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QUEEN ELIZABETH THE SECOND

Being the Fifty-first
Parliament of New Zealand

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Inquiry into the identification and support for students with the significant challenges of dyslexia, dyspraxia, and autism spectrum disorders in primary and secondary schools

Report of the Education and Science Committee

Fifty-first Parliament
(Dr Jian Yang, Chairperson)
November 2016

Presented to the House of Representatives
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Executive summary

Our inquiry examines the delivery of education for students with three particular learning support needs: dyslexia, dyspraxia, and autism spectrum disorder (ASD). Through analysis of submissions and advice, we aim to determine how well the education system supports students with these learning needs in primary and secondary schools.

The terms of reference for this inquiry were to:

- identify best educational practice for dyslexic, dyspraxic, and autism spectrum students
- investigate current screening for dyslexic, dyspraxic, and autism spectrum students in primary and secondary schools
- investigate support to and in schools for the transition through education for students with dyslexia, dyspraxia, and autism spectrum disorders, and the adaptations for their learning, including special assessment conditions
- investigate whether teacher training and professional development prepare teachers to identify and support education of dyslexic, dyspraxic, and autism spectrum students
- review the implementation of the 2008 New Zealand Autism Spectrum Disorder Guideline recommendations specific to education, to assess the level of progress.

Introduction

We examine provisions within the current education system that support students who need additional learning support. The Teaching as Inquiry process aims to identify a student’s strengths and needs, and determines the level of support or intervention required for that student to progress. We investigate the adequacy of current funding models. We discuss strengthening schools’ promotion of inclusive education, which affirms that students with special educational needs have the same legal rights to enrol and receive education at State schools as other students.

We were advised of work the Ministry of Education is doing to strengthen education for students with additional learning support needs, including the Learning Support Update and the Professional Learning and Development Review.

We found that submissions to our inquiry highlighted several key themes:

- Parents need more information about what support is available, and assistance with accessing that support.
- Schools are inconsistent and variable in their approach to supporting students with learning support needs.
- The capability and capacity of teachers, teacher aides, and other specialist support providers varies widely between schools.
• Submitters helped us determine whether the current provision of support services adequately meets the needs of students with learning differences.

• Submitters suggested a range of ways to improve the transitioning of students with learning support needs from early childhood education through to tertiary education.

**Best educational practice for dyslexic, dyspraxic, and autism spectrum students**

Submitters suggested several best-practice learning adaptations to support the education of students with dyslexia, dyspraxia, and ASD. These included reader/writer support, assistive technology, extra time for learning and responding, special assessment conditions, and a variety of programmes supporting neuroplasticity, motor-control, and phonological awareness programmes.

We note that submitters suggested a diverse range of approaches and adaptations that they considered to be best practice, but we were advised that some of these approaches have varying scientific merit. The ministry has published and hosts several best-practice resources on dyslexia, dyspraxia, and ASD on its Literacy Online and Inclusive Education websites.

We identify areas that warrant further research, including analysis of international best practice, strengthening learning support for Māori, Pasifika, refugees, and migrants, and the effect of innovative learning environments on students with learning differences. Our recommendations centre on strengthening and disseminating resources for parents and educators about dyslexia, dyspraxia, and ASD.

**Current screening for dyslexic, dyspraxic, and autism spectrum students**

We discuss the importance of strengthening the early identification of additional learning needs, because delayed progress cumulatively affects academic achievement, self-worth, and personal aspirations. We discuss the adequacy of early screening tools, including the B4 school check that helps identify whether a child needs more support before school, and the Special Education Early Intervention Service that provides specialist support for children in early childhood.

**Challenges to the early identification of learning support needs** include the cost and accessibility of screening services, and the age and context in which such learning needs become apparent. However, a critical feature of education in New Zealand is that support does not depend on diagnosis. Schools have the data and resources required to screen and respond to students’ learning differences. We make recommendations on how schools could better identify and meet the need for additional learning support in their students.

**Support available for the transition through schooling for dyslexic, dyspraxic, and autism spectrum students, and adaptations for their learning, including special assessment conditions**

We examine how transitions through schooling for students with additional learning needs could be strengthened, including establishing the role of a person responsible for managing transitions, and better communication within Communities of Learning.

We discuss strengthening several adaptations currently provided to students with additional learning needs. We discuss the effectiveness of Reading Recovery for students with dyslexia, and investigate increasing the provision of speech language therapy to meet demand. We examine the roles of Special Education Needs Coordinators and Resource Teachers, and how these roles can be strengthened and better used within
Communities of Learning. We discuss the provision of assistive technology and special assessment conditions.

Investigate how teacher training and professional development prepares teachers to identify and support the education of dyslexic, dyspraxic, and autism spectrum students

We discuss strengthening the professional practice of teachers to meet the additional learning needs of students, and make recommendations about Initial Teacher Education and the professional development of teachers. We examine the training of specialist teachers, and how best practice and expertise can be better shared within Communities of Learning.

Review the implementation of the 2008 New Zealand Autism Spectrum Disorder Guideline recommendations specific to education, to assess the level of progress

The New Zealand ASD Guideline was jointly produced by the Ministries of Health and Education in 2008, and has recently been updated. We investigate how the Ministry of Education is implementing and using the education recommendations in the guideline.

Although many resources are available to support students with ASD, we recommend a review of the ministry’s ASD action plan, in consultation with parents, specialists, and educators.

Minority view of Green Party of Aotearoa New Zealand, New Zealand First, and the New Zealand Labour Party

The concerns raised by submitters helped the committee analyse the adequacy of New Zealand’s educational system in supporting students with dyslexia, dyspraxia, and ASD in primary and secondary schools. The recommendations in this report were developed after significant cross-party discussion and collaboration, and in consultation with advisers, and are endorsed by each committee member. Where parties have disagreed with policy direction, or sought to further the recommendations of the report, they have included a minority view.

Summary of recommendations

The Education and Science Committee makes the following recommendations to the Government.

Introduction

1. That the Government task the Ministry of Education to consider collecting the school-entry data from schools and Communities of Learning to better identify responses to possible need.

2. That the Government task the Ministry of Education to consider increasing the funding of Intensive Wraparound Services to meet student needs.

3. That the Government task the Ministry of Education to extend its promotion of inclusive education information and resources to support teachers, including those who may be teaching students with needs arising from dyslexia, dyspraxia, and autism spectrum disorder.
That the Government task the Ministry of Education to develop policy on learning support needs to explicitly explain what best practice for inclusion is, and how monitoring and professional development will support this policy in all schools.

That the Government task the Ministry of Education to investigate the equity of access to publically funded services for Māori and Pasifika.

That the Government require the Ministry of Education to review and, as necessary, update advice about, and resources for, students with additional learning support needs.

That the Government require the Ministry of Education to develop and disseminate consistent intervention guidelines and support pathways for students with dyslexia, dyspraxia, and autism spectrum disorder.

That the Government require the Ministry of Education to develop and disseminate consistent intervention guidelines and support pathways for students with dyslexia, dyspraxia, and autism spectrum disorder.

That the Government require the Ministry of Education to work with Dyslexia NZ to develop a specific pathway guide for families of students with dyslexia.

That the Government require the Ministry of Education to work with Dyspraxia NZ to develop a specific pathway guide for families of students with dyspraxia.

That the Government require the Ministry of Education to develop specific pathway guides for families of students with attention deficit hyperactivity disorder, autism spectrum disorder, and foetal alcohol syndrome.

That the Government task the Ministry of Education to develop more formal links to a range of national and international experts to ensure that its policies, approaches, and supports on specific learning difficulties, including dyslexia, dyspraxia, and autism spectrum disorder, are easily accessible, coherent, and consistent with research evidence and best practice.

That the Government ensure that the Ministry of Education makes evidence regarding best practice and advice about dyslexia, dyspraxia, and autism spectrum disorder available to parents and schools so they can make fully informed decisions when contemplating programmes.

That the Government require the Ministry of Education to investigate the provision of one-stop-shop access to specialist help, which schools can offer families once students have had learning support needs identified.

That the Government require the Ministry of Education to encourage schools to develop a plan for individual learning needs for all students identified with learning support needs.

That the Government task the Ministry of Education to continue to investigate working with bodies, such as the Children’s Commissioner, to create a mediation and dispute-resolution model for parents and schools, which uses arbitration as a last resort.

Best educational practice for dyslexic, dyspraxic, and autism spectrum students

That the Government require the Ministry of Education to initiate research on the effect of innovative learning environments on students with additional learning support needs.

That the Government require the Ministry of Education to research what is needed to strengthen learning support policy, and include culturally appropriate researchers who can identify Māori, Pasifika, and refugee and migrant learning support needs.
18 That the Government require the Ministry of Education to research what is working, and what is failing, for students with learning support needs (nationally and internationally).

19 That the Government require the Ministry of Education to conduct research with a Māori research organisation to look at barriers to Te Tiriti o Waitangi issues, equity issues from a Māori perspective, and recommendations for change.

20 That the Government require the Ministry of Education to convene a process with learning support research communities to identify what research gaps exist.

Current screening for dyslexic, dyspraxic, and autism spectrum students

21 That the Government encourage the Ministry of Education to explore options for earlier identification, assessment, and resources for the literacy, language, and learning needs typically associated with dyslexia, dyspraxia, and autism spectrum disorder.

22 That the Government task the Ministry of Education to investigate lessons from the B4 school check modelled in the State of Victoria, Australia, for learning differences such as dyslexia, which is universally applied to all schools in the state.

23 That the Government require the Ministry of Education to work with the Ministry of Health, as part of the Learning Support Update, on strengthening transition support for all students receiving Early Intervention services, and strengthening referral pathways for students with autism spectrum disorder and dyspraxia.

24 That the Government require the Ministry of Education to investigate, as part of the Learning Support Update, creating targets for the timely identification of the need for, and provision of, additional support for students with learning differences.

Support available for the transition through schooling for dyslexic, dyspraxic, and autism spectrum students and adaptations for their learning, including special assessment conditions

25 That the Government task the Ministry of Education to work with schools and Communities of Learning on opportunities to strengthen teaching for all students, and improve access to, and coordination of, resources and services so they travel with students throughout their education pathway.

26 That the Government task the Ministry of Education to develop further advice on the effectiveness of Reading Recovery for students identified as having dyslexia, and subsequent interventions for students who may need it.

27 That the Government require the Ministry of Education, as part of the Learning Support Update, to conduct an analysis of the demand for communication services for students with speech, language, and communication needs associated with dyslexia, dyspraxia, or autism spectrum disorder, and to make recommendations for workforce planning, and that policy is changed to meet the needs identified.

28 That the Government task the Ministry of Education to continue to work with the New Zealand Qualifications Authority, and the cluster managers of Resource Teachers: Learning and Behaviour, to develop resources to promote good practice for access to special assessment conditions.

29 That the Government task the Ministry of Education to continue to work to provide more equitable access to special assessment conditions—in particular, for low-decile schools.
30 That the Government require the Ministry of Education to support building capability for special assessment conditions staff.

31 That the Government ensure that the Ministry of Education investigates current research on assistive technology for students with dyslexia, dyspraxia, and autism spectrum disorder, and updates its policies on effective teaching and assessment accordingly.

32 That the Government task the Ministry of Education to investigate the feasibility of a recognised qualification for Special Education Needs Coordinators.

33 That the Government task the Ministry of Education with assessing the feasibility of funding full-time, trained Special Education Needs Coordinators for schools with more than 200 students.

34 That the Government task the Ministry of Education to develop an information and support package for Special Education Needs Coordinators.

35 That the Government ensure that the Ministry of Education works with the Education Council to strengthen initial and ongoing teacher education to identify and respond to students’ additional learning needs, particularly those associated with dyslexia, dyspraxia, and autism spectrum disorder.

36 That the Government ensure that the Ministry of Education asks the Education Council to consider amending the Practising Teacher Criteria Key Indicators list to include “ability to create an inclusive classroom, meet the needs of students who need learning support, and access additional help where needed”, as well as “(ii) select teaching approaches, resources, technologies and learning and assessment activities that are inclusive and effective for diverse ākonga”.

37 That the Government require the Ministry of Education to strengthen professional development and support for teachers to identify and respond to learners with additional needs, such as dyslexia, and to engage with the parents of these children.

38 That the Government require the Ministry of Education to incorporate its work into strengthening professional development and support for teachers, to identify and respond to learners with additional needs, into its existing Professional Learning and Development programme.

39 That the Government ensure that the Ministry of Education makes available professional development for specialist teachers (such as Resource Teachers: Learning and Behaviour and Resource Teachers: Literacy) and teacher aides to strengthen working relationships, improve role clarity, and build knowledge of inclusive practice.

40 That the Government require the Ministry of Education to review the alignment of specialist services, such as Resource Teachers: Learning and Behaviour, and Resource Teachers Literacy, and other specialist services, within Communities of Learning.

41 That the Government require the Ministry of Education to investigate and lift the capability of the specialist teacher workforce, including the current capacity and capability of the specialist teacher workforce to support students with dyslexia, dyspraxia, and autism spectrum disorder in schools and Communities of Learning.
That the Government task the Ministry of Education to ensure that Special Education Needs Coordinators’ training and professional development focus on creating a school culture of inclusion, and providing advice about access to additional services, including assisting with Ongoing Resourcing Scheme applications alongside families.

That the Government require the Ministry of Education to work with Communities of Learning on opportunities to use expertise in multiple schools.

**Review the implementation of the 2008 New Zealand Autism Spectrum Disorder Guideline recommendations specific to education, to assess the level of progress**

That the Government require the Ministry of Education to continue to build sector capability that includes autism spectrum disorder-specific content, inclusive practice, and curriculum planning.

That the Government task the Ministry of Education to review its autism spectrum disorder action plan in response to the updated New Zealand Autism Spectrum Disorder Guideline.

That the Government task the Ministry of Education to work with parents, the Ministry of Health, and Autism NZ to review information resources for parents.
1  Introduction

Supporting students with learning support needs

The delivery of education for students with learning support needs has been the subject of review in recent years. In 2010, the public were invited to participate in a Review of Special Education led by the Ministry of Education. Canvassing opinions from throughout the sector, including those of parents and whānau, the review signalled improvements that needed to be made to the delivery of education for students with learning support needs.

In response to the review, the Government launched the Success for All – Every School, Every Child four-year plan in 2010.1 The policy set out changes to be made over four years and included increasing the number of children eligible for Ongoing Resourcing Scheme (ORS) funding, introducing performance targets for schools to demonstrate inclusive practice, changes to the provision of specialist services, and a commitment to better coordination between the Ministries of Education, Health, and Social Development to meet the needs of students with learning support needs.

Currently, most students with learning support needs are enrolled in local schools rather than special schools. Although schools are demonstrating an increasing commitment to inclusive education, reports of the effectiveness of the current system for students with learning support needs are mixed. In a 2015 report, the Education Review Office (ERO) reported that more than three-quarters of schools in their sample were mostly inclusive but that only half of schools were effective in promoting achievement and outcomes for students with learning support needs.2

Our inquiry examines the delivery of education for students with three particular learning support needs: dyslexia, dyspraxia, and autism spectrum disorder (ASD). Through analysis of submissions and advice, it weighs the effectiveness of current teaching methodologies, school practices, policy settings, and the provision of support to students with these learning support needs. It builds on the work done by prior reviews on inclusive education (formerly special education) and aims to inform the work of future reviews and policy.

Our inquiry seeks to determine what works to contribute to the best outcomes for students with these learning support needs. It recognises that the factors that contribute to successful outcomes are varied and interrelated, and can be measured in learning and achievement, as well as in well-being and engagement.

We note that a person’s experiences at school affect their resilience, self-efficacy, confidence, and ability to try new challenges. The chart below details how submitters to our inquiry described the effects of dyslexia, dyspraxia, and ASD on student well-being.

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1 Ministry of Education (October 2010), Success for All – Every School, Every Child, retrieved September 2016 from https://www.parliament.nz/resource/mi-nz/498CES_EVI_00DBSCH_INQ_9975_1_A147433/8a9b77778f192ba4a956a745ed81bceaf57b0

Diagram 1: Number of submitters who described each effect on student well-being.

These school experiences may form patterns of behaviour that continue into adulthood and shape success in later life. Our inquiry recognises that students with learning support needs have a right to expect the best support that we can provide to achieve success for them, not just in education or while they are at school, but in society and throughout their lives.

Our inquiry

On 19 August 2015, the Education and Science Committee began an inquiry into the identification and support for students with the significant challenges of dyslexia, dyspraxia, and autism spectrum disorder in primary and secondary schools.

