

## CREDIT OPINION

29 June 2016

### Update

Rate this Research &gt;&gt;

#### Contacts

Atsi Sheth 65-6398-3727  
 MD-Sovereign Risk  
 atsi.sheth@moodys.com

Steven A. Hess 212-553-4741  
 Senior Vice President  
 steven.hess@moodys.com

Alastair Wilson 44-20-7772-1372  
 MD-Sovereign Risk  
 alastair.wilson@moodys.com

# Government of New Zealand - Aaa Stable

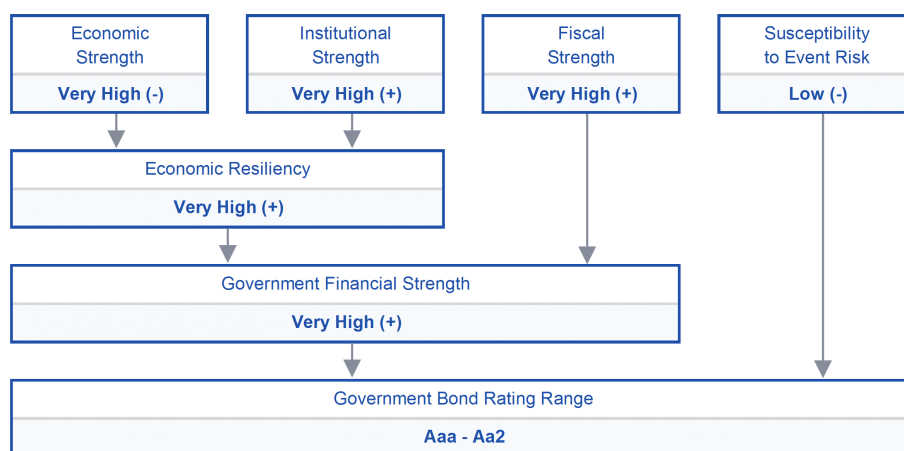
## Semi-Annual Update

### Summary Rating Rationale

- » The **credit strengths** underpinning New Zealand's Aaa rating include: (1) its advanced economy with strong government finances and sound monetary policy, (2) government debt levels that are lower than the median for Aaa sovereigns, despite a rise in recent years, (3) a strong fiscal framework and political consensus on targeting balanced budgets and low debt, and (4) a strong banking system that is mainly foreign owned, lessening the government's contingent liability.
- » The main **credit challenges** facing New Zealand include: (1) a resource-based economy that, on balance, remains exposed to volatile export earnings, and (2) one of the largest net external liability positions of advanced economies.

Exhibit 1

New Zealand's Aaa stable sovereign rating is determined by four factors



Source: Moody's Investors Service

This Credit Opinion provides a discussion of the credit rating(s) for the Government of New Zealand and should be read in conjunction with Moody's most recent Credit Analysis and rating information available on Moody's website.

## Key Indicators

<b>New Zealand</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015E</b>	<b>2016F</b>	<b>2017F</b>
Real GDP (% change)	2.0	1.9	2.8	1.7	3.0	3.4	2.6	2.5
Inflation (CPI, % change, Dec/Dec)	4.0	1.8	0.9	1.6	0.8	0.1	1.1	1.8
Gen. Gov. Financial Balance/GDP (%) <sup>[1]</sup>	-6.5	-6.1	-2.5	-1.5	-0.1	0.3	-0.1	0.1
Gen. Gov. Primary Balance/GDP (%) <sup>[1]</sup>	-4.8	-4.2	-0.5	0.2	1.5	2.0	1.5	1.6
Gen. Gov. Debt/GDP (%) <sup>[1]</sup>	26.9	31.5	32.0	30.8	30.8	30.4	30.0	28.9
Gen. Gov. Debt/Revenues (%) <sup>[1]</sup>	79.0	93.0	94.4	90.8	90.1	86.9	85.4	83.0
Gen. Gov. Interest Payment/Revenues (%) <sup>[1]</sup>	5.0	5.7	5.9	5.2	4.9	4.9	4.6	4.3
Current Account Balance/GDP (%)	-2.3	-2.8	-3.9	-3.2	-3.1	-3.1	-3.0	-2.7

[1] Central Government

## Summary Rating Rationale (continued)

New Zealand's Aaa rating is based on the country's high economic strength, very high institutional and government financial strength, and low susceptibility to event risk. New Zealand's flexible and market-oriented economic policies have supported economic performance that has become stronger and less subject to external shocks. Although per capita income is at the low end of the Aaa range, it is nonetheless high by global standards. The relatively small scale of the economy is also a factor considered in assessing economic strength. Institutional strength is very high, as measured by governance, rule of law, and transparency. In addition, Moody's expects that the government, regardless of the party in power, will maintain a policy of low debt and fiscal discipline.

