

New Zealand's External Imbalances and Macroeconomic Policy

New Zealand's Macroeconomic Imbalances - Causes and Remedies

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- External imbalances a long-term feature of New Zealand's macroeconomic profile
- Global Financial Crisis
 - Impact harshest on large-deficit countries
 - But NZ performed relatively well
- Europe, G20:
 - Push to limit external imbalances
- New Zealand:
 - Should policymakers do more to address external imbalances?

New Zealand's External Position

- Flow: current account deficit
- Stock: net international investment position
- International balance sheet: level and composition of foreign assets and foreign liabilities

New Zealand's Current Account Balance

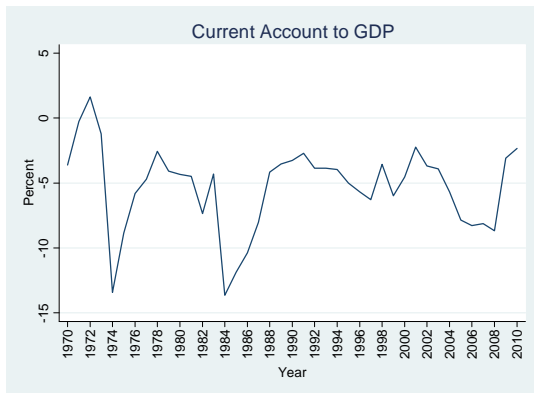


Figure: Current Account Ratio, 1970 to 2010. Source: IMF.

New Zealand's Net International Investment Position

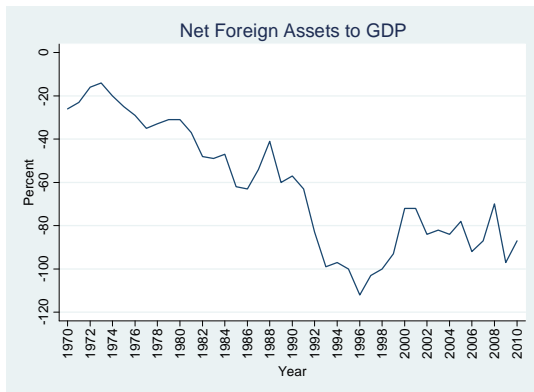


Figure: Net Foreign Asset Position. Note: Expressed as a ratio to GDP. Source: Update on dataset reported in Lane and Milesi-Ferretti (2007).

Table: Major International Debtors, End 2009

	NFA/GDP
Hungary	-128
Portugal	-120
Bulgaria	-109
Ireland	-102
New Zealand	-97
Spain	-95
Greece	-89
Latvia	-87
Estonia	-84
Slovak Republic	-73

Note: Net foreign asset positions, based on updated version of Lane and Milesi-Ferretti (2007).

Table: Evolution of Net Foreign Asset Positions

	2002	2007	2010
New Zealand	-84	-87	-87
Euro Periphery	-48	-77	-101
Emerging Latin America	-47	-24	-21
Emerging Asia	-15	0	16
Emerging Europe	-35	-65	-73

Note: Net foreign asset positions, based on updated version of Lane and Milesi-Ferretti (2007).

Net Foreign Debt and Net Foreign Equity

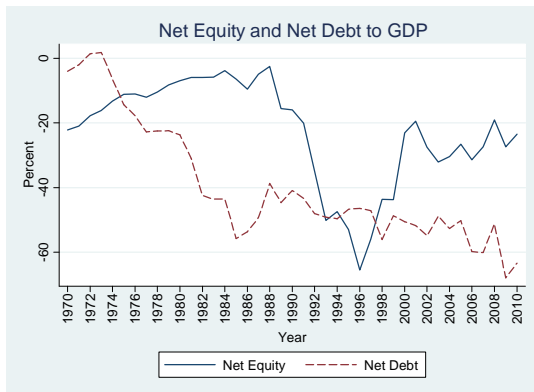


Figure: Net Foreign Equity and Net Foreign Debt Positions. Source: Update on dataset reported in Lane and Milesi-Ferretti (2007).