We initiated the inquiry after receiving a briefing on the identification and support for students with the significant challenges of dyslexia, dyspraxia, and autism spectrum disorder in primary and secondary schools from the Ministry of Education.3

The terms of reference for this inquiry were to:

- identify best educational practice for dyslexic, dyspraxic, and autism spectrum students
- investigate current screening for dyslexic, dyspraxic, and autism spectrum students in primary and secondary schools
- investigate support to, and in, schools for the transition through education for students with dyslexia, dyspraxia, and autism spectrum disorders, and the adaptations for their learning, including special assessment conditions

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investigate whether teacher training and professional development prepare teachers to identify and support education of dyslexic, dyspraxic, and autism spectrum students

• review the implementation of the 2008 New Zealand Autism Spectrum Disorder Guideline recommendations specific to education, to assess the level of progress.

Submissions received

We received written submissions from 445 organisations and individuals.

Organisations included schools, tertiary education providers, community groups, charities, and Crown entities. Individual submitters included children and adults with dyslexia, dyspraxia, and ASD, and their whānau and friends. We also heard from individuals working in the sector, such as teachers (including Resource Teachers) and principals, teacher aides, occupational therapists, speech language therapists, and tutors.

We heard oral evidence from 194 submitters from a wide range of the organisations and individuals mentioned above in Wellington, Auckland, and Christchurch.

Of the written submissions, 110 focused on dyslexia, 33 on dyspraxia, and 80 on ASD. A further 136 submissions commented on a mix of the three learning disabilities. Eighty-six were about other issues, such as other learning disabilities or health issues.

We are grateful for the time and effort of those who submitted to the committee. We are particularly grateful to those who shared their very personal stories of living with dyslexia, dyspraxia, and ASD. We are aware that it was difficult for many to share their experiences.

In hearing and reading the submissions of parents and whānau, students, and teachers, we acknowledge their at-times distressing and difficult experiences, where services, support, and understanding for learning differences were varied and often gained through perseverance and difficulty, or not at all. These contributions have been valuable to our inquiry.

We would also like to acknowledge the submissions that reported examples of effective teaching and support for students with dyslexia, dyspraxia, and ASD. We are grateful for the many teachers and teacher aides who are caring and passionate about creating the best learning outcomes for all their students. We acknowledge school leaders who recognise and value diversity, who create inclusive learning environments, and who support their staff in teaching all students.

We noted a lack of cultural diversity in the submissions. We received very few or no submissions from submitters who identified as Māori, Pasifika, or Asian, or from other ethnic communities.

Submissions about learning differences not included in the inquiry

This inquiry focused on the three prevalent learning differences of dyslexia, dyspraxia, and ASD. Some of the submissions we received were about learning differences outside the inquiry’s scope, such as attention deficit hyperactivity disorder, dyscalculia, foetal alcohol syndrome, Irlen syndrome, and global developmental delay (see page 64 for definitions of these learning differences).

Although these learning differences were outside of the scope of our inquiry, many of the themes raised by these submitters were consistent with the themes and issues raised by
other submitters. We consider that this inquiry’s recommendations apply to the support of a variety of learning differences.

**Submissions about early childhood and tertiary education**

The inquiry focused on students with learning differences in primary and secondary schools. However, some of the submissions we received were about identifying and supporting these students in early childhood and tertiary education.

We considered that, although these submissions fell outside of the scope of our inquiry, they added value to our inquiry. We found these submissions particularly helpful where they commented on the provision of support and services for children with learning differences as they transitioned from early childhood through to tertiary education.

Again, many of the themes and issues raised by these submitters were consistent with what we heard from other submitters, and we consider that many of this inquiry’s recommendations would be applicable to early childhood and tertiary education contexts.

**Definitions**

**What is dyslexia?**

Dyslexia involves an unexpected or persistent difficulty in learning to read, write, and spell that cannot be explained by other factors. Specifically, a person with dyslexia has difficulty decoding and encoding print. This difficulty does not usually affect a person’s ability to understand what is read to them or to formulate text that others can write down for them (unless the person does not have enough vocabulary or grammatical knowledge to understand spoken language). Dyslexia is widely recognised as crossing ethnic, and socio-economic lines.

Although there is currently no globally accepted definition of dyslexia, in 2007 the Ministry of Education formally recognised dyslexia to describe a range of persistent difficulties with aspects of reading, writing, and spelling. In 2008, the ministry produced a range of resources to assist students with dyslexia, including screening tools and strategies for teachers, and information for parents.⁴

**What is dyspraxia?**

Developmental dyspraxia describes a difficulty in learning, planning, and carrying out coordinated movements in sequence to achieve an objective. (Developmental dyspraxia is also called Developmental Coordination Disorder.) For example, students may have difficulty dressing themselves, organising their time and materials, or making themselves understood.

Dyspraxia often affects motor skills, coordination, language, social interactions, and the ability to organise. Participation in many school-related activities is challenging for children with coordination difficulties. Disruptions in the classroom are common because these children may knock things over, drop objects, or bump into other children’s desks. This can make school stressful for them, their teachers, and other students.

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Difficulties with activities involving fine-motor skills, such as written work, can result in avoidance behaviours, such as needing to sharpen a pencil multiple times, talking and asking questions, attention-seeking, and interference with other children. Such students can experience lower self-esteem, anxiety, and depression.

Developmental verbal dyspraxia, or Childhood Apraxia of Speech (CAS), is a complex speech disorder that affects control of the movement required for the accurate articulation of speech sounds and intonation. Children with CAS can have speech that is extremely difficult to understand, even for familiar listeners. In comparison to other speech-sound disorder, CAS is a persistent speech-sound impairment. Oral language and literacy development may be affected because of difficulties with speech production.

**What is autism spectrum disorder?**

ASD is a developmental disorder. It can affect one person completely differently from another, and is life-long. Skill development can be uneven. A person with ASD may be extremely gifted in some academic areas and yet show reduced ability in others. Another may have poor social and self-management skills. Every student with ASD will have a unique range of abilities and needs.

**The current system**

**The Teaching as Inquiry process**

Teachers design effective teaching and learning programmes by using the Teaching as Inquiry process. This begins with identifying student strengths and needs relevant to the learning area, and using evidence-based strategies that are most likely to assist students to learn.

**Three levels of support**

Most students should progress through their schooling in a learning environment where the teacher uses effective strategies and their adaptive expertise to meet students’ needs (Support Level 1).

Some students who do not make the expected progress within their classroom programme (Level 1) may need additional support to accelerate their learning at Support Level 2 or intensive support at Support Level 3.

Support Level 2 includes short and intensive school-based interventions inside and/or outside the classroom. These interventions might include Reading Recovery, Speech Language Therapy, and support from Resource Teachers: Learning and Behaviour (RTLBs), and Resource Teachers: Literacy (RTLits).

Level 3 includes longer-term specialist interventions intended for a small number of students. This may involve specialists working one-to-one with the student in collaboration with the classroom teacher, parents and whānau, and other agencies. These specialists are also expected to help strengthen, influence, and inform support at Support Levels 1 and 2.
The diagram below illustrates the three levels of support.

Diagram 2: The three levels of support available to students with learning support needs.

Current funding support for students with learning support needs

The Government allocates more than $600 million each year for direct and indirect support for students with learning support needs. Funding and services are provided through a mixed-funding framework and are distributed in several ways, including the following.

- The Special Education Grant provides funding for students with learning support needs. Schools receive this grant as part of their operational funding. The grant is paid on a per capita basis according to the total roll of the school and varies according to the decile rating of the school.

- ORS provides resources for students with high and very high needs that are likely to be ongoing during their school years. Students who meet the criteria can receive funding for specialist support, specialist teacher time, teacher aides, and equipment.

- The ministry provides specialist services in Communication, Behaviour, and Early Intervention.

- Staffing and funding are allocated to clusters and groups of schools, and children identified for additional support are prioritised within the cluster. These include RTLB and RTLit services.

- The Intensive Wraparound Service is provided to students with highly complex, challenging behaviour at school, in the community, and with family. The challenging behaviour could be social, emotional, and/or educational, and its cause may involve a learning difficulty.

- Some students attend specialist schools (such as schools for deaf students), regional health schools (which provide teachers for students who are unwell and cannot attend their usual school), day special schools, and residential special schools (for students with vision, hearing, behavioural, and learning needs).
Concerns with current funding models

Some submitters argued that ORS funding is too competitive and limited, and that the eligibility criteria are too restrictive. They told us about students who they felt were unable to function in a classroom context without longer-term specialist intervention but who had been denied or deemed ineligible for ORS funding, and who were left with very little support. These submitters believe that more funding should be made available and that the criteria for eligibility should be broadened to include students with a wider spectrum of learning support needs.

The ministry told us that, when ORS was introduced, it catered to about 1 percent of the student population. Since then, it has been funded according to demand. The proportion of the school population receiving ORS has risen to about 1.08 percent, and ORS received an additional $16.496 million in Budget 2016 to meet this demand.

Some of us felt that ORS funding should be increased to meet the needs of a greater number of students, or about 3 percent of the student population. We note that this would mean an increase in funding allocation of at least an additional $300 million per year. The ministry told us that ORS is intended for students with high and very high needs. Eligibility is determined against nine criteria and assessed by a team of independent national verifiers. The ministry said that all students who meet the criteria currently receive funding.

Some submitters suggested that the Special Education Grant funding model be reviewed, and that it should be allocated according to the number of students with learning support needs, rather than by the roll and decile rating of the school. Some submitters observed that schools’ Special Education Grant funding is not adequate to meet the needs of their students, and that those schools are allocating money from their operational funding and other fundraising.

Many submitters also commented that there seems to be no accountability for how schools spend the grant to meet the needs of their students with learning differences. These submitters argued that schools should be compelled to report against performance measures that determine the effectiveness of the support and services provided to students with learning support needs, such as through the Special Education Grant.

Although some of us argued for introducing accountability measures for how schools use the Special Education Grant, most of us felt that schools need discretion in how they use the grant. Allowing flexibility in how they spend the grant means that schools can target the grant to maximise its effectiveness for more students in a variety of contexts.

Having considered the current funding settings for ORS, the Special Education Grant, and Intensive Wraparound Services, and the concerns of submitters to our inquiry about the accessibility of funding, we felt that more work could be done on identifying the level of potential need for additional learning support.

Although some of us suggested creating a register of students with learning support needs, we note that the New Zealand education system does not depend on diagnoses to meet the needs of the students. Rather, it is expected that the Teaching as Inquiry process will identify student’s learning support needs. Establishing and maintaining a register would also incur significant compliance and administrative costs.

However, we acknowledge that schools already gather data that could be used to better determine the levels of learning support needs for which appropriate responses could be developed.
Recommendation

1. We recommend that the Government task the Ministry of Education to consider collecting the school-entry data from schools and Communities of Learning to better identify responses to possible need.

Some of us argued that Intensive Wraparound Services funding be uncapped to meet students’ learning support needs. We note that this service delivers intensive support for students with the highest and most complex behavioural and learning needs. However, we also consider that this funding model could be reviewed to meet a greater proportion of students’ learning support needs.

Recommendation

2. We recommend that the Government task the Ministry of Education to consider increasing the funding of Intensive Wraparound Services to meet student needs.

Inclusive education

Inclusive education is founded in Part 8 of the Education Act 1989, which states that “people who have special educational needs (whether because of disability or otherwise) have the same rights to enrol and receive education at State schools as people who do not”.

Students with learning support needs also have rights under international law. New Zealand is a signatory to the United Nations Convention on the Rights of Persons with Disabilities and the United Nations Convention of the Rights of the Child. These conventions affirm the rights of persons with disabilities to effective access to inclusive education, and that persons with disabilities are not to be excluded from the general education system on the basis of disability.

At fully inclusive schools, diversity is respected and upheld. All students are able to take part in all aspects of school life; students’ identities, languages, abilities, and talents are recognised and affirmed; and their learning needs are addressed.

Strengthening inclusive education forms a critical part of one of the ministry’s six strategic intentions: “Targeting resources to address disparity in achievement”.

By strengthening inclusive education, the ministry hopes to improve educational outcomes for children with learning support needs, and provide whānau and students with confidence that all children will succeed.

Parents and whānau who made submissions to our inquiry held differing views about whether mainstream inclusive education could adequately cater to their child’s educational needs.

Submissions supporting inclusive education

Some submitters argued that inclusive education could provide for all children, as long as:

- teachers were adequately trained

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• schools had funding and could draw on expertise for additional and intensive support where needed
• schools created learning environments that recognised, valued, and responded to learning diversity.

Additionally, some submitters argued that current assessment methods need to be changed to better facilitate inclusive education. For example, some parents and whānau of children with dyslexia submitted that the National Standards assessments in reading, writing, and mathematics discriminate against children who are challenged in these areas by their learning differences. These parents and whānau felt that, from an early age, children with dyslexia are being labelled as “failures”, which discourages engagement, confidence, participation in learning, and positive social behaviour. Some submitters also suggested that schools are disincentivised to include students with learning differences such as dyslexia, because these students’ National Standards judgements negatively affect the schools’ reporting.

Submitters who support inclusive education also support a broader model of assessment that recognises the strengths and gifts of students with dyslexia, dyspraxia, and ASD. Other submitters suggested that these students should have their National Standards judgements reported “off register”.

Some of us consider that the National Standards help teachers, parents, and whānau to make clear judgements about whether students’ competence in reading, writing, and mathematics enables their learning for the full curriculum, and whether they are making the expected progress. It is not intended as a means of sorting and labelling, but as a means of informing improvement.

However, we also acknowledge that New Zealand National Standards is not derived from a single source of information, such as a national test result, as is the case in the United Kingdom and the United States of America, because this cannot accurately summarise a student’s achievement. We expect that teachers will compile a range of evidence from a variety of sources to communicate a comprehensive picture of a child’s progress and achievement to parents and whānau.

**Submissions supporting specialised education**

Other submitters supported inclusive education, supplemented with specialist and expert support for students with learning difficulties. Some submitters, for example, observed that their child learned social and verbal skills in mainstream contexts but needed a specialised environment for academic learning. Others saw mainstream education as a reachable goal but felt that their child needed specialist support or tutoring to achieve that.

Some submitting parents and whānau were satisfied with the mix of mainstream and specialist classes being offered to their child. However, most submitters reported that achieving that balance had been hampered by the school’s ability to provide adequate specialist support, or to allow students to participate in specialist programmes during school hours.

Some submitters argued that inclusive education could not adequately provide for students with dyslexia, dyspraxia, and, particularly, ASD. For example, some parents noted that their child suffered anxiety in mainstream contexts or struggled to cope because of sensory sensitivity. Some submitters specifically mentioned the challenges of modern, or
innovative, learning environments to their child’s particular learning support need. We discuss this further in Chapter 2.

Some parents felt that their child could be better supported by classes or schools that cater for a particular learning difference. Students with dyslexia from Kāpiti College, for example, felt that they benefited more from being in specialised classes for dyslexic students where they could take more time to process information and ask questions, without feeling like they “stuck out” in a mainstream class.

Some teachers also argued that teachers and schools are not always trained or resourced to cater for students with high learning needs and associated behaviours. Many parents agreed, observing that their child had been sent home or excluded from school activities when schools could not accommodate them. Some submitters, especially parents of students with ASD, reported that their child was excluded from activities, such as school trips or special assemblies, because schools felt unequipped to manage the behaviours associated with their learning difference. One submitter reported being told by a school that it “was not set up for a child like ours”.

Submitters to our inquiry argued that not all schools champion the principles of inclusive education. Some submitters felt that they had no choice but to home-school their child, and have incurred significant cost and stress as they try to manage their child’s education independently.

We acknowledge that magnet schools provide inclusive environments, support, and services to students with particular learning differences. However, we recognise that the existence of magnet schools demonstrates that there is more work to be done to build inclusion throughout the system.

**Strengthening inclusive education**

The ministry told us that, in 2015, it delivered workshops to 1,520 RTLBs, Special Education Needs Coordinators (SENCOs), learning support staff, principals, deputy principals, and ministry special education staff. These workshops introduced inclusive education concepts and the resources available to support inclusive practices in schools.

The ministry said that the workshops were well received. Participants reported that the workshops had a focus on effective, flexible teaching practices for all students, including those with needs arising from dyslexia, dyspraxia, and ASD. Participants reported that the workshops led them to think about inclusive practices in a different way, and to see the opportunities for planning for all students.

