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RISKS TO WATCH

NEW ZEALAND

New Zealand's economy is stuttering as it struggles to pick up pace after its longest recession in more than 30 years, with consumers still wary in the face of low wage growth, high unemployment, and the uncertainty posed by the fragility of the global recovery.

PUBLIC DEBT AND POLICY CONSTRAINTS

New Zealand's public finances remain pressured as revenue continues to feel the pinch from the global crisis and recession, forcing hefty government borrowing to finance the shortfall. The government needs to maintain a tight hold on its fiscal position with ratings agencies hovering in the background. New Zealand's economic fortunes have improved and there is no imminent risk of a downgrade, but the country's debt level and the constraints it places on policy remain a key theme.

What to watch:

- National debt and government finances data. The National Party-led government will update its economic and fiscal forecasts in mid-December but already the Finance Minister has said revenue for the new fiscal year is running below expectations and the May budget forecasts will be pared back. That will likely add pressure for more restraint in official finances and reduce chances for any quicker return to budget surpluses..
- The May budget delivered wide ranging personal tax cuts which are calculated to offset a rise in the indirect goods and services tax, but they are forecast to be a net cost to the government.
- The New Zealand dollar and debt prices remain vulnerable to any hint the New Zealand government's fiscal position is weaker than forecast.

TAX REFORM

Long awaited changes for the tax system came into effect on Oct 1, with wide ranging income tax cuts, lower company tax, closing of loopholes favouring property investment, and a rise in the value-added goods and services tax (GST). It was the most comprehensive reform of the tax system in more than 20 years, but still steered away from the politically difficult capital gains and land taxes. It will likely take some time for the full impact to show through, but any signs that low income families are getting little or no benefit from the tax cuts, or indeed are being hurt by the rise in GST, may crimp National's high political ratings and lead to infighting among its smaller coalition partners.

What to watch:

- National's poll ratings. An election is not due until late 2011 but National is sensitive to public opinion.

GOVERNMENT EFFECTIVENESS

The centre-right National Party has been at pains to hold "the political centre ground" and offend as few voters as possible. Accordingly it has maintained remarkably high poll ratings. However, it has reversed or diluted several policies in the face of public discontent.



A montage of spectators in costume watching the international rugby sevens tournament in Wellington. REUTERS/Anthony Phelps

A plan to allow more exploration and mining of metals in national parks and reserves has been scrapped; plans to revamp foreign land ownership rules to encourage overseas investment are set to be sent for further study with the prospect that restrictions will not be loosened as suggested; plans to tighten drink driving laws by reducing the alcohol-blood level have been sent for further study over the next two years - beyond the date of the next election.

The government also has to balance the varying demands of its three smaller coalition parties. The three have pledged to support National on key matters of supply and confidence, ensuring its political survival, but much of the rest of National's political programme depends on negotiation on individual policies, which at times means compromise and delay.

What to watch:

- The government is expected to last its three-year term but at times may struggle to enact policies, or be forced to make concessions which are unpopular with its support base in order to get laws passed.
- Reform of the law over control of the coastal foreshore and seabed has caused divisions within one of the coalition parties, the Maori Party, and may have further repercussions upon the government's relations with the indigenous Maori people.
- Any extension of the emissions trading scheme which is seen as out of kilter with what is happening internationally..

RISK DATA BOX

Sovereign foreign currency:	
S&P	AA+ (stable)
Moody's	Aaa (stable)
Fitch	AA+ (stable)
World Governance Indicators:	
Voice & Accountability	96.7
Political Stability	84.9
Govt Effectiveness	97.6
Regulatory Quality	98.6
Rule of Law	99.1
Control of Corruption	99.5
IHS Global Insight	
Country risk	1.52
Sovereign	AA- (stable)
Economist Intelligence Unit	
Sovereign risk	BBB
Political risk	AAA
Country risk	BBB

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FOREIGN INVESTMENT RULES

Hong Kong-based [Natural Dairy Holdings Ltd](#) has announced plans to enter the New Zealand dairy sector by buying a group of farms currently up for sale. It says it wants to spend as much as NZ\$1.5 billion to buy more farms and set up its own processing plants. China's [Bright Dairy and Food](#) plans to [take a 51 percent stake in small scale milk producer Synlait Ltd](#), prompting concerns about foreign ownership of such a vital economic sector. The dairy sector is economically vital to New Zealand, providing a quarter of exports and more than 7 percent of gross domestic product.