While the fiscal balance deteriorated as a result of a recession and the earthquakes that struck the country in 2010 and 2011, the government that first came into office in 2008 and is now in its third term has indicated its intention to return debt to a prudent level. Gross "total crown" debt has peaked at well below 40% of GDP before beginning to decline, although the IMF reports a lower value using market value of the debt. We believe that the debt trajectory and the policy to deal with shocks remain compatible with a Aaa rating.

The external liability position will remain high. However, there are several factors that make the large external liability position less risky than it might appear, including the high proportion of liabilities denominated in NZ dollars and of foreign currency liabilities that are hedged, and the related-party nature of much of bank liabilities. The composition of the external liability position supports an assessment of low susceptibility to event risk.

## Rating Outlook

The stable outlook is anchored by the government's low debt relative to most other Aaa-rated countries and our expectation that New Zealand will continue with fiscal and monetary discipline and market-oriented policies

## Factors that Could Lead to a Downgrade

An upward government debt trajectory in the next few years could cause the rating to move down. A major problem with access to external finance that affected New Zealand banks and the Australian banks that operate in the country would also pressure the rating.

## Recent Developments

During the first quarter of 2016, the economy continued to grow at a fairly strong pace. Expenditure on real GDP was up 0.5% from the previous quarter and 3.1% for the year ended in March. (Figures in the Key Indicators table are for calendar years.) This followed a 3.2% rise in the year ended March 2015. On a production basis, which is the series most generally used in New Zealand, the quarterly rise was 0.7%, led by a very strong 4.9% increase in construction, mainly of infrastructure and housing. Net immigration, which is near record levels, has also contributed to GDP growth, as has tourism, which has been strong in the past couple of years. We expect that service exports and construction will continue to grow at a relatively strong pace, supporting growth of above 2% annually over the next two years.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

After four reductions in the Official Cash Rate during the course of 2015, the Reserve Bank lowered the rate again in March to 2.25%, its lowest level in recent history. The reduction in the interest rate target has occurred despite the relatively solid economic growth, because inflation as measured by the CPI remains below the RBNZ's target range of 1-3%. After reaching a low point of a 0.1% year-over-year increase in the fourth quarter of last year, the annual change in the CPI rose to 0.4% during the first quarter of 2016, still well below the target range. The RBNZ said in its June Monetary Policy Statement that the rate could possibly go down further. The policy dilemma is that while consumer price inflation remains low, lower interest rates are a contributing factor in the rise in housing prices. Further macroprudential measures may be considered to dampen house price rises while maintaining an accommodative monetary policy.

Dairy prices, after falling more than 50% in 2014 and further in early 2015, later in 2015 and in early 2016 but are once again on a downward trend. Nonetheless, while they remain below historical averages, they are well above their low points reached in 2015. Fonterra, the cooperative milk marketing organization, expects relative stability in the coming nine months. Lower average prices have placed strain on farm balance sheets and NZ banks are likely to see problem loans rising in the sector. However, the proportion of total bank assets in the dairy sector remains fairly low, meaning that this problem remains manageable for the banking system.

The Budget Economic and Fiscal Update was released with the budget in May, showing a small estimated operating surplus of 0.3% of GDP for the fiscal year ending June 30, 2016 following a surplus of 0.2% during the previous fiscal year. The balance for the latest fiscal year had previously been estimated as a deficit. The government's forecasts show rising surpluses in the coming four fiscal years, reaching 2.2% of GDP in 2019-20. As the government is committed to not raising taxes, and revenues as a percentage of GDP will remain fairly steady, the rising surplus is based primarily on expenditure controls. If these forecasts are realized, the ratio of gross debt to GDP would decline to 27.9% by 2020 from the estimated peak of 36.2% at in 2017. The government has indicated a goal of a net debt figure (now about 25% of GDP) of around 20% of GDP or less by 2020, and the latest forecasts indicate this figure at 20.8% in that year.