The ministry told us that it plans to continue the workshops and to complete coverage of the country in the first half of 2016. The ministry is also examining how it can use the workshops as the basis for more in-depth work with teachers and school leaders. We acknowledge the ministry’s work in promoting the principles of inclusive education. However, based on the experiences of submitters to our inquiry, we feel that these principles could further be strengthened and communicated to schools.

We consider that schools need to be provided with clarity on the legislative framework for inclusive education, and have explicit guidance on what best practice for inclusion is.

**Recommendations**

3 We recommend that the Government task the Ministry of Education to extend its promotion of inclusive education information and resources to support teachers, including
those who may be teaching students with needs arising from dyslexia, dyspraxia, and autism spectrum disorder.

4 We recommend that the Government task the Ministry of Education to develop policy on learning support needs to explicitly explain what best practice for inclusion is, and how monitoring and professional development will support this policy in all schools.

Current Ministry of Education reviews and updates

The Learning Support Update (formerly the Special Education Update)

Our inquiry coincides with a broader programme of work the ministry is pursuing called the Learning Support Update. The ministry informed us that it is working to improve the education system for children and young people who need additional learning support.

In 2015, the ministry engaged widely about proposed improvements through the Learning Support Update consultation process. It said that 156 engagement forums were held with more than 3,650 people throughout New Zealand. It noted that many of the matters raised by parents, students, whānau, teachers, and others during our inquiry are consistent with what the ministry heard in the consultation process on the Learning Support Update.

Learning Support Update action plan

The ministry said that, from 2016, it will lead a programme of work that will significantly redesign the system of additional support for students with additional learning needs. It stated that the programme will:

- design a recognisable, simple system of additional learning support
- redesign the service delivery model to remove fragmentation, inflexibility, and other barriers to effective service delivery
- implement the revised service delivery model
- carry out an ongoing programme of work to ensure the best use of funds, and examine the return on investment for all system components.

We have been told that the feedback from our inquiry will support and strengthen this programme of work. We expect that many of the recommendations in our inquiry will be incorporated into the ministry’s action plan.

The Professional Learning and Development Review

Our inquiry also coincides with the ministry’s Professional Learning and Development (PLD) Review, which is based on the findings of an advisory group from 2013.

The review aims to make centrally funded PLD more effective, make more of a difference to student outcomes in priority areas, support school leadership to lead and sustain improvement, and strengthen professional networks as a complementary source of support.

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for teachers and leaders. The ministry is currently implementing changes to PLD that will be operational from 2017.

Many of the issues raised during the inquiry about the professional needs of teachers and schools have also been raised as part of the work of the advisory group. We note the ministry’s assurance that this existing work programme will incorporate recommendations from our inquiry about professional development.

Themes raised by submitters to our inquiry

The submissions we received underpin several key themes.

Parents need more information about what support is available, and assistance with accessing that support

Many submitters reported feeling relief when their child was diagnosed with a learning difference, expecting that predetermined tailored support could now be delivered to meet the identified challenges associated with that particular learning need. However, submitters reported that there did not seem to be a clearly defined pathway of support, either for parents or for schools, to cater to a particular learning need.

Submitters reported a range of problems arising from a lack of information or a pathway of support.

Submitters struggled to know what services and support the school should provide, and what parents and whānau needed to find, and pay for, themselves. Many parents and whānau reported having to “fight” for the school to provide more support or specialist services.

Some submitters also suggested that the level of parental involvement necessary in seeking and accessing services from the school raised fundamental equity issues, because some cultural and socio-economic groups are more easily able to advocate for themselves and their whānau.

Additionally, submitters noted that some parents and whānau who had been unsuccessful in securing more support from the school felt that they needed to pay for additional support for their child. Many submitters reported investing thousands of additional dollars into their child’s education. This included before- and after-school programmes and tuition, digital and technical equipment, occupational therapy, and funding for schools to employ teacher-aide assistance for their child. This raises further equity issues, because many other parents cannot afford these services and must trust that the education system will adequately provide for their child.

The ministry told us that it gathers data on the ethnicity of service users to monitor potential disparities in access. Equity of access to learning support services is an area of concern for the ministry. Although the ministry advised that the Learning Support Update will introduce an approach that is more responsive to learners’ diverse needs and local circumstances, we consider that equity of access issues warrant further investigation.

Recommendation

5 We recommend that the Government task the Ministry of Education to investigate the equity of access to publically funded services for Māori and Pasifika.
When trying to find support for their child, many parents reported turning to a variety of educational, psychological, and medical services for help. Submitters reported that the quality and consistency of the support they received could depend on where they had sought help. For example, parents who had sought help for their child from an educational psychologist often found that they received support more quickly, and which was better suited to a classroom context, than those parents who had sought help from their child’s doctor.

Some submitters argued that, because of a lack of accessibility to up-to-date information, schools and parents appear to be vulnerable to the market-driven industry of commercial products and programmes that claim to address dyslexia and other learning needs, but that can lack scientific evidence to show their effectiveness. For example, where some submitters supported a particular programme, others reported that it had not benefited their child. Some submitters reported trying a range of different programmes until they found one that helped their child.

The ministry advised that it has several portals of information available to parents, whānau, and schools about various learning support needs. In the last 12 months, it has launched the Inclusive Education website. The website provides schools, parents, and students with information, resources, and curriculum materials to enhance teaching and learning, raise student achievement, and advance professional development.

The website includes information on dyslexia, dyspraxia, and ASD. As a result of this inquiry, the ministry has reviewed the website and found it generally fit for purpose. However, the ministry has resolved to update its resources on ASD to reflect current research and thinking, and to improve the awareness of, and access to, the website’s resources for teachers and parents.

The ministry also observed that several inclusive education resource materials are located on The New Zealand Curriculum Online website. Although the Inclusive Education and The New Zealand Curriculum Online websites have related information and shared hyperlinks, the potential exists to cause confusion for the sector, and the ministry is investigating ways to mitigate this. It is reviewing the relationship between the two websites.

We acknowledge the ministry’s work in developing a range of resources for parents and educators of students with additional learning support needs. However, we agree with some submitters that improvements could be made to the development and dissemination of these resources.

**Recommendations**

6 We recommend that the Government require the Ministry of Education to review and, as necessary, update advice about, and resources for, students with additional learning support needs.

7 We recommend that the Government require the Ministry of Education to develop and disseminate consistent intervention guidelines and support pathways for students with dyslexia, dyspraxia, and autism spectrum disorder.

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8. We recommend that the Government require the Ministry of Education to work with Dyslexia NZ to develop a specific pathway guide for families of students with dyslexia.

9. We recommend that the Government require the Ministry of Education to work with Dyspraxia NZ to develop a specific pathway guide for families of students with dyspraxia.

10. We recommend that the Government require the Ministry of Education to develop specific pathway guides for families of students with attention deficit hyperactivity disorder, autism spectrum disorder, and foetal alcohol syndrome.

11. We recommend that the Government task the Ministry of Education to develop more formal links to a range of national and international experts to ensure that its policies, approaches, and supports on specific learning difficulties, including dyslexia, dyspraxia, and autism spectrum disorder, are easily accessible, coherent, and consistent with research evidence and best practice.

12. We recommend that the Government ensure that the Ministry of Education makes evidence regarding best practice and advice about dyslexia, dyspraxia, and autism spectrum disorder available to parents and schools so they can make fully informed decisions when contemplating programmes.

13. We recommend that the Government require the Ministry of Education to investigate the provision of one-stop-shop access to specialist help for schools to offer families, once a student has had learning support needs identified.

Schools are inconsistent and variable in their approach to supporting students with learning support needs

The environments, teaching methods, programmes, support, and services that schools provide to students with learning differences are inconsistent. Some parents and caregivers of students with dyslexia, dyspraxia, and ASD reported moving their child from one school to another to find a “better fit,” or more support, for their child’s learning needs.

Submitters argued that several variables determine how much support a student with learning support needs receives. The attitude of teachers and school leaders, the level of staff training, the intensity of parental involvement, the school decile, available funding, and the behaviour of the student are all factors in determining the level of support a student with learning differences may receive.

We observe that not all schools employ SENCOs, noting that employment of a SENCO will often depend on the size of the school roll. Some submitters reported that schools were inconsistent in implementing individual education plans (IEPs) for their students with learning support needs.

We recognise that IEPs are a comprehensive resource appropriate for students with a high level of learning support needs requiring specialised strategies, supports, resources, and equipment within the classroom setting. Enforcing IEPs for all students with learning support needs could place an undue burden on schools, and subsequently decrease the value of the IEP. However, we consider that all students with identified learning support needs would benefit from an intentional teaching and learning plan to guide their progress.
Recommendation

14 We recommend that the Government require the Ministry of Education to encourage schools to develop a plan for individual learning needs for all students identified with learning support needs.

Submitters also believe that there are inadequate specialist services and expertise available to assist schools. They argued for more training and provision of specialist support to schools.

Some submitters argued that families and schools in rural areas also have less access to support and services for children with learning differences.

Some submitters argued that some ministry policy settings and schools’ best practice teaching methodologies were outdated. They felt that greater consistency of practice between schools could be achieved if policies and methodologies were updated with current research and evidence.

Some submitters felt that greater consistency of practice between schools could also be achieved if schools were held more accountable for how they supported students with learning support needs. Submitters suggested a range of accountability mechanisms that could be used to strengthen the consistency of practice between schools.

Some parents advocated for a regulatory body to promote the interests of parents, or for the return to something like the Parents Advocacy Council, which was established under the 1989 education reforms but subsequently abolished. These submitters reported that, when they felt that the school was treating their child unfairly or not providing adequate support, their only recourse, as advised by the ministry, was a complaint to the school’s Board of Trustees.

Not only did some submitters find this ineffective as a means of resolution but they also argued that sometimes their concerns were systemic and should be addressed by the ministry as a means of informing future policy and change for all students with learning support needs.

The ministry told us that it has been working in partnership with the New Zealand School Trustees Association, and with the Centre for Dispute Resolution based in the Ministry of Business, Innovation and Employment, to develop a dispute-resolution process when challenges for schools and families with individual students cannot be resolved at a local level.

We were pleased to hear that the project has been steered by a group comprising representatives of school and parent groups, and has been supported by cross-sector stakeholder workshops.

Recommendation

15 We recommend that the Government task the Ministry of Education to continue to investigate working with bodies, such as the Children’s Commissioner, to create a mediation and dispute-resolution model for parents and schools, which uses arbitration as a last resort.
Other submitters suggested that a range of performance measures be introduced to demonstrate how adequately schools were providing for the success of students with learning support needs.

The ministry advised us that it is working with the New Zealand Council for Educational Research to develop an approach to reporting on the progress and achievement of children who are learning long-term within one level of the curriculum. This will enable schools to report to their boards consistently on the performance of all students.

**The capability and capacity of teachers, teacher aides, and other specialist support providers varies widely between schools**

Submitters expressed concern that there are not enough specialist support providers to meet the needs of students with learning support needs. For example, parents reported having to pay for a teacher aide for their child when the school could not afford to.

Other submitters described the difficulties they had encountered in trying to access RTLB and RTLit services. Submitters reported that many specialist services, such as speech therapy, have long waiting lists. We discuss these issues further in Chapter 4.

Submitters also reported experiencing a wide range of teaching capabilities in teachers and teacher aides of students with dyslexia, dyspraxia, and ASD. A consistent theme in submissions was the suggestion that teachers are not being adequately trained and developed to teach students with learning differences. Submitters were also conflicted as to whether teachers should be trained to diagnose learning differences such as dyslexia, dyspraxia, and ASD. We discuss these issues further in Chapter 5.

**Submitters helped us determine whether the current provision of support services adequately meets the needs of students with learning differences**

Submitters observed that students with dyslexia, dyspraxia, and ASD can present with a spectrum of different cognitive, physical, and behavioural needs. Submitters recognise that there is no “one size fits all” approach but that students with a particular learning need may require a range of different interventions and supports.

These submitters urged the ministry to develop comprehensive “tool kits,” which include a range of resources and support that could be tailored to the diverse needs of individual students. Others felt that students with a wide variety of learning support needs could be catered for if schools improved the adaptability of their teaching methods within the framework of inclusive education.

Many submitters believed that schools were simply not funded adequately to meet the needs of all students with learning differences, recognising that resources were being prioritised to where they were most critically needed. These submitters argued that schools and parents had different ideas about what needs should be prioritised, with schools choosing to target resources and support to students with behavioural challenges or academic underperformance, rather than providing support to meet the actual learning need.

Some submitters argued that qualifying for support was “a race to the bottom”. These submitters argued that support addresses only the most severe behavioural and academic
challenges, while other students with learning differences who did not demonstrate these challenges were not supported in achieving their potential. Some submitters described this approach as “symptomatic” and “reactive”, with students needing a “history of failures” before they were seen as eligible for support and intervention.

Submitters suggested that neglecting a student’s learning difference often resulted in challenging behaviours. Some submitters felt that schools sought to address these challenges through targeted behavioural intervention or punitive measures, when a more effective intervention would be to meet and address the learning difference itself. Parents and whānau of ASD students, in particular, expressed frustration that their child was often targeted with behavioural interventions, when ASD is widely recognised as a neurological disorder.

Some submitters suggested that students who were academically under-performing were also a priority for targeted interventions. These submitters expressed frustration that students with moderate needs were not being catered to, and that the student’s academic performance, rather than the learning difference, determined the level of support provided. Some submitters, particularly parents of students with ASD, felt that, because their children were often academically gifted and meeting assessment standards, their other needs were neglected.

To provide further evidence that interventions are determined by academic performance and behaviour rather than learning needs, some submitters reported instances where a student was given teacher-aide support until a particular behavioural or academic need was addressed. The teacher-aide support was then withdrawn until the student declined to the point where they needed the support again.

Submitters also argued that it was difficult to determine whether the current provisioning of support services was adequately meeting the number of students with dyslexia, dyspraxia, and ASD. Since a fundamental feature of inclusive education is that it does not depend on diagnosis, it is difficult to determine how many students might have these learning support needs. For example, the ministry told us that it does not collect or hold information on the number of students with dyslexia in New Zealand. However, international research estimates that between 3 and 20 percent of the world’s population may have dyslexia. This wide range reflects the diversity of views in this area.

Many submitters suggested that some students with dyslexia, dyspraxia, or ASD were going unrecognised. They felt they were “flying under the radar” in the classroom, lacked funding and support for diagnosis or assessment, were not being appropriately advocated for, or had found limited ways of coping with their learning difference in a classroom context. For example, some submitters argued that high-decile schools have a greater proportion of students with diagnosed learning differences because parents of children at these schools can afford to pay for diagnostic services. These submitters suggested that a significant group of students are not reaching their potential because their learning needs are not being recognised and addressed.

Many submitting parents and whānau whose children’s learning needs had been identified argued that the provision of support was still insufficient to meet their children’s needs. As discussed previously, these submitters reported having to “fight” for services, having to pay for supplementary services, or having been deemed ineligible for services. They perceived that the reason was that the criteria for funding was set too high. Many submitters argued
for more funding to increase the provision of RTLB and RTLi support, teacher aides, speech therapists, diagnostic services, and other specialist support services.

Submitters suggested a range of ways to improve the transitioning of students with learning support needs from early childhood education through to tertiary education

Many submitters reported that they had secured services and support for their child at a particular point in their schooling but had lost these services when their child transitioned to another school or to the next level of schooling. Parents and whānau were frustrated at having to work to secure these services again.

Submitters argued that transitions could be improved if schools committed time and resources to transitioning, shared information and coordinated with other schools, and involved families and students more in the transition process.

We discuss these issues further in Chapter 4.
2 Best educational practice for dyslexic, dyspraxic, and autism spectrum students

We were interested to find out more about the best educational practices for students with dyslexia, dyspraxia, and ASD. We were interested in the suggestions of global academics, teachers, and specialists, and in the experience of parents, students, and whānau.

Submitters identified a range of approaches that they considered to be best practice in enabling inclusion and education for students with dyslexia, dyspraxia, and ASD.

Best practice for students with dyslexia

International research notes that defining dyslexia is a complex and contested process, and that there is no agreed remedial intervention or specific approach or programme to address dyslexia. Because every student with dyslexia will have a unique range of abilities, it is recommended that teachers and educational practitioners be resourced with a variety of different strategies.

The ministry advised that academic literature suggests that the dominant cognitive explanation for dyslexia is the “phonological deficit hypothesis”, which is defined as a difficulty in connecting the sounds of language to letters because of a structural deficit in the part of the brain associated with processing the sounds of language.

