S&P Global Ratings

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Research Update:

New Zealand Outlook Revised To Positive On Improving Fiscal Position; 'AA+' LC And 'AA' FC Ratings Affirmed

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Ratings

Foreign Currency: AA/Positive/A-1+
Local Currency: AA+/Positive/A-1+
For further details see Ratings List.

Overview

- New Zealand's general government budget could achieve a surplus over the next few years, which would provide the sovereign with additional resilience to macroeconomic or financial sector risks should they arise.
- As a result, we are revising our outlook on the sovereign long-term ratings to positive from stable.
- We are affirming our 'AA/A-1+' foreign currency and 'AA+/A-1+' local currency sovereign credit ratings on New Zealand.
- New Zealand has monetary and fiscal flexibility, a resilient economy, and institutions conducive to swift and decisive policy actions. The high level of external liabilities remains New Zealand's main credit weakness.

Rating Action

On Jan. 31, 2019, S&P Global Ratings revised its outlook on New Zealand to positive from stable. At the same time, we affirmed our 'AA/A-1+' foreign currency and 'AA+/A-1+' local currency sovereign credit ratings on New Zealand.

Outlook

The positive outlook on the long-term ratings on New Zealand reflects our view that the general government budget could achieve a surplus in the early 2020s. This would reduce net general government debt and provide additional resilience to macroeconomic or financial sector risks that could arise due to high levels of external and domestic leverage.

We could revise the outlook to stable within the next two years if the general government budget does not achieve surplus in the early 2020s. This scenario would weaken its debt profile through debt levels and interest expenses that are higher than our expectations, reducing its headroom to address potential macroeconomic and financial sector risks, should they materialize.

Rationale

The ratings on New Zealand reflect the country's fiscal and monetary policy flexibility, economic wealth and resilience, and stable public policy settings. These strengths provide the country with flexibility to offset potential risks related to its large external imbalances, high household and agriculture sector debt, dependence on commodity income, and financial system stability.

Institutional and Economic Profile: Proactive policy-making and effective institutions support the economy and underpin sovereign rating

- Stable institutional and governance settings underpinning the rating with high level of transparency and reliability.
- Wealthy and resilient economy, reflecting decades of structural reforms and proactive policymaking.

New Zealand's stable institutional and governance settings are key credit factors underpinning the sovereign rating. Proactive policy-making supports sustainable public finances and economic growth. These settings are buoyed by extensive checks and balances between institutions, a high level of transparency with timely provision of information, and a cohesive society that respects the rule of law. New Zealand ranks near the top of many surveys on governance, government efficiency, and business promotion. It was ranked first out of 190 countries on the World Bank's 2019 Doing Business survey, and first on the latest corruption perceptions index.

New Zealand benefits from an open, prosperous, flexible, and resilient economy, which draws from decades of structural reforms. Gross domestic product (GDP) per capita was about US$42,600 as of June 30, 2018, and economic growth has been strong during the past few years at 3.5%, despite global and domestic challenges. We expect population growth to slow from record levels of more than 2% per year, based on the government's expectations of a lower migration intake. This will result in real economic growth slowing to 2.8% per year between 2019 and 2021. Real per capita growth of about 1.4% per year continues to outpace similarly rated peers' of about 1%. Accommodative monetary policy, population growth, higher wage outcomes, and higher government spending continue to support growth. Strong inward migration has boosted economic growth in recent years.

Along with strong population growth, New Zealand's free-floating exchange rate, which has depreciated sharply since mid-2014, is helping to sustain solid economic growth. Services exports, especially tourism, have become an important contributor to growth, and are helping to diversify the country's exports. The agriculture sector, especially dairy, remains the key export of New Zealand. We don't believe trade tensions between New Zealand's major trading partners will currently have a substantial impact on the country's economy and external performance, particularly given that key exports are imported for domestic consumption in China, rather than for re-exporting. Headwinds remain with consumption growth likely to slow from its highest levels in more than a decade, and business confidence remaining weak due to policy uncertainty.

Risks stemming from rising property prices and household debt appear to have stabilized since 2017. However, it will take some time before the risks to economic and financial stability subside. We believe that credit growth is playing a diminishing role as a driver of economic growth with household lending slowing to about 6% in 2018, down from 9% in December 2017. Recent financial history in other developed markets shows that rapid credit growth can lead to vulnerabilities to financial, fiscal, and economic stability if a dynamic expansion experiences a sudden and unexpected slowdown.

Flexibility and Performance Profile: Improving fiscal position and strong debt profile provide buffer for high external imbalances

- Fiscal balance moving toward surplus, improving the sovereign's debt levels.
- Large external imbalances remain a key risk, reflecting New Zealand's reliance on foreign funding and a history of current account deficits.

