASIC and AFMA is also supporting our stance.

2. **ASIC Derivative Transaction Reporting Rules – Legal Entity Identification (LEI)**

ASIC as part of their Derivative Transaction Reporting Rules is requiring Australian Bank subsidiaries, based in NZ, to ensure their derivative transaction counterparties have LEI's. We believe that this is an unintended consequence and again another example of ASIC extending the regulatory reach outside of their jurisdiction. The fact that local and some international banks operating in NZ are not captured results in a significant competitive advantage for these banks.

We continue to lobby ASIC on this matter with the support of our local regulators.

Joint NZFMA, NZX Initiative raises NZD 50,000 for Charity

On a positive final note the co-hosting by the NZFMA and the NZX of a charity golf tournament resulted in the raising of NZD 50,000 for Neo Natal Trust, a charity to support the families of premature babies.

Ends.

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