Many submitters supported a greater emphasis on phonological awareness development for students with dyslexia in early childhood and primary education, and believed that the explicit teaching of phonics should be mandatory in every primary school classroom. Some submitters were concerned by the curriculum’s “whole language” emphasis, which encourages students to recognise words as whole pieces of language, and to focus on language meaning rather than the phonetic approach of decoding language.

Submitters suggested several adaptations to teaching practice to improve the educational outcomes for students with dyslexia. Submitters suggested that giving students extra time to process learning, ask questions, and complete assessments was beneficial. Submitters also recommended reader/writer support and assistive technologies, such as laptops and software.

Submitters found special assessment conditions helpful. These include reader/writer support during assessments, extra time to complete assessments, using a computer, and rest breaks. For students with dyslexia, reducing writing requirements and reliance on text, and a greater use of visual and pictorial aids in learning, was also considered beneficial.

Submitters suggested a wide range of programmes to assist students with dyslexia. These include:

- Specific Learning Disabilities (SPED) tutoring
- Braingym
- Morningside Academy teaching methods
SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

- Lexia Learning Programme
- Orton-Gillingham Approach
- Multisensory Structured Language
- Nessy Learning Programme
- Davis Dyslexia
- Irlen’s Intervention
- Fast Forward system
- Listening Programme
- Lumosity Programme
- Perceptual Motor Programme.

Several submissions focused on students with visual perception problems who seem to have responded to Irlen lenses and overlays. The ministry told us that this is an example of the diversity of views on what works. Although this may help some students, the ministry told us that research demonstrates that approaches such as visual training activities, tinted lenses, and visual-motor activities have questionable validity and empirical support.

The ministry has provided every school with a resource booklet called “About Dyslexia”\textsuperscript{10}. This booklet provides in-depth information on how to recognise dyslexia and how to support children with this learning difference. In addition, two ministry websites—Literacy Online\textsuperscript{11} and Inclusive Education\textsuperscript{12}—have sections on dyslexia that are based on best evidence.

We note that these resources were not specifically mentioned in submissions, which indicates that many schools and parents are unaware of them and that more promotion of these websites is needed.

**Best practice for students with dyspraxia**

Dyspraxia often affects motor skills, coordination, language, social interactions, and the ability to organise. Disruptions in the classroom are common for students who have coordination difficulties, because they may accidentally knock things over, drop objects, or bump into other students’ desks. Participating in school-related activities can be challenging and stressful, and may result in avoidance behaviours, or lead to feelings of low self-esteem and anxiety. Submissions emphasised the importance of teachers understanding the nature of the challenges students with dyspraxia face at school.

Submitters suggested several specific adaptations to improve the educational outcomes for students with dyspraxia. Special assessment conditions, extra time for processing and


responding, and reader/writer assistance were among the most popular recommendations. Submitters also suggested several programmes that they had found beneficial, including SPELD tutoring and the Perceptual Motor Programme.

Some submitters said that the diagnosis pathways for children with dyspraxia were less developed than those for children with dyslexia or ASD. These submitters suggested that the Ministries of Health and Education work together to develop and disseminate guidelines to facilitate the diagnosis of dyspraxia.

The Ministry of Education has previously published support material on the Inclusive Education website to help teachers to understand dyspraxia, the learning needs associated with it, and options for responding to learners’ needs. A booklet is also available titled “Developmental dyspraxia: A resource for educators”.

**Best practice for students with autism spectrum disorder**

Students with ASD have a wide range of needs and abilities, from being gifted through to being identified as having very high cognitive and behavioural needs. In response to these diverse needs, a wide range of whole-class strategies, supplementary supports, and specialist supports are needed.

The ministry’s work on autism is outlined in its ASD Action Plan, which responds to the inter-agency work on the New Zealand Autism Spectrum Disorder Guideline. However, the action plan is due for review and updating. We discuss this further in Chapter 6.

Submitters wanted ASD-friendly classrooms and schools, where teachers welcome students and understand the specific nature of ASD. Aspects that were important included:

- the need for routine
- managed change and transition
- effectively managing sensory distractions, such as smells, sound, and light levels
- scaffolding social interactions
- understanding the effect of anxiety on behaviour
- creating quiet spaces in classrooms
- smaller class sizes.

Many submitters said that students with ASD had benefited from neuroplasticity programmes, such as Arrowsmith. Neuroplasticity programmes focus on strengthening and “rewiring” areas of the brain affected by learning differences.

Some submitters said that students with ASD suffered anxiety in modern, or innovative, learning environments because of sensory sensitivity. We note that the ministry has developed a guide for school leaders on planning innovative learning environments that consider the needs of all learners. The guide will assist schools in designing a learning space

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that is responsive to individual learner preferences, needs, and values, and that encourages schools to consult with parents, teachers, and students. The ministry noted that this guide is available on the Inclusive Education website, and should be read in conjunction with specific information about ASD on the Te Kete Ipurangi (TKI) website.\footnote{16 \textit{Ministry of Education, Inclusive Education, Guides for schools: ASD and learning}, retrieved September 2016 from \url{http://inclusive.tki.org.nz/guides/autism-spectrum-disorder-asd-and-learning/}.}

**Recommendation**

16 We recommend that the Government require the Ministry of Education to initiate research on the effect of innovative learning environments on students with additional learning support needs.

### Whole-of-class strategies

The ministry advised that it has published resources on its Inclusive Education website that demonstrate how making changes to classroom practice enable all students to be included and supported. These changes include:

- using predictable routines throughout the day
- curriculum differentiation
- scaffolding social relationships
- reducing reliance on writing
- increasing access to technology
- using visual supports to help students learn.

The ministry said that the whole-classroom approach has several important benefits. It supports students who may have an unrecognised learning need. It maximises the efficiency of teaching and preparation time, because teachers need to do less adaption focused on sub-groups of students. It also boosts the self-esteem of students with identified learning needs, because they do not feel singled out for extra support.

### Identifying further research opportunities

We consider that our inquiry identifies the need for further research into the development and implementation of best practice to support students with learning differences in New Zealand.

**Recommendations**

17 We recommend that the Government require the Ministry of Education to research what is needed to strengthen learning support policy, and include culturally appropriate researchers who can identify Māori, Pasifika, refugee, and migrant learning support needs.

18 We recommend that the Government require the Ministry of Education to research what is working, and what is failing, for students with learning support needs (nationally and internationally).
19 We recommend that the Government require the Ministry of Education to conduct research with a Māori research organisation to look at barriers to Te Tiriti o Waitangi issues, equity issues from a Māori perspective, and recommendations for change.

20 We recommend that the Government require the Ministry of Education to convene a process with learning support research communities to identify what research gaps exist.
3 Current screening for dyslexic, dyspraxic, and autism spectrum students

We wanted to investigate the current screening, assessment, and diagnosis of students with dyslexia, dyspraxia, and ASD.

The terms, “screening”, “assessment”, and “diagnosis” can mean different things to different people. The Ministry of Education uses the following definitions:

• “Screening” means identifying whether there is a potential need that requires a response.

• “Assessment” means determining the specific level and nature of need for individuals, and what and how much support is needed.

• “Diagnosis” means establishing a medical definition of the underlying cause of the need.

Early identification of dyslexia, dyspraxia, and autism spectrum disorder

The B4 School Check is a free voluntary health and development check for all children in New Zealand when they turn four years old. It is the last “Well Child” check before a child starts school, and is carried out by a registered nurse on behalf of the Ministry of Health.

The checks include assessing a child’s development and their social and emotional well-being. As part of this assessment, an early childhood educator will fill out a questionnaire about a child’s strengths and weaknesses. The questionnaire is a tool to identify where a child may need further help before they start school. It focuses on strengths that can support the child, as well as any challenges the child is experiencing, such as difficulties with concentration, behaviour, or getting along with others.

Some submitters argued that there needs to be a greater provision of screening for learning differences. They were concerned that learning differences were, in some instances, identified later than they could have been. Such late identification of needs can have a lifelong effect because delayed progress cumulatively affects academic achievement, feelings of self-worth, and personal aspirations.

Submitters argued that people with learning differences who had a delayed or no assessment of their learning needs were over-represented in New Zealand’s benefit-dependent, mental-health, and prison demographics. These submitters argued that the cost of improving the diagnosis of, and provision of services to, children with learning differences far outweighed the cost of later-life problems, should the learning difference go undiagnosed.

We agree that early identification of learning needs is important and should take place within the first school year or, if possible, before children start school. Every teacher should identify learning needs as part of their normal learner assessment processes at each year level.

However, we heard that initial teacher training and professional development did not always adequately support the capacity of teaching staff to identify the learning needs of students with dyslexia, dyspraxia, and ASD, and/or access available resources to support these.

Recommendations

21 We recommend that the Government encourage the Ministry of Education to explore options for earlier identification, assessment, and resources for the literacy, language, and learning needs typically associated with dyslexia, dyspraxia, and autism spectrum disorder.

22 We recommend that the Government task the Ministry of Education to investigate lessons from the B4 school check modelled in the State of Victoria, Australia, for learning differences such as dyslexia, which is universally applied to all schools in the state.

Special Education Early Intervention Service

The Early Intervention Service provides specialist support for children who have a developmental or learning delay, a disability, a behaviour difficulty, or a communication difficulty that significantly affects their ability to participate and learn at home or in an early childhood education setting. The service can work with children from birth until they start school.

After an assessment, a child may be given specialist assistance, such as speech language therapy, special equipment, teaching and learning strategies, or support from a psychologist or other professional.

In 2014/15, early intervention services and support were provided to about 13,000 children under the age of five years. Demand for early intervention services is growing. We were unable to obtain any definitive evidence to indicate why there is a growing demand. Growing demand for early intervention services could provide some confidence that early childhood teachers, parents, health professionals, and others are identifying concerns early on and that children are accessing services and support.

Recommendation

23 We recommend that the Government require the Ministry of Education to work with the Ministry of Health, as part of the Learning Support Update, on strengthening transition support for all students receiving Early Intervention services and strengthening referral pathways for students with autism spectrum disorder and dyspraxia.

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Challenges with identifying and diagnosing dyslexia, dyspraxia, and autism spectrum disorder

Submitters identified several challenges to identifying and diagnosing children with dyslexia, dyspraxia, and ASD.

Accessibility of services

Parents and whānau who suspected that their child might have a learning disorder or felt that “something wasn’t right” found it difficult to know where to go for an assessment or diagnosis of their child. Submitters reported seeking these services from teachers and schools, their doctor or local hospital, educational psychologists, professional organisations such as SPELD, and various other specialists.

Diagram 3 (below) shows who submitters reported had first identified that a child had dyslexia, dyspraxia, and/or ASD.

Some submitters also felt that these services were “stretched,” and reported being on waitlists of several months for a diagnostic or assessment service.
Cost of services

Some submitters reported that their child’s school had told them that the school would not be able to pay for an assessment or diagnosis of their child. Many submitters reported incurring substantial costs in having their child diagnosed. They noted the equity issues this raises, especially for parents and whānau in low decile areas, because many families are not able to afford these assessments. We recognise that this may be a contributor to the very low number of Māori and Pasifika submitters to our inquiry.

Many submitters argued that all primary schools or early childhood education centres should provide screening for dyslexia, dyspraxia, and ASD. Submitters suggested that this would resolve affordability and equity issues, and also address the concern that some students are being diagnosed with learning difficulties too late, such as in secondary and even tertiary education.

Learning differences becoming apparent

Another challenge to obtaining an assessment or diagnosis of a learning difference is that, especially for students with moderate needs, these can take some time to become apparent. This could happen for several reasons.

Learning needs, such as dyslexia, can be difficult to identify in a classroom of diverse students, who may come from a range of cultures and language backgrounds, and who progress at different levels in English language and literacy. Students with dyslexia-related needs may be masked by this diversity, which can make it difficult to identify additional learning needs at an early stage.

Several submitters also argued that some learning needs are identified only over time. For example, some submitters reported that they were not able to obtain a diagnosis of dyslexia for their child until their child had progressed to a greater reliance on writing and text in later school years.

The ministry also considers that National Standards and literacy learning progressions are able to identify whether students are falling behind expectations. Results from these can serve as the trigger for teachers to investigate further, and identify potential factors inhibiting progress.

Is getting a diagnosis beneficial?

We were advised that a critical feature of education in New Zealand is that it does not depend on diagnosis. The ministry recognises that the cost of diagnoses can be a financial burden for parents when diagnoses are not funded. This can disproportionately affect those with the fewest resources and be a source of inequity.

The ministry said that the needs-based approach in the New Zealand education system means that a diagnosis or private assessment is not required to access any additional State-funded support, including, for example, ORS funding and special assessment conditions.

Some submitting parents disagreed, arguing that the school did not take their child’s needs seriously or give their child support until they obtained a diagnosis proving that their child had a learning difference. For example, some parents reported that their child was declined RTL4 support or special assessment conditions until they had been diagnosed.
Some submitters agreed that a diagnosis is not necessary and felt that a more worthwhile investment would be in strengthening teacher training and providing specialist services, rather than in diagnostic services. Some submitters argued that getting a “label” does not help a student get access to more funding or better teaching but that, if teachers were adequately trained and assisted with specialist services, all students’ learning support needs could be catered for.

Some parents also felt challenged to make schools believe that their child should be screened for a potential learning difference, noting that a child’s behaviour might be different at home than at school. These submitters argued for a consistent and comprehensive approach to screening.

Some submitters suggested that all teachers should be trained and equipped with a screening resource. Others submitted that teachers were not best placed or resourced to screen and felt that the focus should be on diagnosis through early intervention services and in early childhood education.

The ministry advised that schools do have the data and resources to screen students for learning differences that require additional support. As discussed previously in the report, these assessments can enable the school to develop appropriate responses and interventions, such as the provision of ORS funding or special assessment conditions.

However, in response to submitters’ concerns about the time it takes for schools to screen and develop interventions for students with learning differences, we consider that the ministry should consider setting targets for screening and providing timely support to students with learning differences. We consider that these targets could be investigated in line with the work the ministry is doing in the Learning Support Update.

**Recommendation**

24 We recommend that the Government require the Ministry of Education to consider, as part of the Learning Support Update, creating targets for the timely identification of the need for, and provision of, additional support for students with learning differences.

**Diagnosis and student well-being**

Some submitters, especially students in secondary school and parents of secondary students, felt that obtaining a diagnosis had been detrimental to their well-being. Conscious of their relationships with their peers, these students felt that their “label” further isolated them from their fellow students. Some students reported being reluctant to take up special assessment conditions because other students had commented that these were “an unfair advantage”.

Some of us consider that many negative effects on a student’s well-being of obtaining a diagnosis could be mitigated if schools nurtured welcoming and inclusive environments. We were pleased to hear the reports of some submitters about schools that had held special assemblies or invited experts to talk to all students about learning differences. We were encouraged to hear of teachers who incorporated adaptive teaching methodologies for diverse learners into their classroom practice as a matter of course.
The coordination of services to support the diagnosis of a learning difference

Many parents stated that, once a diagnosis or assessment had been obtained, they were better able to engage with schools about the learning needs of their child and how those needs could be addressed. Many submitters reported feeling relieved when their child received an “official” diagnosis, expecting that their child’s school could now deliver a predetermined pathway of support.

However, some submitters said that schools seemed unsure how to incorporate the diagnostic results into their teaching and classroom management. For example, they believed that it was difficult for teachers to inform their educational practice from a report that could be medical in nature. Some submitters reported that their feelings of relief turned to frustration when they felt that the reports were ignored or under-used by their child’s school.

Submitters told us that strong relationships between the ministry and Child Development Services in local district health boards were important in the context of early identification and referrals. We heard from some submitters that there were some inconsistencies throughout the country with regard to this relationship.

Submitters argued that there needs to be improved coordination and communication between health and education services to achieve a holistic picture of the child in various contexts, and to develop a coordinated response. Some submitters suggested that common guidelines and systems be developed for the Ministry of Health, the Ministry of Social Development, and the Ministry of Education, to support students with learning support needs.
4 Support available for the transition through schooling for dyslexic, dyspraxic, and autism spectrum students, and adaptations for their learning, including special assessment conditions

Transitioning through the schooling system

Most submitters believed that students with dyslexia, dyspraxia, and ASD did not fare as well as they should have through transition points.