We forecast New Zealand's fiscal outcomes to improve and narrow its deficit, after temporarily widening in fiscal 2019, resulting in the change in net general government debt of just 0.2% of GDP in 2022. The budget could move into surplus in the early 2020s. Strong labor market conditions with unemployment falling to less than 4% and wage inflation picking up, are providing upside to government's income, company and consumption tax forecasts. New road user charges and petrol excises rates, and the cancelation of the previous government's personal income tax cuts are also helping to offset spending initiatives including wage, welfare, education, and housing policies.

We see little change on the policy front from the 2018-2019 mid-year budget update affecting the medium-term fiscal position. Although we expect the central government to achieve a surplus in the year ending June 30, 2022, we believe the general government budget will remain in deficit because of the local government sector's large infrastructure spending requirements. We forecast the deficit in fiscal 2019 will be higher than we previously expected because of expenditure being delayed from 2018. The deficit averaged 0.6% of GDP between fiscals 2016 and 2018. The former government made substantial headway in improving its fiscal performance since the negative effects of the 2008 global recession and 2010–2011 Canterbury earthquakes, when the general government sector fiscal deficit peaked at 7.6% of GDP and net debt increased by 9.1% of GDP.

We expect smaller deficits and solid economic growth to result in net general government debt declining to less than 19% of GDP in fiscal 2022, from 20% in fiscal 2020. As a result, interest expenses should average less than 5% of revenues. We have restated our historical net debt figures to face value instead of market value, which New Zealand reports, to eliminate fluctuations in the debt ratio caused by changing interest rates and to be consistent with peers'. This revision has lowered New Zealand's historical net debt to GDP by several percentage points, and has no effect on our assessment of New Zealand's debt profile.

In contrast to its strong fiscal and debt profiles, New Zealand's external imbalances remain the key credit risk. We expect current account deficits to remain stable at about 3.3% between 2019 and 2021, after narrowing briefly in 2016-2017. While such deficits are not out of the ordinary for New Zealand from a historical perspective, they are high as a proportion of our preferred measure, current account receipts (CAR), at about 10% per year between 2019 and 2021.

Consequently, we expect the economy's external debt--net of official reserves and financial sector external assets--to remain very high compared with peers', at about 160% to 170% of CARs. Narrow net external debt fell as a proportion of CARs in 2018 to 160% from 183% in 2017 when the New Zealand exchange rate depreciated by about 7% against the U.S. dollar, improving asset values, and an increase in the CAR by about 9%.

In addition, there is a large market for nonresident offshore issuance in New Zealand dollars, which affects demand for the currency. Nearly half of nonresident onshore issuance--Kauri bonds, which amounted to NZ$26 billion in June 2018, or about 45% of CARs--is held by nonresidents. This contributes to the liquidity of the New Zealand-dollar foreign-exchange market, but by the same token could intensify a currency correction if offshore demand were to fall.

Exacerbating external risks further is our measure of net external liabilities as a share of CARs, which would be at 175% from 2019-2021, which is among the highest in the Organisation for Economic Co-operation and Development (OECD). It is only surpassed by Australia, Greece, Portugal, Spain, Turkey, and the U.S., underlining continued and significant external vulnerabilities of the economy (see "Sovereign Risk Indicators," Oct. 11, 2018; an interactive free-of-charge version is available at http://spratings.com/sri).

We also forecast New Zealand's gross external financing needs to remain very high compared with peers', at more than 190% of the nation's CARs and reserves. However, somewhat mitigating these risks are the depth of the New Zealand dollar foreign-exchange market and its exchange-rate flexibility. The 'Kiwi' is ranked 10th of actively traded currencies in the Bank for International Settlements' 2016 triennial survey of foreign-exchange trading.

New Zealand's current account deficits are traditionally associated with external borrowings by its banks to fund its growth and is a weakness to the banking system, in our view. The possibility of foreign investors becoming less willing to fund banks at low interest rates poses a risk to the banking system, the broader economy, and, in turn, government finances. However, we believe that New Zealand's banks will retain ready access to external markets.

We consider that the housing-related imbalances facing New Zealand's financial system have stabilized, as reflected in the slowdown of rapidly increasing residential house prices and private sector credit, and the maturing of the credit cycle. In our view, the key drivers behind the stabilization are tighter bank lending standards and macroprudential tools implemented by the Reserve Bank of New Zealand (RBNZ); in the future, government policy initiatives may also play a role.

That said, because of the historical buildup, the risk of a sharp correction in property prices remains elevated. If a fall were to occur, the impact on financial institutions would be amplified by the New Zealand economy's external weaknesses--in particular its persistent current account deficits, which we expect to be in line with historical levels of about 3% of GDP (see "Banking Industry Country Risk Assessment: New Zealand," published Nov. 26, 2018).