## Rating Methodology and Scorecard Factors

### Rating Factors Grid - New Zealand

Rating Factors	Sub-Factor Weighting	Indicator	Factor Score
<b>Factor 1: Economic Strength</b>			VH-
<b>Growth Dynamics</b>	50%		
Average Real GDP Growth (2011-20F)		2.6	
Volatility in Real GDP Growth (Standard Deviation, 2006-15)		1.4	
WEF Global Competitiveness Index (2015)		5.3	
<b>Scale of the Economy</b>	25%		
Nominal GDP (US\$ billion, 2015)		172	
<b>National Income</b>	25%		
GDP per Capita (PPP, US\$, 2015)		36,172	
<b>Factor 2: Institutional Strength</b>			VH+
<b>Institutional Framework and Effectiveness</b>	75%		
Worldwide Government Effectiveness Index (2014)		1.9	
Worldwide Rule of Law Index (2014)		2.0	
Worldwide Control of Corruption Index (2014)		2.3	
<b>Policy Credibility and Effectiveness</b>	25%		
Inflation Level (% , 2011-20F)		1.6	
Inflation Volatility (Standard Deviation, 2006-15)		1.3	
<b>Economic Resiliency (F1xF2)</b>			VH+
<b>Factor 3: Fiscal Strength</b>			VH+
<b>Debt Burden</b>	50%		
General Government Debt/GDP (2015)		30.4	
General Government Debt/Revenues (2015)		86.9	
<b>Debt Affordability</b>	50%		
General Government Interest Payments/Revenue (2015)		4.9	
General Government Interest Payments/GDP (2015)		1.7	
<b>Government Financial Strength (F1xF2xF3)</b>			VH+
<b>Factor 4: Susceptibility to Event Risk</b>	Max. Function		L-
<b>Political Risk</b>			
Worldwide Voice & Accountability Index (2014)		1.6	
<b>Government Liquidity Risk</b>			
Gross Borrowing Requirements/GDP		1.5	
Non-Resident Share of General Government Debt (%)		74	
Market-Implied Ratings		--	
<b>Banking Sector Risk</b>			
Average Baseline Credit Assessment (BCA)		a3	
Total Domestic Bank Assets/GDP		200	
Banking System Loan-to-Deposit Ratio		148	
<b>External Vulnerability Risk</b>			
(Current Account Balance + FDI Inflows)/GDP		-3.6	
External Vulnerability Indicator (EVI)		--	
Net International Investment Position/GDP		-61.4	
<b>Government Bond Rating Range (F1xF2xF3xF4)</b>			Aaa - Aa2
<b>Assigned Foreign Currency Government Bond Rating</b>		Aaa	

**Note:** While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.

For more information please see our [Sovereign Bond Rating Methodology](#)

**Footnotes: (1) Rating Range:** Factors 1, Economic Strength, and Factor 2, Institutional Strength, combine with equal weight into a construct we designate as Economic Resiliency or ER. An aggregation function then combines ER and Factor 3, Fiscal Strength (FS), following a non-linear pattern where FS has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the preliminary Government Financial Strength rating range as given by combining the first three factors.

**(2) 15 Ranking Categories:** VH+, VH, VH-, H+, H, H-, M+, M, M-, L+, L, L-, VL+, VL, VL- **(3) Indicator Value:** If not explicitly stated otherwise, the indicator value corresponds to the latest data available.

## Moody's Related Research

- » **Sector In-depth:** [High Public, Private Sector Leverage Poses Credit Risks Across the Region](#), 26 April 2016
- » **Issuer Comment:** [The 2016-17 Budget: Strong Economic and Fiscal Outlooks Are Credit Positive](#), 27 May 2016
- » **Credit Analysis:** [Government of New Zealand](#), 24 March 2016
- » **Country Statistics:** [New Zealand, Government of](#), 1 June 2016
- » **Banking System Outlook:** [Outlook Remains Stable But Pressure on Asset Quality Is Rising](#), 5 April 2016
- » **Rating Methodology:** [Sovereign Bond Ratings](#), 18 December 2015

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

## Authors

### Steven Hess

*Senior Vice President*

[steven.hess@moodys.com](mailto:steven.hess@moodys.com)

### Matt Kulakovskiy

*Associate Analyst*

[matt.kulakovskiy@moodys.com](mailto:matt.kulakovskiy@moodys.com)

© 2016 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moody's.com](http://www.moody's.com) under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER 1033004