Many submitters reported that support for students with dyslexia, dyspraxia, and ASD did not carry across transition points. This could be because of a lack of communication between schools about the learning needs of the student, or because resources and support were tied to a particular school or learning age. For example, some parents reported that support they had received for their pre-school child through the Special Education Early Intervention Service was discontinued when their child started school.

Some submitters felt that there was a general lack of time, commitment, and resources available for transitions. Many parents reported that they became the main source of passing on knowledge about their child to the next year’s teacher and that, even if records and assessment data were available, they were often ignored.

For submitters who had found getting support challenging, this was especially frustrating, because they felt that they had to restart the process of getting support at the point of transition.

Submitters identified that students with ASD were also particularly vulnerable during transitions, because of their sensitivity to change in environment and routine.

Submitters suggested several improvements to support the transition of students with dyslexia, dyspraxia, and ASD from one school to the next, including:

- an ongoing pathway or individual education plan established from the beginning of the child’s schooling that travelled with them, and was acted on and updated by every teacher at each different year level

- support from early childhood centres and early intervention providers for transition into primary school, for a period of up to six months

- team transition planning—involving parents, teachers, SENCOs, the student, and other support providers—for transitions between and within schools

- teacher-to-teacher information-sharing to support transitions.

The ministry’s view is that schools in Communities of Learning can increase the opportunities to learn effective practices from each other about transitioning students. This could be particularly effective when students transition between schools in the same Community of Learning.
The ministry has also indicated that, as part of the Learning Support Update, it is looking at strengthening the provision of support across transitions for students with learning differences by establishing the role of a “responsible person” within the transition team of educators, specialist support staff, and whānau.

We are pleased that the ministry has indicated that it will continue to look at improving transitions for students with learning support needs.

**Recommendation**

25 We recommend that the Government task the Ministry of Education to work with schools and Communities of Learning on opportunities to strengthen teaching for all students, and improve access to, and coordination of, resources and services so they travel with students throughout their education pathway.

**Adaptive learning currently provided to students**

**Resource Teachers: Learning and Behaviour, and Resource Teachers: Literacy**

RTLBs are funded to work with schools, teachers, and Years 1–10 students with learning and behaviour difficulties. The RTLB service is organised on a “cluster” model. Nationally, all state, state-integrated, and partnership kura/schools are grouped into 40 clusters. One school in each cluster (the lead school) provides the service to, and on behalf of, all schools in the cluster.

In the 2015 school year, the RTLB workforce had 917 full-time equivalents, and a total of 15,379 individual students in 2,073 schools had received a service.

RTLit have specialist skills in teaching reading and writing, and work with students experiencing literacy difficulties and their teachers. There are 109 RTLIts.

RTLBs and RTLIts directly support classroom teachers to adapt the curriculum to support learners, such as students with dyslexia, dyspraxia, and ASD.

Many submitters felt that RTLB and RTLIt resources, and other specialist services, were stretched to deal with the demand for their services. We further discuss the capacity and capability of RTLB and RTLIt in Chapter 5.

**Reading Recovery**

Reading Recovery (RR)\(^9\) is a Support Level 2 intervention for students who do not make expected progress in reading and writing after one year of good classroom teaching. Its primary function is to accelerate students’ literacy progress so that they catch up with their peers. We heard that it does this successfully for about 80 percent of children, after the standard 12–20 weeks of intensive support, depending on need.

Although some of us argued that RR was ineffective for students with dyslexia, the ministry said that RR identifies students who, despite the intervention, will need further and ongoing intervention. We heard that, for this 20 percent who do not respond to RR,

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some may have dyslexia or other long-term persistent difficulties. RR’s second function is to identify these students so that they may be referred on to more specialised support.

The ministry said that support at Level 3 is presently not adequate to accommodate all of the students that need support in our system, and that planning is under way to address this.

We also heard that RR may be outdated and could be reassessed to ensure its relevancy, especially when technology has become more prevalent in helping those with learning differences such as dyslexia.

Recommendation

26  We recommend that the Government task the Ministry of Education to develop further advice on the effectiveness of Reading Recovery for students identified as having dyslexia, and subsequent interventions for students who may need it.

Speech language therapy

Students with speech, language, and communication needs may need support with understanding and using language, speaking clearly and fluently, and interacting with others. Speech language therapists employed by the ministry may provide this support, and the ministry currently funds this service for up to 6,600 students each year. This figure includes Language and Learning Intervention support for up to 1,000 students with significant language needs affecting their learning. This service is typically provided to support school-aged students between Years 1 and 3.

Submitters told us that sometimes there is a waiting period before students are able to access speech language therapy. The intensity and duration of services can also be an issue—in particular, for students with childhood apraxia of speech and ASD when communication issues persist beyond Year 3 but services do not. Some submitters identified funding as a factor that limits access to this service.

Some of us argued that funded services for speech language therapy should be available throughout the compulsory school years, where necessary for the student. We were advised that speech language therapy services focus on children under the age of eight years, because intervention and support when a child is young provides maximum benefits. However, the ministry told us that current policy settings enable access to speech language therapy for children beyond eight years. In the 2015 financial year, of the 6,859 children who were provided with speech language therapy services, 1,174 were aged eight years or older, with 253 of those children being older than 10 years.

The ministry also told us that it plans to review the Communication Service as part of the Learning Support Update. One purpose of the review is to improve flexibility to respond to the needs of older children.

Recommendation

27  We recommend that the Government require the Ministry of Education, as part of the Learning Support Update, to conduct an analysis of the demand for communication services for students with speech, language, and communication needs associated with
dyslexia, dyspraxia, or autism spectrum disorder, and make recommendations for workforce planning, and that policy is changed to meet the needs identified.

**Special assessment conditions**

Special assessment conditions provide extra help for approved secondary students when they are being assessed so that barriers to achievement can be removed and they have a fair opportunity to achieve credits. The support is used both for internal and external qualifications standards.

Currently, students approved by the New Zealand Qualifications Authority (NZQA) can use special assessment conditions for National Certificate of Educational Achievement (NCEA) assessment. In 2015, there were 7,024 applications for special assessment conditions, covering 7,886 needs in learning, medical, physical, and sensory categories.

Examples of special assessment conditions are the use of a writer or computer, rest breaks, Braille or enlarged papers, or a reader.

Readers and/or writers are currently provided to some secondary students who need additional support in qualifications assessments. They may read the questions out loud to a student, write down the answer for a student, or do both. If a person is providing support with reading or writing, they may not guide the student or explain the assessment.

We heard that there is a relationship between school decile and the proportion of students who access special assessment conditions, with higher-decile schools having a higher percentage of students accessing special assessment conditions than lower-decile schools.

The ministry told us that it has identified several reasons for this disparity. They include:

- the complexity of the special assessment conditions application process
- the timing of the application process (too late in the year)
- the timing of special assessment conditions approvals (too late in the year)
- the high cost to parents of having a Level C Assessor or registered psychologist assess their child (for a specific learning disability)
- the resources needed for schools to identify students, carry out school-based assessments, manage the special assessment conditions process, and access community supports (such as readers and writers)
- the need for low-decile schools to focus on priorities other than special assessment conditions—for example, broader student achievement goals and language, literacy, and numeracy achievement.

We heard that, in response to this disparity, the ministry has undertaken to improve access to special assessment conditions. The ministry has worked with the RTLB service to develop resources that promote good practice in accessing special assessment conditions.

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The 2015 results show an improvement over 2014, with a 77 percent increase in applications received from decile 1–3 schools, compared with a 10 percent increase in applications received from decile 8–10 schools. The ministry expects the decile imbalance to continue to improve as a result of the actions being taken.

**Recommendations**

28 We recommend that the Government task the Ministry of Education to continue to work with the New Zealand Qualifications Authority, and cluster managers of Resource Teachers: Learning and Behaviour, to develop resources to promote good practice for access to special assessment conditions.

29 We recommend that the Government task the Ministry of Education to continue to work to provide more equitable access to special assessment conditions—in particular, for low-decile schools.  

30 We recommend that the Government require the Ministry of Education to support building capability for special assessment conditions staff.

**Assistive technology**

Assistive technology helps students with learning differences to improve their writing and reading skills, their engagement with the curriculum, and their social interaction and behaviour.

Assistive technology varies greatly, depending on the learning needs of a student, and may include devices such as laptops, tablets, specialist software, or hearing loops for classrooms. For example, a student with dyslexia or dyspraxia may have a literacy app on an iPad to aid them with reading and writing, or a student with ASD may use it to keep them on task and improve their communication skills.

The ministry funds some assistive technology. The ministry also expects schools to provide assistive technologies to students from its own resources, such as the Special Education Grant. However, we heard from submitters that many families are required to pay for assistive technologies for their children.

We heard from submitters that many families cannot afford to pay for the technology their children need, and have tried to get funding from the ministry. However, only students with the highest need are currently eligible for assistive technology. The ministry told us that, in Budget 2016, an additional $1.45 million was allocated over the next four years to support the existing assistive technology budget.

Many submitters found that students with dyslexia were able to improve their achievement when they could use speech recognition programs, such as Dragon software, to help them read and write. Many schools support the use of these programs in a classroom setting. However, although students have access to a wide range of assistive technology, students are prohibited from using this technology during NCEA examinations, which submitters felt disadvantaged these students. Additionally, allowing students a greater use of digital technologies would reduce the need for reader/writer resources. (One school reported having to employ up to 172 readers/writers during an assessment period.)
The ministry said that NZQA is in regular communication with sector groups to ensure that there continues to be an ongoing awareness of new technologies to assist students. We heard that these technologies are considered and assessed as NZQA increasingly moves toward digital assessment.

As technology continues to develop and improve, it can assist more and more students. There is an upward trend in the number of students accessing assistive technology. The ministry said that, although the growth of personal devices provides an increasing range of options, the focus needs to remain on effective teaching practice.

**Recommendation**

31 We recommend that the Government ensure that the Ministry of Education investigates current research on assistive technology for students with dyslexia, dyspraxia, and autism spectrum disorder, and updates its policies on effective teaching and assessment accordingly.

**Special Education Needs Coordinators**

Some schools designate teachers as SENCOs. SENCOs can provide advice as well as coordinate additional support for students with learning differences who need it.

Some submitters said that not all schools employ SENCOs to help manage the needs of students with learning differences. Submitters also noted that the SENCO role was often an additional role done by busy senior staff as part of their work, and felt that these staff did not have adequate time or training to fulfil this role.

We consider that work should be done in investigating the appropriateness of funding full-time SENCO positions for schools with larger student rolls.

We consider that there are further opportunities to help schools make better use of their SENCO resource. One opportunity is to develop an information and support package that will bring together all the information SENCOs need for effective practice. We also consider that the ministry should investigate whether staff in a SENCO role should be formally trained and qualified.

The ministry is also working to better align specialist support services in schools in Communities of Learning. This would enable Communities of Learning to pool their SENCO resources so that individual schools without a dedicated SENCO could still access one.

**Recommendations**

32 We recommend that the Government task the Ministry of Education to investigate the feasibility of a recognised qualification for Special Education Needs Coordinators.

33 We recommend that the Government task the Ministry of Education with assessing the feasibility of funding full-time trained Special Education Needs Coordinators for schools with more than 200 students.

34 We recommend that the Government task the Ministry of Education to develop an information and support package for Special Education Needs Coordinators.
Other services

Other specialist services are also available to students with learning support needs, including occupational therapists and behaviour specialists. Submissions noted that these services are important, particularly for students with ASD and dyspraxia. However, we heard from many parents that they found it hard to access these services, in part because of demand and in part because of financial constraints.

The ministry acknowledged that growing demand is placing pressure on these services. The ministry said that, through the Learning Support Update, it is reviewing these services to improve their efficiency and effectiveness, and to help meet demand pressure. As discussed previously, the ministry is also actively pursuing opportunities for Communities of Learning to collaborate to share expertise and resources.
5 Investigate how teacher training and professional development prepares teachers to identify and support the education of dyslexic, dyspraxic, and autism spectrum students

One of the main themes that came through the oral submissions was about teachers’ capability to effectively teach students with additional learning needs such as dyslexia, dyspraxia, and ASD.

Many submitters argued that teachers, teacher aides, and SENCOs were not adequately trained, either when they completed their qualification or through further professional development. Some submitters even reported that the classroom teacher did not know what dyslexia or dyspraxia were.

Some submitters expressed frustration that there seems to be no mandatory ongoing training about how to teach the curriculum in a way that engages, and uses the strengths of, students with dyslexia, dyspraxia, and ASD. Some submitting parents believe that current teaching techniques are outdated, disenfranchise students with learning differences, and breach the students’ right to receive an education.

Some submitters reported positive and supportive experiences with teachers. However, submitters argued that even effective teachers lacked the necessary training, and that their methodologies for adapting to learning differences were “ad hoc, chaotic, and courageous” with little evidence of a uniform best-practice approach.

Submitters argued that more time, funding, and development needed to be allocated to professionally develop teachers and specialist support staff to effectively teach students with learning support needs. Some submitters called for a review of Initial Teacher Education (ITE) programmes and ongoing professional development.

Submitters also suggested that teacher aide and SENCO roles needed to be valued and remunerated appropriately to avoid burnout and high turnover.

Initial Teacher Education

The ministry’s current expectation for training teachers to support students with learning needs, as set out in the Minister of Education’s 2011 Letter of Expectation to the New Zealand Teachers Council, is that “…all teachers are confident and competent to teach students with disabilities and special education needs”. This is reinforced by the Graduating Teacher Standards, which require teachers to have the skills and knowledge necessary to teach “diverse learners”.  

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Of the 46 teachers who submitted, including an initial graduate, 35 indicated that their training did not prepare them for working with students who have dyslexia, dyspraxia, or ASD.

However, the ministry told us that it has an expectation that more recent graduate teachers will have a better understanding of teaching learners with learning support needs such as dyslexia. It estimates that, currently, 11 percent of teachers could reasonably be expected to have graduated in the last five years.

The ministry told us that it believes that variability in the competency of teachers to teach students with learning support needs can be explained by variability in the ITE—depending on where and when they trained—and professional development opportunities during their careers. For example, the ministry advised us that all ITE providers have been teaching some phonological awareness in their programmes, which it recognises as effective for teaching literacy skills to students with dyslexia. Most have explored additional needs associated with dyslexia, if only briefly, since 2007 when the ministry officially acknowledged it.

The ministry recognises that ITE providers will train teachers to address the needs of diverse learners but that this might not result in all trained teachers having the skills and confidence to teach students with the specific learning needs of dyslexia, dyspraxia, and ASD.

The ministry said that it has supported the teaching of students with dyspraxia, dyslexia, and ASD by publishing professional support material for teachers. However, we note that none of the submitting teachers mentioned any of the ministry-provided supports and resources that are available online or in hard copy booklets in schools.

We heard that the ministry wishes to explore the issue of teacher training further with the Education Council, which is currently reviewing the teacher standards and the provision of ITE.

**Recommendation**

35 We recommend that the Government ensure that the Ministry of Education works with the Education Council to strengthen initial and ongoing teacher education to identify and respond to students’ additional learning needs, particularly those associated with dyslexia, dyspraxia, and autism spectrum disorder.

**Professional development for practising teachers and teacher aides**

Many submitters were concerned at the quality of ongoing professional development available to teachers and teacher aides. They argued that research about dyslexia, dyspraxia, and ASD is a dynamic and evolving field, and that the implications for teaching and professional development are ongoing. Parents of children with ASD were particularly concerned, and listed in their submissions the capability of teachers, specialist teachers, and teacher aides as their top three issues.

Some submitters felt that schools neglected to provide ongoing professional development because of cost and time pressures. Many submitters felt that teacher aides, in particular, were an undervalued and under-invested resource, noting their low pay and high turnover.
Some submitters argued that, with little knowledge and training, teacher aides functioned as “babysitters” with harmful consequences for students of whom the teacher aide had little understanding of how to address their learning needs and behaviours.

The ministry said that it is working to strengthen the capability of less-recent teaching graduates. Teachers must renew their certification every three years, and are required to meet the Practising Teacher Criteria to renew their certificate.\textsuperscript{22} These criteria include requirements that practising teachers “select teaching approaches, resources, technologies and learning and assessment activities that are inclusive and effective for diverse ākonga”\textsuperscript{23} and “modify teaching approaches to address the needs of individuals and groups of ākonga”.

The ministry expects that this will ensure that all teachers are confident in teaching students with learning support needs arising from dyslexia, dyspraxia, and ASD. However, based on the submissions of many teachers to our inquiry, this is not always the case.