The parent companies of the four major banks in New Zealand are headquartered in Australia. Our ratings on the four major New Zealand banks are equalized with those on their Australian parents, given our view that they are core parts of their parents' groups. Our ratings on these Australian banking groups face downward pressure during the next two years that could emerge from the government's supportiveness toward the Australian banking sector (see "Australian Major Banks, Macquarie Bank, Cuscal Still On Negative Outlook Despite Revision In Sovereign Outlook To Stable", published Sept. 21, 2018). A lowering of our ratings on the Australian major banks would have a flow-on effect on our ratings on the banks' New Zealand subsidiaries, and possibly their cost of funding.

We consider the Reserve Bank of New Zealand's (RBNZ) inflation mandate and supervisory role have strong credibility, and that the RBNZ is operationally independent from the government. In December 2018, the government amended the RBNZ's objectives and processes to include supporting employment alongside price stability, and requiring decisions to be made by a committee of internal and external members.

The government is undertaking a second phase of review aimed at ensuring the RBNZ Act provides a strong, flexible, and enduring regulatory framework. The terms of reference were guided by the Productivity Commission and International Monetary Fund. It is not the government's intention to separate the RBNZ's prudential supervision responsibilities.

The one-notch distinction between the long-term foreign currency and local currency ratings is because of the credibility of the country's monetary policy, the freely floating currency, and the depth of domestic debt markets.

Monetary flexibility can support a sovereign's greater debt-servicing flexibility in its own currency.

Key Statistics

New Zealand - Selected Indicators										
Economic indicators (%)	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Nominal GDP (bil. LC)	219	237	245	257	273	288	303	318	336	356
Nominal GDP (bil. $)	180	196	190	172	195	206	204	217	233	247
GDP per capita (000s $)	40.6	43.8	41.5	36.8	40.9	42.4	41.4	43.6	46.3	48.4
Real GDP growth	2.2	2.7	4.0	3.6	3.4	3.1	2.7	2.5	3.0	3.0
Real GDP per capita growth	1.5	1.5	2.1	1.5	1.2	1.1	1.4	1.2	1.8	1.8
Real investment growth	4.7	8.0	5.7	3.9	2.3	6.3	2.6	2.4	2.5	2.5
Investment/GDP	20.9	22.4	23.1	23.0	23.3	23.9	23.6	23.7	23.5	23.4
Savings/GDP	17.3	20.0	19.7	20.7	20.7	20.6	20.1	20.3	20.4	20.5
Exports/GDP	28.5	28.8	27.8	27.8	26.6	27.7	27.7	27.9	28.2	28.4
Real exports growth	3.0	0.3	6.2	5.4	0.3	3.6	3.0	2.5	2.6	2.3
Unemployment rate	6.1	5.6	5.4	5.2	5.0	4.5	4.4	4.5	4.6	4.6
External indicators (%)										
Current account balance/GDP	(3.6)	(2.4)	(3.4)	(2.3)	(2.6)	(3.3)	(3.5)	(3.4)	(3.1)	(2.9)
Current account balance/CARs	(11.1)	(7.5)	(10.6)	(7.2)	(8.5)	(10.5)	(11.1)	(10.9)	(9.9)	(9.2)
CARs/GDP	32.2	32.5	31.7	31.7	30.5	31.4	31.3	31.5	31.5	31.6
Trade balance/GDP	0.1	1.4	(0.6)	(0.9)	(1.0)	(1.2)	(1.0)	(1.1)	(0.7)	(0.6)
Net FDI/GDP	1.4	0.4	1.7	0.0	1.1	0.7	1.1	1.1	1.1	1.1
Net portfolio equity inflow/GDP	0.8	(1.1)	0.1	0.0	(1.9)	0.3	0.3	0.3	0.3	0.3
Gross external financing needs/CARs plus usable reserves	204.6	194.3	207.3	200.8	202.2	195.3	189.6	195.6	194.1	192.3
Narrow net external debt/CARs	188.8	184.9	164.7	189.6	182.7	159.6	170.1	167.9	159.6	154.5
Narrow net external debt/CAPs	169.9	172.0	148.9	176.9	168.4	144.4	153.2	151.4	145.2	141.5
Net external liabilities/CARs	196.9	202.6	164.4	204.4	183.0	153.8	173.6	173.0	170.8	170.3
Net external liabilities/CAPs	177.1	188.6	148.6	190.7	168.6	139.1	156.3	156.0	155.3	155.9
Short-term external debt by remaining maturity/CARs	164.1	140.4	160.4	160.2	154.5	145.4	143.1	130.0	121.1	114.6
Usable reserves/CAPs (months)	3.7	3.1	3.3	3.7	3.3	3.4	3.7	2.5	2.1	1.8
Usable reserves (mil. $)	17,637	18,494	18,061	17,868	20,138	21,736	15,791	14,019	12,774	12,024
Fiscal indicators (general government; %)										
Balance/GDP	(3.9)	(2.8)	(1.8)	(1.4)	(0.0)	(0.6)	(2.0)	(1.2)	(0.7)	(0.2)
Change in net debt/GDP	0.6	1.8	0.5	0.8	0.0	0.7	2.0	1.2	0.7	0.2
Primary balance/GDP	(2.0)	(0.7)	0.3	0.5	1.8	1.1	(0.4)	0.3	0.8	1.2
Revenue/GDP	32.7	31.8	33.2	32.9	33.1	33.3	33.0	33.5	33.6	33.4