Net Foreign Debt and Net Foreign Equity

Table: Net Foreign Debt and Net Foreign Equity Positions

	Net Debt			Net Equity		
	2002	2007	2010	2002	2007	2010
New Zealand	-55	-60	-63	-28	-27	-23
Euro Periphery	-39	-69	-91	-19	-26	-11
Emerging Latin America	-23	3	4	-24	-27	-25
Emerging Asia	0	27	36	-14	-27	-19
Emerging Europe	-2	-18	-25	-34	-47	-47

Note: This table reports net external debt (international debt assets plus foreign exchange reserves minus international debt liabilities) and net foreign equity (portfolio equity assets plus FDI assets minus sum of portfolio equity liabilities and FDI liabilities), expressed as percentages of GDP. Source: Updated version of dataset reported by Lane and Milesi-Ferretti (2007).

International Financial Integration

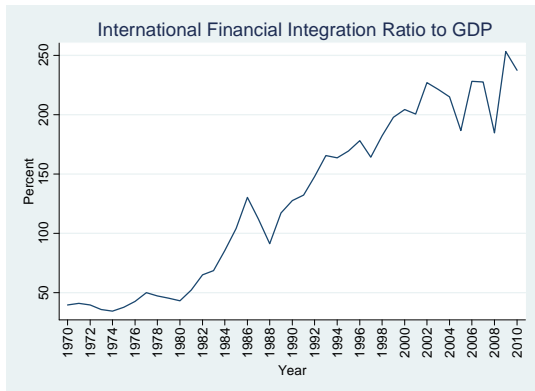


Figure: International Financial Integration Ratio. Source: Update on dataset reported in Lane and Milesi-Ferretti (2007).

Table: Gross Foreign Debt and Official Reserve Assets

	Gross Debt			Foreign Exchange Reserves		
	2002	2007	2010	2002	2007	2010
New Zealand	91	91	96	8	13	12
Euro Periphery	184	315	367	6	0	1
Emerging Latin America	61	34	28	10	13	14
Emerging Asia	46	37	33	29	36	43
Emerging Europe	46	71	84	21	20	20

Note: This table reports gross external debt (international portfolio and other debt liabilities) and official reserve assets, expressed as percentages of GDP. Source: Updated version of dataset reported by Lane and Milesi-Ferretti (2007).

Table: International Financial Integration

	2002	2007	2009
New Zealand	227	227	253
Euro Periphery	593	927	1063
Emerging Latin America	142	126	133
Emerging Asia	133	182	192
Emerging Europe	132	214	244

Source: Updated version of dataset reported by Lane and Milesi-Ferretti (2007).

Table: International Balance Sheet

	2002	2007	2010
Assets			
Portfolio Equity	15	21	21
FDI	15	12	13
Official Reserves	8	13	12
Portfolio Debt	9	6	8
Other Debt	18	12	12
Liabilities			
Portfolio Equity	9	10	7
FDI	49	51	50
Portfolio Debt	46	45	46
Other Debt	44	47	50

Table: Private Domestic Credit

	2002	2007	2009
New Zealand	109	140	153
Euro Periphery	99	149	181
Emerging Latin America	30	33	44
Emerging Asia	78	60	53
Emerging Europe	28	54	75

Note: This table reports private credit by deposit money banks and other financial institutions as a percentage of GDP. Source: Beck et al (2009).