**Recommendation**

36 We recommend that the Government ensure that the Ministry of Education asks the Education Council to consider amending the Practising Teacher Criteria Key Indicators list to include “ability to create an inclusive classroom, meet the needs of students who need learning support, and access additional help where needed”, as well as “(ii) select teaching approaches, resources, technologies, and learning and assessment activities that are inclusive and effective for diverse ākonga”.

As noted previously in our report, in 2015 the ministry delivered workshops to 1,520 RTLBs, SENCOs, learning support staff, principals, deputy principals, and ministry special education staff. These workshops introduced inclusive education concepts and resources, with a focus on effective, flexible teaching practices for all students, including those with needs arising from dyslexia, dyspraxia, and ASD. The ministry said that it hopes to further develop and continue these workshops.

Some of us argued that the ministry should centrally fund mandatory professional development for teachers and teacher aides to address the gaps in teacher capability raised by the submitters. The ministry said that it has chosen not to mandate professional development, because schools need to retain the discretion to identify their own unique professional development needs, and determine the most appropriate way to meet them.

However, the ministry said that it is working with schools to update them on what packages of learning support are available, and on how to access support based on individual learning needs.

**Recommendation**

37 We recommend that the Government require the Ministry of Education to strengthen professional development and support for teachers to identify and respond to learners with additional needs, such as dyslexia, and to engage with the parents of these children.


\textsuperscript{23} Ākonga: Māori word for “learner” or “student”.

50
Professional Learning and Development review

PLD is currently being changed as a result of the PLD review, which we discussed in the Introduction.

One priority of the review will be to strengthen professional support that builds the capability of teachers to carry out inquiry. The ministry hopes that building inquiry capability will support school leaders and teachers to identify and develop students who need additional learning support.

Other priorities of the review include a focus on developing reading and writing. In addition, the ministry will continue to support, develop, and strengthen Communities of Learning to enable teachers to learn with, and from, each other about effective practice.

The ministry told us that literacy, including dyslexia, is one of the national priority outcome areas for the next three to five years. The redesign of PLD will seek to ensure that quality support is available to schools, kura, and Communities of Learning. This includes making sure there are accredited facilitators who can support teachers and leaders to identify and respond to the different learning needs of their students.

The ministry is also seeking to build and strengthen local, regional, and national networks of expertise so that teachers can access timely support to respond to students with additional needs.

**Recommendation**

38 We recommend that the Government require the Ministry of Education to incorporate its work into strengthening professional development and support for teachers, to identify and respond to learners with additional needs, into its existing Professional Learning and Development programme.

Training of specialist teachers

The ministry told us that it takes steps to ensure that there are enough specialist teachers by providing about 200 special education study awards and scholarships each year.

However, the ministry acknowledged that RTLits and RTLBs do not receive explicit training in identifying or supporting students with dyslexia or dyspraxia, and that only some RTLBs have done a specialist course in ASD. Additionally, the RTLit and RTLB groups function with limited cohesion, with each group having different governance and management arrangements.

The ministry advised that the development of Communities of Learning provides an opportunity for schools to group together to share and allocate resources, such as RTLBs and SENCOs. This would mean that resources could be more coordinated and targeted to where they are most needed.

**Recommendations**

39 We recommend that the Government ensure the Ministry of Education makes available professional development for specialist teachers (such as Resource Teachers: Learning and Behaviour, and Resource Teachers: Literacy) and teacher aides to strengthen working relationships, improve role clarity, and build knowledge of inclusive practice.
I.2A SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

40 We recommend that the Government require the Ministry of Education to review the alignment of specialist teaching services (such as Resource Teachers: Learning and Behaviour, and Resource Teachers Literacy services) and other specialist services, within Communities of Learning.

41 We recommend that the Government require the Ministry of Education to investigate and lift the capability of the specialist teacher workforce, including the current capacity and capability of the specialist teacher workforce to support students with dyslexia, dyspraxia, and autism spectrum disorder in schools and Communities of Learning.

42 We recommend that the Government task the Ministry of Education to ensure that Special Education Needs Coordinators’ training and professional development focus on creating a school culture of inclusion, and on providing advice about access to additional services, including assisting with Ongoing Resourcing Scheme applications alongside families.

43 We recommend that the Government require the Ministry of Education to work with Communities of Learning on opportunities to use expertise in multiple schools.
6 Review the implementation of the 2008 New Zealand Autism Spectrum Disorder Guideline recommendations specific to education, to assess the level of progress

The New Zealand Autism Spectrum Disorder Guideline was jointly produced by the Ministries of Health and Education. The guideline was created using evidence-based material from New Zealand and overseas. We wanted to know how the ministry was implementing and using the recommendations in the guideline specific to education.

Submitters’ views

The submissions we received about ASD covered a range of concerns, including the following:

- Teachers and parents need more support and resources to ensure that children with ASD have the maximum opportunity to succeed.
- Parents lack information about how the education system works and how to access support. They also want more support to resolve conflicts at school.
- The initial transition from home/preschool/early intervention to school is very important.
- Parents value inclusive attitudes in schools, but some schools are unwelcoming to students with ASD.
- Teachers’ attitudes and capability make all the difference, but many students experienced inconsistency from year to year. Parents want teachers to work with them, and to know their child as an individual.
- Support for communication and social relationships, sensory strategies, assistive technology, and behaviour support were identified as key areas of focus for students with ASD. Changes to the physical environment, such as quiet spaces and fencing, are valued. Many parents said that they found accessing specialist services difficult and the level of service inadequate, particularly for speech language therapy and occupational therapy.
- Typical learning environments may need to adapt to meet the needs of some children with ASD.

Ministry of Education’s use of the guideline

We heard that, since the ASD guideline was published, the ministry has researched and implemented a wide range of evidence-based interventions in line with the guideline. ASD-specific interventions include More than Words, Tips for Autism, Stepping Stone Positive Parenting Programme, SCERTS, and ASD study awards. These approaches sit alongside specialist services, such as speech language therapy, occupational therapy, and RTLB services, to support students, parents, and educators.

The ministry said that it continues to collaborate with the Ministry of Health to fund Tips for Autism, which is a three-day course for teams that support students with ASD aged 5–12 years. The ministry also jointly funds ASD Plus with the Ministry of Health. This is an initiative to increase parents’ knowledge and skill to support their pre-school children with ASD. Participation in these programmes is voluntary for teachers and parents.

The ministry told us that more students with ASD are now accessing a higher level of support. Overall, the numbers of students verified as having high or very high needs has increased to 8,507 in 2015. Between 2011 and 2015, the total number of verified students increased by 932. The percentage of students verified under criteria 4 and 8 (language use and social communication, including ASD) is increasing. This group now makes up 25 percent of all verified students.

Resources to build teacher capability have been made available online on the Inclusive Education website and on The New Zealand Curriculum Online website. This content includes ASD-specific information for educators, as well as information about inclusion, curriculum planning, progress, and achievement.

ASD-specific study awards are available for a range of educational professionals each year. Resources have also been developed so that ministry teams and RTLB clusters continue to support school staff to access other professional learning development about ASD.

New Zealand Autism Spectrum Disorder Guideline update

The ministry told us that the guideline has just been updated. Although the Ministry of Health has overall responsibility for reviewing the guideline, it is a shared initiative with the Ministry of Education. The Ministry of Education said that it will review its ASD action plan in response to the updated guideline. We were told that the review will seek input from families/whānau, educators, and specialists about additional professional learning and development needs for teachers. We will monitor this review with interest.

Recommendations

44 We recommend that the Government require the Ministry of Education to continue to build sector capability that includes autism spectrum disorder-specific content, inclusive practice, and curriculum planning.

45 We recommend that the Government task the Ministry of Education to review its autism spectrum disorder action plan in response to the updated New Zealand Autism Spectrum Disorder Guideline.

We recommend that the Government task the Ministry of Education to work with parents, the Ministry of Health, and Autism NZ to review information resources for parents.
7  Minority view of Green Party of Aotearoa New Zealand, New Zealand First, and the New Zealand Labour Party

Introduction

The Green Party of Aotearoa New Zealand, New Zealand First, and the New Zealand Labour Party are unable to fully support the select committee report on the inquiry into the identification and support for students with the significant challenges of dyslexia, dyspraxia, and autism spectrum disorder in primary and secondary schools.

Although this inquiry was initiated by the Green Party and selected by this committee, where members fully engaged with the issues, the report recommendations do not fully address some fundamental issues raised by submissions.

This minority view covers the gaps in the report and the alternative recommendations developed to address the clear and consistent messages we heard from the submitters.

The issues we believe have not been fully addressed are issues around children’s rights, funding, equity, and accountability to ensure that inclusion is developed in all schools. The capped competitive funding model is at the heart of the problems identified by numerous submitters through the inquiry, and there is no political will in Government to address it.

We do not accept that the implementation of our recommendations is hampered by Tomorrow’s Schools’ autonomy, as presented to us at select committee. It is our view that the Ministry of Education carries the responsibility to ensure that schools are fully resourced and supported to meet their responsibilities to these students, and that the Tomorrow’s Schools’ model is not the barrier.

We acknowledge the progress we have made and the positive recommendations in the committee’s report; however, the basic assumptions that we cannot afford to remove funding caps for the needs of these children is ignoring the cost of the current model to the health, education, and justice systems. Other countries, such as the United States of America, do not permit capped funding for disabled students’ needs.

The recommendations related to funding from the Green Party, New Zealand First, and the New Zealand Labour Party reflect the underfunding of learner support needs in schools over many years.

Without changes to the Education Act 1989 to strongly enshrine disabled children’s rights to education and a strong directive to fix a broken system, these recommendations fail to address the equity and accountability issues raised.

Recent examples of a hands-off approach to issues such as “seclusion rooms” have not reassured the Green Party, New Zealand First, or the New Zealand Labour Party that urgent action will occur. Extreme situations, such as year-long waiting lists for specialist support, parents paying for extra support in State schools, or a child only receiving one hour of education per day, are not addressed by recommendations which do not require targets or increases to the limited number of those currently in this skilled workforce.
The Green Party, New Zealand First, and the New Zealand Labour Party wish to honour the impassioned submissions of many students, parents, specialists, support groups, and teachers who asked for systemic changes to a broken and inequitable system that fails to provide authentic inclusion. We acknowledge that merely placing a child with special challenges in the mainstream system is not in itself inclusion. We particularly wish to acknowledge the students who were brave and articulate in their contributions and challenges to us at the hearings, and the hospitality of Kāpiti College when we visited their dyslexia class.

We also acknowledge that the committee has been willing to consider a wide range of issues and has addressed some very positively.

**Context**

A disturbing feature of the inquiry was virtually the complete absence of submitters identifying as Māori, Pasifika, or from cultures other than Pākehā. There is no evidence that suggests that these cultures have less learning support needs within our education system, but they were not represented and their needs are therefore not specifically addressed in the report, except to require research into this critical issue.

The failure to recognise the need for urgent action for dyslexic students (although the need was clearly articulated by submitters during the visit to the dyslexia classes at Kāpiti College) is particularly disappointing given the specific focus of the inquiry.

**Content issues**

This inquiry revealed that, for a significant number of students with learning differences, the experience of education is an experience of marginalisation. The experience is not one of inclusion or being taught in a manner that facilitates them to learn. As one submitter said, “how can you teach me if you don’t know how I learn?”.

Despite the Education Review Office target that 80 percent of schools would be “doing a good job” for children with high learning needs by 2014, and research saying 80 percent of schools are now “mostly inclusive”, we heard from many students and their families that they are not all satisfactory. They told us their children’s needs are not properly identified, properly supported, or included in school life, and that the supports are expensive, hard to access, and insufficient to allow them to fulfil their potential. An overriding theme of submissions was the need to pay for diagnosis and support that theoretically is not needed because the schools provide access to these things. The reality is that many schools are simply unable to fund support to the level it is required, and ones that have made this commitment are often skimping on other needs.

We heard a great deal about system failure and the absence of best practice. as well as some concrete examples of what works and what can be described as inclusive practice for these learning differences. The disturbing issue is the gap between how the supports in the system are supposed to work, and how they are frequently inaccessible to families. The assumption of the ministry that 80 percent of schools are inclusive was contradicted by the testimonies from throughout the country that the system is not including all children with learning differences, and unacceptable levels of bullying were mentioned by both students and parents.

As there is no accurate data about how many students have learning support needs and no register of the levels of need, it is very difficult to plan a system that covers this need.
Without this data, the competitive and capped funding system continues to fail Ongoing Resource Scheme (ORS) students and students with moderate needs, as well as students whose families cannot afford additional specialist help that is hard to access unless the families pay for it. We are pleased that the committee is recommending that data collection should be investigated, but we recommend that this is carried out immediately.

We are disappointed that the Government did not accept the Youth Law submission and that of the Human Rights Commission that there is a need to entrench the rights of disabled learners in the Education Act. Such an action is also implied in the United Nations Convention on the Rights of Children (UNCROC) Committee’s 2016 comments about disabled children.

This makes our law considerably weaker than the United Kingdom’s or the United States of America’s laws and means that the human rights of disabled students can be endlessly debated rather than upheld. This is not acceptable.

The inquiry submissions also revealed massive inequities in access to assistance, including teacher aides and specialist support. It is clear that, despite ministry claims, student assessment is necessary to access specialist support and adequate teacher aide hours in a timely manner for students with high needs, and extremely difficult for students with moderate needs, unless the parents pay. Parents are paying for teacher aide hours, after-school coaching, assessment of needs, and speech language therapy, among other things.

The free services are overstretched and inadequate, and parents who can afford it do not wait. For learning needs such as dyslexia (which some schools do not acknowledge), additional support always costs money. Teacher aide hours are not for the whole school day, nor sustained throughout the schooling of some students. A number of families are regularly asked to take their child away from school or told that the school can only manage their needs for one hour per day. The Special Education Needs Coordinator (SENCO) is often part-time and untrained in the specific learning support needs of individual students, so cannot help students and teachers without further professional development.

Reliance on Communities of Learning to address inequities and skills gaps will reinforce the inconsistent picture rather than universalise best practice.

The assumption that the Teaching as Inquiry model is the best way to support these students is debatable when the current inclusion culture is weak in many schools and resources are overstretched. It is our view that there is the need for mandatory Initial Teacher Education (ITE) and professional development supported with centralised funding. Voluntary professional development about learning support is one issue amongst many competing priorities that is not working.

Overall, the inquiry has made some good recommendations, but the systemic problems remain that have been raised by students, parents, teachers, and specialists in a series of inquiries and consultations. The Green Party, New Zealand First, and the New Zealand Labour Party additional recommendations are more concrete and specific for good reason.
Additional recommendations by the Green Party of Aotearoa New Zealand, New Zealand First, and the New Zealand Labour Party

**Recommendation 1** – That the Ministry of Education immediately create a register of students identified with learning differences requiring extra support, so that need can be measured and thereby funded.

**Recommendation 2** – Increase Ongoing Resourcing Scheme funding to 3 percent to meet the actual number of high needs students, and remove the complex application process.

Note: The New Zealand Labour Party is committed to this increase and acknowledges it will be phased in over time.

**Recommendation 3** – Ensure (rather than just consider) an uncapped Intensive Wraparound Services fund, or an alternative effective system of support, to meet students’ needs.

**Recommendation 4** – Provide for moderate needs by increasing the Special Education Grant to meet the actual needs of the identified number of students in each school, annually adjusted.

**Recommendation 5** – That the Ministry of Education adjust the funding model so that schools leading on best practice are financially rewarded, not penalised for their efforts.

**Recommendation 6** – Require the Education Review Office to report on the use of the Special Education Grant in each school, and report to Parliament annually on the adequacy of the Special Education Grant to meet needs.

**Recommendation 7** – Create a nationwide professional development career pathway framework for teacher aides, and centrally fund the wages, to ensure skilled support for students who need it.

**Recommendation 8** – Establish a national qualification and ongoing professional learning and development programme for Special Needs Coordinators with responsibility for the full spectrum of special needs learners.

**Recommendation 9** – That the Government carry out a cost–benefit analysis of an uncapped funding model for learning support needs, which includes quantifying the savings in health and justice sectors if educational needs are met.

**Recommendation 10** – Centrally fund mandatory professional development for teachers on inclusion and working with learning differences.

**Recommendation 11** – That National Standards are not used to identify learning support needs, and that assessments are developed that are relevant to the diverse learning needs of students in schools and early childhood education.