Foreign ownership of farmland strikes at the heart of agricultural New Zealand's national identity. The issue has already stirred passions and led to a well organised and financed campaign to limit foreign ownership. The government has said it will tighten rules on overseas land ownership to ensure the national interest is protected, which may be seen at odds with its free-market credentials and bilateral trade agreements.

What to watch:

- Rejection of applications. The Overseas Investment Office has authority to approve small-scale applications but will seek government approval on any sensitive deals.
- The detail of an ongoing review of foreign ownership rules and the definition of what is regarded as an asset that should be retained in local ownership in the national interest.

ASSET SALES

The National-led government is politically inclined towards the selling of state assets like coal mines, power companies and railway operations, but is pragmatically inclined not to propose this because of a likely strong negative public reaction. The party's policy is that there will be no state asset sales in the first term of government and that any policy change will be put to voters at the next election.

But Prime Minister John Key ruled out any privatisation of the small state-owned Kiwibank, a low cost retail bank catering for consumer and small businesses, after a strong public reaction to a suggestion that it might be sold at some stage in the future.

What to watch:

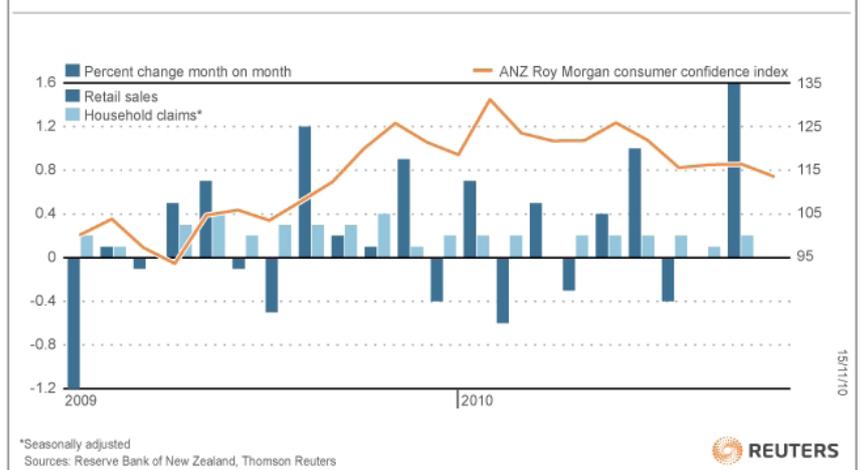
- Any overt policy change and announcement of assets to be privatised. Conversely, any more moves to rule out the privatisation of some assets, as happened with Kiwibank.

EMISSIONS TRADING SCHEME

New Zealand's [emissions trading scheme expanded on July 1](#) with the inclusion of the energy, transport and industrial sectors, which account for [just over half of carbon emissions](#).

The government has been lukewarm on the ETS, accepting that it must fulfil its Kyoto Protocol obligations, but unwilling to make any far reaching promises not matched by its main trading partners and competitors. Nonetheless, fuel and energy prices are rising. Added to October's increase in the goods and services tax, and [rising interest rates as the central bank tightens policy](#), New Zealanders face a rising cost of living.

New Zealand retail sales and interest rates



One of the government's minor support parties, ACT, is campaigning against the scheme, and many farmers as well as some big business backers of the National Party also want it scrapped.

What to watch:

- The Government will review the scheme in 2011 and has said it will **delay full implementation if there is no international progress** on similar schemes.
- Any watering down or undermining of the scheme will motivate the well-organised and vocal environmental movement and likely erode National's ratings. Conversely any tightening and expansion of the scheme will anger National supporters..

KEY DATES

- **December 9, 2010**
Reserve Bank of New Zealand policy statement
- **December 13, 2010**
Food price index for November released
- **December 23, 2010**
Third-quarter GDP data issued
- **Late 2011**
Next general election due

RISK DATA

JLT Group	
Strikes, riots & civil unrest	3
Terrorism	2
War & civil war	1
Economic risk	4
Currency risk	1
Sovereign risk	2
Expropriation	1
Contract repudiation risk	1
Legal & regulatory risk	2
Coface	
Country rating	A1
Business climate	A1
Transparency International	
Corruption Perceptions Index Score	9.4
Rank (of 180)	1
World Bank Doing Business	
Rank (of 183)	2
WEF Global Competitiveness	
Score	4.92
Rank (of 133)	23
Reporters Sans Frontières	
World Press Freedom Index Score	1.50
Rank (of 175)	8