New Zealand - Selected Indicators (cont.)										
Economic indicators (%)	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Expenditures/GDP	36.6	34.6	35.0	34.3	33.1	33.9	35.0	34.7	34.3	33.6
Interest/revenues	5.8	6.6	6.4	5.9	5.4	5.1	4.8	4.5	4.6	4.3
Debt/GDP	37.0	36.7	37.3	37.4	36.4	34.8	35.1	34.7	33.5	31.8
Debt/revenues	113.4	115.4	112.5	113.7	109.8	104.6	106.5	103.5	99.8	95.4
Net debt/GDP	20.2	20.4	20.2	20.0	18.9	18.6	19.7	20.0	19.6	18.7
Liquid assets/GDP	16.9	16.3	17.1	17.3	17.5	16.2	15.4	14.7	13.9	13.1
Monetary indicators (%)										
CPI growth	0.8	1.5	0.6	0.3	1.4	1.5	2.3	2.2	2.4	2.4
GDP deflator growth	(0.5)	5.3	(0.5)	1.4	2.8	2.3	2.4	2.3	2.8	2.8
Exchange rate, year-end (LC/$)	1.28	1.14	1.47	1.41	1.37	1.48	1.45	1.47	1.45	1.43
Banks' claims on resident non-gov't sector growth	2.0	4.2	5.9	7.3	7.5	5.2	5.6	5.6	5.6	5.6
Banks' claims on resident non-gov't sector/GDP	158.7	152.9	156.5	159.8	161.6	161.0	161.8	163.0	162.6	162.2
Foreign currency share of claims by banks on residents	1.2	1.1	1.0	1.0	1.2	1.2	1.2	1.2	1.2	1.2
Foreign currency share of residents' bank deposits	29.0	26.8	26.7	25.1	27.0	27.0	27.0	27.0	27.0	27.0
Real effective exchange rate growth	5.4	6.3	(3.9)	(3.9)	6.6	(3.2)	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments.The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

New Zealand - Ratings Score Snapshot	
Key rating factors	
Institutional assessment	1
Economic assessment	1
External assessment	6
Fiscal assessment: flexibility and performance	2
Fiscal assessment: debt burden	1

New Zealand - Ratings Score Snapshot (cont.)	
Key rating factors	
Monetary assessment	1

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings List, April 6, 2018
- Sovereign Ratings History, April 6, 2018
- Sovereign Debt 2018: Global Borrowing To Remain Steady At US$7.4 Trillion, Feb. 22, 2018
- Asia-Pacific Central Governments Likely To Issue US$3 Trillion In Sovereign Debt In 2018, Feb. 22, 2018
- Banking Industry Country Risk Assessment: New Zealand, Nov. 25, 2018
- Country Risk Assessments Update: January 2018, Jan. 26, 2018
- Asia-Pacific Sovereign Rating Trends 2018, Jan. 10, 2018
- Global Sovereign Rating Trends 2018, Jan. 10, 2018
- Sovereign Risk Indicators, found at http://www.spratings.com/sri
- Global Sovereign Rating Outlook 2018: Brighter With Risk Of Turbulence, Dec. 13, 2017
- 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision. After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The committee agreed that "key rating factor" had improved/deteriorated and that the "key rating factor" had improved/deteriorated. All other key rating factors were unchanged. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
New Zealand		
Sovereign Credit Rating		
Foreign Currency	AA/Positive/A-1+	AA/Stable/A-1+
Local Currency	AA+/Positive/A-1+	AA+/Stable/A-1+
New Zealand		
Transfer & Convertibility Assessment		
Local Currency	AAA	
New Zealand		
Senior Unsecured	AA	
Senior Unsecured	AA+	
Short-Term Debt	A-1+	
Commercial Paper	A-1+	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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