**Recommendation 12** – That the committee advocate to the Minister of Education for a Supplementary Order Paper in the Education (Update) Amendment Bill, with amendments to provide:

- a statement on the purpose of support in education for students with disabilities in line with international law
- clarity on the definition of “inclusive education” and the role of special schools
- the creation of a Code of Practice outlining procedural protections for the support in education for students with disabilities
• for amendments to Section 8 of the Education Act so that reference to section 14 cannot apply to students with high learning support needs

• for an enforceable right to meaningful education.

**Recommendation 13** – That the Ministry of Education engage with peak bodies and educators to assess the level of need and access for Māori, Pasifika, and other cultures, which did not submit to the hearings, and whose issues of equity and access are not being recognised, and then make recommendations to support these students.

**Recommendation 14** – That the Ministry of Education fully fund access to specialists when needed.

**Recommendation 15** – That a national programme for dyslexic education is funded, with a key educational leader assisting schools to develop best practice.

**Recommendation 16** – That Early Intervention Services are available free of charge to families from early childhood education through to age eight years.

**Recommendation 17** – That reasonable criteria be developed so that parents are able to request a free assessment for a learning support need at any time and that schools are resourced for any request within three months.

**Recommendation 18** – That Reading Recovery is not relied upon for dyslexic students.

**Recommendation 19** – That the Ministry of Education assess the gaps, and create a workforce plan to attract and develop specialist services based on the issues identified in this inquiry around cost, waiting lists, and access.

**Recommendation 20** – That the Ministry of Education expand its policy to clearly acknowledge that funded services for speech language therapists will be available throughout the whole of the compulsory school years, where necessary, for the students.

**Recommendation 21** – That the Ministry of Education fund assistive technology when it cannot be covered by schools.

**Recommendation 22** – That the Ministry of Education establish a pilot programme in partnership with the early childhood education sector, initially in a defined area, for the collection and analysis of school entry baseline evidence, expanded to include recently developed early screening tools for dyslexia, dyspraxia, and other challenges, to target staffing and resourcing to meet need and inform practice.

**Recommendation 23** – That the Ministry of Education provide a clear policy to Communities of Learning about how they should collaborate and share resources for best practice, specifically in terms of inclusion of learning support.

**Recommendation 24** – That the Ministry of Education request the Education Council of New Zealand to ensure that the Initial Teacher Education (ITE) curriculum includes education and skills for teaching students with specific learning support needs, with the aim of providers being required to offer a comprehensive education on inclusion strategies and basic familiarity with the range of learning differences.

**Recommendation 25** – That the Ministry of Education creates a pathway for families with students on the autism spectrum, which includes legal rights to inclusion and access to appeal services when needed.
Recommendation 26 – New Zealand First recommends that the Government continue to support true choice for parents of children with severe and multiple challenges that includes easily accessible single-sex residential provision, day school provision, and inclusive mainstream provision, which provides both English medium and Te Reo Māori medium schooling.
Appendix A

Committee procedure

The committee met between 19 August 2015 and 16 November 2016 to consider the inquiry. We called for public submissions with a closing date of 2 October 2015. We received 445 written submissions from the organisations and individuals listed in Appendix D, and heard oral evidence from 194 of the submitters. A subcommittee heard evidence in Wellington, Christchurch, and Auckland. We received advice from the Ministry of Education.

Committee members

Dr Jian Yang (Chairperson)
Catherine Delahunty
Sarah Dowie
Chris Hipkins
Melissa Lee
Tracey Martin
Todd Muller
Adrian Rurawhe
Jenny Salesa
Stuart Smith
Hon Maurice Williamson
Appendix B

Useful resources for parents and educators, referred to in the report

About Dyslexia

ASD Action Plan
September 2010. A Ministry of Education resource that maps out current activities that are funded by the ministry, including parent education, courses for teams, and practical teaching materials. Retrievable from http://seonline.tki.org.nz/ASD/About/ASD-action-plan.

ASD and learning
A guide focusing on areas for specific support and on whole-class strategies that benefit all students, including students with ASD. The website also contains links to in-depth resources and specialist support services. Developed by the Ministry of Education and retrievable from http://inclusive.tki.org.nz/guides/autism-spectrum-disorder-asd-and-learning/.

Assistive technology
May 2016. Produced by the Ministry of Education, this guide includes information about, and an application form for, assistive technology for students with special education needs to use in classrooms to participate and learn. Retrievable from http://www.education.govt.nz/school/student-support/special-education/assistive-technology/.

B4 School Check

Developmental dyspraxia, a resource for educators

Dyslexia and learning
A guide focusing on areas for specific support and on whole-class strategies that benefit all students, including students with dyslexia. The website also contains links to in-depth resources. Developed by the Ministry of Education and retrievable from http://inclusive.tki.org.nz/guides/dyslexia-and-learning/.

Dyspraxia and learning
A guide focusing on areas for specific support and on whole-class strategies that benefit all students, including students with dyspraxia. The site also contains links to in-depth...

Inclusive Education website
A Ministry of Education website providing schools, parents, and students with information, resources, and curriculum materials to enhance teaching and learning, raise student achievement, and advance professional development. Retrievable from http://inclusive.tki.org.nz/.

Inclusive Practice and the School Curriculum

Language and Learning intervention

Literacy Online, Literacy and students with special education needs: dyslexia

The New Zealand Curriculum Online
Ministry of Education website offering information, resources, news, advice, guidance, inspiring school stories, practical ideas, research reports, how to get support, and more. Retrievable from http://nzcurriculum.tki.org.nz/.

New Zealand Autism Spectrum Disorder Guideline, 2nd ed

Reading Recovery
September 2016. Information about the programme, which is delivered as a one-to-one intervention for learners who have low literacy achievement levels. This resource is produced by the Ministry of Education and includes an application form for the programme. Retrievable from http://nzcurriculum.tki.org.nz/System-of-support-incl.-PLD/Learner-initiated-supports/Reading-Recovery.

Resource Teacher: Learning and Behaviour (RTLB) service
Produced by the Ministry of Education, this resource includes information about the service, and links to resources to support the service. Retrievable from http://nzcurriculum.tki.org.nz/System-of-support-incl.-PLD/Learner-initiated-supports/Resource-Teacher-Learning-and-Behaviour-RTLB.
Resource Teacher Literacy (RTLit) service
Produced by the Ministry of Education, this resource includes information about the service, and links to resources to support the service. Retrievable from http://nzcurriculum.tki.org.nz/System-of-support-incl-PLD/Learner-initiated-supports/Resource-Teacher-Literacy-RTLit.

Special assessment conditions

Special Education Early Intervention Service
October 2016. Information produced by the Ministry of Education about a service that provides specialist support for children who have a developmental or learning delay, a disability, a behaviour difficulty, or a communication difficulty that significantly affects their ability to participate and learn at home or in an early childhood education setting. Retrievable from http://www.education.govt.nz/early-childhood/teaching-and-learning/learning-tools-and-resources/early-intervention/.

An integrated system of supports for learners and schools
September 2015. A resource for educators to assist the identification of learning needs, select appropriate resources and support to meet those needs, and design learning processes and pathways. Produced by the Ministry of Education and retrievable from http://nzcurriculum.tki.org.nz/System-of-support-incl-PLD.

Tips for Autism
Jointly funded by the Ministries of Education and Health, this free three-day course is for teams of parents, teachers, and specialists that support students with ASD aged 5–12 years. Retrievable from http://www.tipsforautism.org.nz/.
Appendix C

Glossary of acronyms and terms
ADHD: Attention deficit hyperactivity disorder
ASD: Autism spectrum disorder
CAS: Childhood apraxia of speech
ERO: Education Review Office
IEP: Individual education plan
ITE: Initial teacher education
NCEA: National Certificate of Educational Achievement
NZQA: New Zealand Qualifications Authority
ORS: Ongoing resourcing scheme
PLD: Professional learning and development
RR: Reading recovery
RTLB: Resource teacher: learning and behaviour
RTLit: Resource teacher: literacy
SCERTS: Social communication, emotional regulation, and transactional supports
SEG: Special education grant
SENCO: Special education needs coordinator
SPELD: Specific learning disabilities
TA: Teacher aide
TKI: Te Kete Ipurangi – the online knowledge basket (www.tki.org.nz)

Ākonga: Māori word for “learner” or “student”.

Assistive technology: Helps students with learning differences to improve their writing and reading skills, their engagement with the curriculum, and their social interaction and behaviour. Assistive technology includes devices such as laptops, tablets, specialist software, or hearing loops for classrooms.

Attention deficit hyperactivity disorder: Any of a range of behavioral disorders occurring primarily in children, including such symptoms as poor concentration, hyperactivity, and learning difficulties.

Autism spectrum disorder: A general term for a group of complex disorders of brain development. These disorders are characterised, in varying degrees, by difficulties in social interaction, verbal and nonverbal communication, and repetitive behaviours.
**B4 School Check:** A free voluntary health and development check for all children in New Zealand when they turn four years old.

**Childhood apraxia of speech:** A complex speech disorder that affects control of the movement required for the accurate articulation of speech sounds and intonation.

**Community of learning:** A regional group of education and training providers (early learning, schools, kura, and post-secondary) working together to help students achieve their full potential. There are 148 Communities of Learning spread throughout the country.

**Decile:** A measure of the socio-economic position of a school’s student community relative to other schools throughout the country. Deciles are used to target funding, for state and state-integrated schools, to help them overcome any barriers to learning that students from lower socio-economic communities may face.

**Dragon software:** Speech recognition software that converts speech to text.

**Dyscalculia:** A difficulty in learning or comprehending arithmetic, such as difficulty in understanding numbers, learning how to manipulate numbers, and learning facts in mathematics.

**Dyslexia:** A general term for disorders that involve an unexpected or persistent difficulty in learning to read, write, and spell that cannot be explained by other factors. Specifically, a person with dyslexia has difficulty decoding and encoding print.

**Dyspraxia:** Describes a difficulty in learning, planning, and carrying out coordinated movements in sequence to achieve an objective.

**Early Intervention Service:** Provides specialist support for children who have a developmental or learning delay, a disability, a behaviour difficulty, or a communication difficulty that significantly affects their ability to participate and learn at home or in an early childhood education setting. The service can work with children from birth until they start school.

**Foetal alcohol spectrum disorder:** A group of conditions that can occur in a person whose mother drank alcohol during pregnancy. Difficulties can include poor coordination, low intelligence, behavioural problems, and issues with hearing or seeing.

**Global developmental delay:** A child may be described as having global developmental delay if they have not reached two or more milestones in all areas of development, including motor skills, speech and language, cognitive skills, and social and emotional skills.

**Inclusive education:** This is founded in Part 8 of the Education Act 1989, which states that “people who have special educational needs (whether because of disability or otherwise) have the same rights to enrol and receive education at State schools as people who do not”. At fully inclusive schools, all students are able to take part in all aspects of school life; students’ identities, languages, abilities, and talents are recognised and affirmed; and their learning needs are addressed.

**Individual education plan:** A written plan to support the education of a child with additional learning needs. The plan can include teaching strategies and supports, resources and special equipment, and goals and success criteria.

**Irlen syndrome:** A perceptual processing disorder that causes a problem with the brain’s ability to process visual information.
Irlen lenses and overlays: Coloured screens that are intended to filter out wavelengths of light that inhibit people with Irlen syndrome from processing visual information correctly.

Learning Support Update: A programme of work being conducted by the Ministry of Education to strengthen inclusion and modernise how learning support is delivered throughout the education sector.

Magnet school: A school that attracts students from various areas or groups, especially because it offers specialist teaching or subjects.

Modern learning environments, also called Innovative learning environments: These are more open than traditional classrooms, and can often accommodate more than one class and several teachers. They are often made up of many different-sized spaces, so they can support different ways of teaching and learning, and can be used for different types of activities. They are designed with the right acoustics, lighting, technology, heating, and air quality to support learning.

Neuroplasticity programmes: Focus on strengthening and “rewiring” areas of the brain affected by learning differences.

Parents’ Advocacy Council: Established under the 1989 education reforms to represent parents in the new school system, but later abolished.

Perceptual motor programme: A programme designed to help children with their fine motor and gross motor skills.

Phonological deficit hypothesis: A prevalent explanation for the cause of dyslexia, which attributes a difficulty in connecting the sounds of language to letters because of a structural deficit in the part of the brain associated with processing the sounds of language.

Reading recovery: An early literacy intervention designed to accelerate a student’s reading and writing progress to the average level of their peers, and to identify students who need ongoing specialist literacy support.

RTLB: Resource Teacher: Learning and Behaviour, funded to work with schools, teachers, and Years 1–10 students with learning and behaviour difficulties.

RTLit: A Resource Teacher: Literacy has specialist skills in teaching reading and writing, and works with students experiencing literacy difficulties, and their teachers

Special assessment conditions: Provide extra help for approved secondary students when they are being assessed, so that barriers to achievement can be removed and they have a fair opportunity to achieve credits. Examples of special assessment conditions are the use of a reader/writer or computer, rest breaks, and Braille or enlarged papers.

Special Education Needs Coordinator (SENO): Oversees the day-to-day operation of a school’s special education needs policy. The SENCO can provide advice, as well as coordinate additional support for students who need it.

SPELD NZ: A not-for-profit organisation that provides information, assessment, and tuition to families, whanau, schools, businesses, and individuals living with specific learning disabilities.
Appendix D

List of submitters
ACE Aotearoa
Action Dyslexia Training and Consultancy Ltd
ADHD Association
Adrienne Pallatt
Alena Wafer
Alex Gilks
Alice Mason
Alison Derbyshire
Alison Wardle
Allyson Mary Gofton
Altogether Autism/Parent to Parent
Amanda Drumm
Amanda Nasilasila
Amanda P
Amelia-Jane Brocklebank
Ananda Doornekamp
Andrea Aspden
Andrea Bailey
Ange Genet
Angela Basher
Angela Bensemann
Angela McCluckie
Anna Boyt
Anna Jenkins
Anna Lindroos
Anne Gaze
Anne Smith
Anne Stercq
Annette Bradley
Annie Bretherton
Annie Zhuoni Cai
Anonymous
Ariell King
Asperger’s Connections, Tauranga
Autism Action NZ
Autism New Zealand
Autumn Ede
Babs Theinert-Brown
Barbara Broughton
Barbara Stet
Belinda Walsh
Ben Duffy
Berhampore School
I.2A SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

Berinthia Binnie
Bernadette Reedy
Bre-Anne McDonald
Bronwyn Coppin
Broomfield School
Byrin Malone
Cade Brinck
Calliope Kennedy
Cameron Flude
Carol Webb
Caroline Cavanagh
Carolyn Holmes
Catherine Croft
Catherine Fraser
Catherine Frogley
CCS Disability Action
CDHB Child Development Service
Celeste Littek
Cellfield NZ
Cherie Apers
Cherie King
Cherie Stayner
Cheryl Hoskins-Wilder
Children’s Autism Foundation
Chris Blewden
Christine Cole and Adele Hibbs
Christine Gallagher
Christine Hommel
Christine Thesiger
Claire Dowsett
Claire Hanham
Claire O’Connell
Colin James White
Colleen Shaw
COMET Auckland (Community Education Trust Auckland)
Cordelia Locket
Craig D. Atkinson
Craig Jackson
Danny de Hek
Darlene Warnock
David and Judith Squirrel
David Marra
David Taylor
David Whyte
Debbie Donald
Deborah Tobin
Debra Kenwright
Deidre Senior
I.2A SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

Henry Collette
Hermione Blair
Hobsonville Point Primary
Hugo van Stratum
Human Rights Commission
Ian McKelvie, Bernadette Mellwaine, Norma Humphries, Margaret Sagar, Liz Kane,
Lucinda Dodunski, Kathryn Marsh, Karen Swenson, John and Angela Turkington
IHC
Inclusive Education Action Group Incorporated (IEAG)
Irlen NZ
Jackie Ziegler
Jacqui Scott
James Barber
Jamie Marsden
Jan Wigmore and Andrew Bird
Jane Macgregor
Janelle Bailey
Janelle Wills
Janene Love
Janet Hunter, Liz Kane, and Deb Fitzgerald
Janin Deiconti
Janine Boag
Janine Lee
Jarrod Hook
Jayne Bolsover
Jayne MacDonald
Jayran Mansouri
Jen Cooze
Jennifer Parkinson
Jenny Tippett
Jill Hughes
Jo Moffat
Jo Voss
Joan Roberts
Joanna Hodgkinson
Joanna Kayes
Joanne Newlands
Jodi Mitchell
Jodi Wichers
Jodie Peterson
Jodie Ruth Garrett
Johanne McArthur
John Carrodus
John McKenzie
Jude Bignell
Judy Black
Julia Watson
Julie Utting
SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