- 'Test' of global financial crisis
 - Monetary expansion, currency depreciation
 - Fiscal activism (large swing in fiscal balance)
 - NZ not a target
- But two outstanding problems
 - Growth performance
 - Risk of future crises
- Macro externalities: "overborrowing" syndrome

- Current Account Deficit squeezes export sector
 - Exporting and productivity growth
 - “Learning by doing”
 - Financial frictions and sectoral growth
- Volatility in sectoral employment
- External debt and real interest rate

External Debt and Real Interest Rate

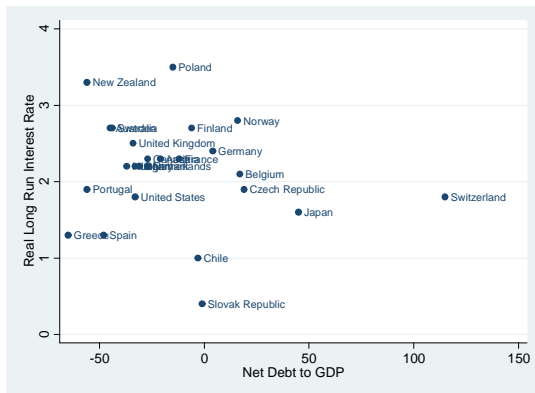


Figure: Scatter of Real Interest Rate Against Net External Debt. Source: OECD for interest rates and inflation. Source: Update on dataset reported in Lane and Milesi-Ferretti (2007).

- Sudden stop in net flows
- Sudden stop in debt rollover
- Large output and expenditure declines during sudden stops
- Asset price decline; financial stability risks
- Evidence from external adjustment during global financial crisis (Lane and Milesi-Ferretti 2011a, 2011b)

- High external debt
 - FX risk hedged
 - Foreign-owned banks
- Reversal in house/farm prices
- “Asia” shock and impact on AUS/NZ?
- Global re-assessment of debt limits

- Monetary Policy
 - Inflation targeting regime appropriate
 - Interest rate instrument too blunt to target external balance or asset prices
 - Stabilising role of activist policy during crises
 - Sterilised currency interventions?
- Macro-Prudential Regulation
 - Central role of banks in cross-border finance
 - Limitation: direct cross-border borrowing by non-banks

External Imbalances and Macroeconomic Policy Framework

II

- Structural Policies

- Pro-Growth Policies

- Pro-export policies

- Shock Absorbers

- Labour market

- Financial system

- Legal system

- Financial Development (Inward equity investment)

- International financial insurance

- Swap lines

- Credit lines

- Stabilisation fund

- Foreign-exchange reserves

- Fiscal Policy

- preventive role in targeting external imbalances
- fiscal policy and external adjustment
- fiscal policy and crisis management
- making fiscal policy effective
- formal fiscal framework

- Prevention/Correction
 - “Danger Zone”
- Temporary/permanent shifts in government consumption
- G_N , G_T and relative price of nontradables
- Microeconomic interventions
 - Time-varying tax rates
- Fiscal balance and external balance (flows; stocks)

- Strong fiscal position limits “negative feedback loops”
- Fiscal activism limits macroeconomic costs of crises
- Empirically, financial crises carry fiscal costs
 - Direct: bailout costs (policy choices)
 - Explicit
 - Implicit
 - Indirect: Weak growth

Making Fiscal Policy Effective

- Fiscal sustainability critically important
 - Low public debt ratio
 - Correction mechanism to avoid “drift”
- Framework to avoid pro-cyclicality and enable counter-cyclicality
- Identification and implementation lags
- Diagnostics of structural balance
 - Financial cycle and fiscal cycle
 - Terms of trade shocks
- “Leaning against the wind”
 - GDP cycle
 - external and domestic financial imbalances

- Fiscal rules
 - “Safe” target for public debt ratio
 - Avoid fiscal procyclicality
 - GDP cycle; financial cycle; TT cycle
- Independent fiscal council
 - Monitoring of rules
 - Promote rigorous debate on macroeconomic and financial risks
 - Avoid “small country syndrome”
- Political “buy in” essential

- Scale of external imbalances problematic
 - Chronic - export squeeze and growth
 - Acute - risk of future crisis
- “Risk management” perspective on macroeconomic policy
 - Low-probability but high-cost scenarios
- Emphasis here on fiscal policy