Justine Brock
Justine Fletcher and Giovanni Tiso
K Keppel
Karen Avery
Karen Davis
Karen E Jones
Karen Faye Holmes
Karen Holmes
Karen Lusis
Karen Marie Jones
Karen Radich
Kat Gilbert-Tunney
Kate Davey
Kate Spragg
Kath Heather
Katharine Shaw
Kathleen Jestin
Kathy Juriss
Kellie Sherwen
Kelly Cavanagh
Keren Graham
Kerrie Whistler
Kerry English
Kerry Stephen
Kihikihi School
Kiri Scott
Kirsty Christian
Korakonui School
Kristin McKee
Lara Gaze
Lara Lipp
Laughton King
Laura Ellis
Laura Katherine Manson
Learning for You—South Canterbury
Learning Support
Lee Tempest and Brian Humphries
Leigh Ezernieks
Leonie Partridge
Lesley Burkett and Annemie Peeters
Lesley Gray
Lesley Martin
Lewis J Cormack
Liliane Gordon
Linda Bowman
Linda Rowan
L. Shearman
Lisa Gibson
I.2A SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

Liz Taute
Lois McNaughton
Lois Ruth Harrison
Lorreen Hartley
Louise Hayne
Louise Stephenson
Louise Vera Wassell
Luana Aulalo
Lucy Wilkinson
Lynda Woodgate
Lynne Lowery
Lynne Oldham
Mahia Hurst
Maj De Poorter
Malcolm Alexander Croft
Mali Allen
Mandia Mentis
Mandy Bunce
Manukau ASD & Related Disorders Whanau Support Group
Maree Evans
Maree Strange
Margaret Bothwell
Margaret Ereckson and Yvonne Browning
Margaret Hunt
Margaret Sagar
Maria
Marian Galvin
Martin Hales
Mary
Matipo Primary School
Megan Bourke
Megan Hunt
Megan Pickering
Mel Rea and Jackie Allen
Melanie Benge
Melanie Curry
Melanie Dorrian
Melanie Taylor
Melinda Lee E Silva
Melinda McNamara
Melissa Mitchell-Bain
Merlin Clisby
Merryn Giblin
Michael Grigg
Michael O’Keefe
M. Nicholas
Michelle Fitzsimons
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I.2A  SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

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Primary ITO
Professor James Chapman and Distinguished Professor William Tunmer
Puriri School
R. Anne Hoskin
Rachel Fowler
Rachel Mackay
Rachel McCulloch
Rachel Park
Rachel Trimble
Rachel Winter
Ragne Maxwell
Raising Achievement
Rangitoto College
Ravensbourne School
Rebecca Bosco
Rebecca Collis
Rebecca Fraser
Rebecca Hall
Rebecca Mathieson
Richard Belton
Robert John Michael Calder
Robyn Greig
Robyn Harawira
Robyn Joyce
Robyn Stead
Robyn Whitmarsh
Roger Hindle
Rose Gerven
Ross Dunn
Rowan and Maria Williams
Ruakituri School
Ruby Little
Ruth Gibbons
S Anonymous
S. Hartmann
Salisbury School
Sally Neary
Sally Waters
Sam Lane
Samantha White
Sandra Lewis
Sara Baker
Sarah Johnston
Sarah Laing
Sarah Lear
SUPPORT IN SCHOOLS FOR DYSEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

Sarah Millar
Sarah Prebble
Sarah Rose Fugaz
Sarah Sharpe
Sarah Urquhart
Shane McInroe and Roger Marsden
Sharon Thakur
Shelley McMeeken
Shelley Mercer
Sheree Coombes
Siobhan Harvey
Southern Regional Health School
Specific Learning Disabilities Whangarei Inc.
SPELADD NZ Inc.
SPELD NZ
St Therese School
Stasia Jackson
Stephanie Thomson
Steven Crawford
Stuart Trounson and Mary Trounson
Su'Rynn Wong
Sue Bannister and Paul Sutton
Sue X
Susan Anderson
Susan Haldane
Susan Taylor
Susanne Ritzenhoff
Suzanne M. Croft
Tami Harris
Tania Hodgson
Tania Longair and Heather Harvey
Tania Mahoney
Tania Vallender
Tanja Ottaway Parkes
Tansy Sayers
Tanya Coats
Tanya Hampton
Tara O’Neil
Te Marunui Toki
Tegan McIndoe
T. Moore
Terrie Beardsworth
Terry Burrell
Terry Casey
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The Cube—Invisible Disabilities Collective
The Dyspraxia Support Group of New Zealand Inc.
The Dyspraxia Support Group of New Zealand Inc. (on behalf of a parent)
I.2A SUPPORT IN SCHOOLS FOR DYSLEXIA, DYSPRAXIA, AND AUTISM SPECTRUM DISORDER

The Learning Staircase Ltd
The Paediatric Society of New Zealand Developmental Special Interest Group
The Royal Australian and NZ College of Psychiatrists
Tisbury School
Todd Reid
Tom Nicholson
Toni Silvester
Tonya Cruikshank
Tracey Adams
Tracey Reid
Tracey Rountree
Tracey, Sean, and Connor Stevens
Tree Town Early Childcare Centre & Preschool
Tui Foster
Uaina Leuluai
Universities of Auckland and Canterbury, and Massey University
Ursula Edgington
Vanessa O’Sullivan
Vanessa Wood
Vicki Febery
Vicky Devine
Vijaya M.Dharan
W. Therese Eberhard
Waikato Bay of Plenty OMEP Chapter
Waikite Valley School
YouthLaw Aotearoa
Yvonne Culling
Zac Markham
Reserve Bank of New Zealand’s Financial Stability Report, November 2014

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
December 2014

Presented to the House of Representatives
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Reserve Bank of New Zealand’s Financial Stability Report, November 2014

Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Financial Stability Report, November 2014, and recommends that the House take note of its report.

Introduction

The Reserve Bank of New Zealand is required to report twice a year on the soundness and efficiency of New Zealand’s financial system. The following are the main points from its November 2014 financial stability assessment:

- New Zealand’s financial system remains sound by a range of measures, and continues to operate effectively.
- The banking system is well capitalised, with funding and liquidity buffers above minimum requirements. Non-performing loans continue to decline.
- The Reserve Bank has identified four main risks to the financial system: imbalances in the housing market, high indebtedness in the dairy sector, the potential effect of an abrupt slowdown in the Chinese economy, and the banking system’s reliance on overseas funding.
- The balance of the four risks has shifted since the publication of the May financial stability report. Housing market pressures have eased, but global dairy prices are weaker, increasing the risk of loan defaults. Global financial conditions remain relatively benign as a result of stimulatory central bank policies.
- The Reserve Bank has decided not to ease the temporary loan-to-value ratio (LVR) restrictions now because of the risk of a resurgence in house price inflation, particularly in the light of strong immigration.
- The non-bank lending sector has grown modestly in the past 12 months, after shrinking significantly since 2007. There are few signs that this growth has resulted from the LVR restrictions.
- The insurance sector is facing challenging business conditions, including the continuing processing of claims regarding the Canterbury earthquakes. Falling reinsurance costs are however benefiting the property insurance sector.
- Stress tests of the New Zealand banking system have demonstrated that banks have the capacity to manage a range of adverse shocks.
- The Reserve Bank is undertaking a stocktake of the regulatory framework, assessing better ways to measure and define adequate bank capital, introducing a comprehensive stress-testing framework, and re-evaluating its outsourcing policy.
The rest of this report discusses the main issues we considered during our examination of the financial stability report and in our discussion with the Governor of the Reserve Bank.

**Main risks to financial system**

The Reserve Bank reported on the same four risks in its May financial stability report: imbalances in the housing market, indebtedness in the dairy sector, vulnerability to any slowing of the Chinese economy, and the banking system’s reliance on offshore funding. We observed that some of these risks may worsen under current policy settings, and asked about the Reserve Bank’s ability to influence the situation. The governor said the bank has presented its views publicly on a number of matters related to these risks, including the need for housing supply measures, and diversification of our export markets and export products. It has also commented that the exchange rate is overvalued.

**Housing market and mortgage lending restrictions**

We asked about the success of the LVR mortgage lending restrictions, noting that although planned as a temporary measure they have been in place for 12 months and it is not yet proposed to lift them. The Reserve Bank considers that the policy has been successful; since the restrictions were imposed average house price inflation has fallen from just under 10 percent to around 5 percent.

In Auckland house price inflation has halved from around 17 percent to 8.5 percent. In September 2013 house prices in Taranaki, Nelson, Hawke’s Bay and Otago increased by an annual rate of 6 to 8 percent. We heard that had the LVR restrictions not been introduced in the environment of low interest rates, housing shortages and a growing economy it is likely that house price inflation would have increased quite considerably, along with aggressive lending to people with low deposits. We were told that the LVR restrictions are more likely to be phased out than removed in one stroke.

The current surge in immigration is of concern because, among the many factors that influence housing market conditions, migration has been closely correlated with house price inflation in the past. New Zealand had its highest ever net inflow of around 46,000 people for the September 2014 year. The Reserve Bank therefore decided not to ease the LVR restrictions at present because of the risk of contributing to a resurgence in house price inflation.

**Effect on first-home buyers**

We asked how the policy has affected first-home buyers. Data analysed by CoreLogic, a company that provides property information, indicates that over the last 10 years first-home buyers accounted for 19 percent of house sales. That has fallen slightly to around 17 percent, while the total number of house sales is about 12 percent lower than when the policy was introduced.

We discussed the sources of funding for first-home purchases, and heard that it is difficult to get reliable estimates of family financing for property purchases. However, the bank has not seen evidence of a big increase in non-bank lending for housing.

We asked whether the Reserve Bank is concerned that investors account for 45 percent of annual house sales, according to a New Zealand Institute of Economic Research paper on housing. The governor said he has been thinking quite deeply about whether measures are needed to discourage investors who buy multiple houses. The Reserve Bank is exploring
this further after receiving feedback from financial service providers and from real estate agents and investors on a consultative document it produced earlier in the year.

We asked how such measures might be formulated. We heard that the Reserve Bank would be more likely to categorise a borrower as a residential investor on the basis of the proportion of their total income that comes from their property portfolio rather than on the basis of the number of houses they own.

**Effect on regional property markets**

We asked about the impact of the LVR restrictions on regional property markets, given that Quotable Value has reported that in the past 12 months 27 local authorities recorded a fall in average house prices, nearly a third more than in the year before. The governor told us the impact of the LVR restrictions has been spread throughout the country, with house sales down about 12 percent nationwide. We heard that the many reasons for regional house prices movements include the cost of financing, supply and demand, and local job opportunities.

**House prices in New Zealand**

On average New Zealand’s house prices are high relative to incomes or rents, historical benchmarks, and international measures. Research conducted by the International Monetary Fund last year found that the house-price-to-income ratio was 65 percent for New Zealand as a whole. Only Norway had a slightly higher ratio, and in most comparable countries it was considerably lower.

In October 2014 Standard and Poor’s conducted an assessment of risks in New Zealand’s banking system, concluding that banks here would face increasing economic risks if the growth of house prices is not slowed down in an orderly way in the next year. The Reserve Bank considers that increasing the housing supply is critical to improving balance in the housing market.

**Housing in Auckland**

We note that the governor called the Auckland housing market overvalued, but said he would not describe it as a bubble. He acknowledged that the combination of a housing shortage, the lowest mortgage rates in 50 years, and a rapidly increasing population due to immigration have given house prices momentum. Had the bank not introduced the LVR policy last year when house price inflation was 17 percent and expected to climb to above 20 percent, a bubble would have been a real risk. Also, a bubble is typified by increasing leverage (debt relative to the assets in question). We heard that over the past year leverage has fallen.

We asked the governor why he thinks so few houses have been built in Auckland despite thousands of consents being granted since the Government’s housing accord with Auckland Council was signed. He said the slow progress was down to infrastructure development costs and delays in the consenting process, but that the Productivity Commission is investigating these factors and will report on them and potential solutions.

**Property purchases by non-residents**

Although limited data is available on house purchases by non-residents, the Residential Market Survey provided by the BNZ and the Real Estate Institute of New Zealand in March this year found that 9 percent of purchases were by people from overseas. Forty percent of such buyers said they intended to move to New Zealand, suggesting sales to
people not intending to live here amounted to around 5 percent. Eighteen percent of the total number of sales to non-residents were to people from the United Kingdom, 15 percent from China, and 14 percent from Australia. Some of us believe that there should be a register of land and house ownership, and would encourage the Government to establish one.

**Interest rates and the exchange rate**

Regarding the outlook for interest rates, we heard that despite four increases in the OCR this year, interest rates are still low in New Zealand by historic standards, and continuing to provide stimulus to the economy. Some of the committee members dispute this. The Reserve Bank judges that a neutral OCR would be about 4.5 percent, rather than the present 3.5 percent. Without the LVR restrictions the Reserve Bank believes it would have had to raise interest rates earlier and more steeply than it has done, putting more pressure on the exchange rate. The exchange rate in future will depend to a large extent on what happens to the US dollar, which is potentially at the start of an appreciation cycle; historically such cycles last for four or five years. However, meat and dairy prices will also be an important influence.

**Falling milk prices**

The forecast dairy payout announced by Fonterra for the 2014–15 season of $5.30 per kilogram of milk solids (excluding dividends) is well below that for the previous season of $8.40. We discussed how this will affect farmers, since DairyNZ estimates that about a quarter of farmers could struggle to meet interest payments and working expenses. We heard that the sector as a whole appears to have acted prudently and used last season’s record payout to reduce debt. The lower payout has been signalled well in advance, and financial conditions for most dairy farms are likely to remain manageable. Financial pressures would mount, however, if reduced payouts were to continue for several seasons.

**Financial sector regulation**

As signalled in the previous financial stability report, the Reserve Bank is undertaking a stocktake of the regulatory framework for banks and non-bank deposit-takers to check that the prudential requirements are operating efficiently and consistently, and not imposing unnecessary costs. It plans to consult publicly in mid-2015, and to complete the review about September of that year. We learned that it will also use the exercise to explore ways of improving the Reserve Bank’s process for introducing or amending prudential requirements.

**Outsourcing requirements**

The Reserve Bank is also embarking on a fundamental review of the policy it applies to the outsourcing of activities by large banks. The policy is designed to reduce the risk of any failure of an outsourced function causing interruption to a bank’s operations. The bank considers it good practice to review and consult on the policy, considering such issues as the legal and practical controls banks should retain over their outsourced functions.
Appendix A

Committee procedure
We met on 12 and 26 November 2014 to consider the Reserve Bank of New Zealand’s Financial Stability Report, released on 12 November 2014. We heard evidence from the Governor of the Reserve Bank, and received advice from our independent specialist adviser, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Stuart Nash
Dr Russel Norman
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Corrected transcript of hearing of evidence 12 November 2014

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Dr David Clark
Kris Faafoi
Paul Foster-Bell
Rt Hon Winston Peters
Alastair Scott
David Seymour
Phil Twyford

Witnesses
Graeme Wheeler, Governor, Reserve Bank of New Zealand
Grant Spencer, Deputy Governor and Head of Financial Stability
Bernard Hodgetts, Head of Macro-Financial Department

Bennett OK, welcome, Governor. We’ve got a few new members of our committee, especially on the National side, so perhaps if in your introductions you just want to acknowledge members of the team, so they can be aware of them. We’ve got a few substituted members on the Labour side at the moment, but they’d appreciate that welcome as well. So thank you for coming to the committee, and we look forward to hearing what you’ve got to say.

Wheeler Well, good morning and thank you for the invitation. [Introductions] Perhaps, just a few opening comments, if that’s all right. New Zealand’s financial system remains sound, the banking system is well capitalised, funding and liquidity levels are about the minimum requirements, and the volume of non-performing loans continues to decline. Stress tests of the major bank portfolios indicate that the banks have capacity to manage various shocks. We believe that the financial system faces four key risks, and we reported on these in the May Financial Stability Report, but we feel that the balance of risks have shifted in the last 6 months. If I very briefly go through those, first, the housing market. Pressures in the housing market have eased since the introduction of loan-to-value ratios and the rise in interest rates. We’ve always indicated that the loan-to-value restrictions are a temporary measure, and we welcome the reduction in house price inflation, the decline in the growth of housing credit, and the increased residential building that is taking place. But there remains a risk of resurgence in house price inflation, especially with the strong immigration flows, and, consequently, we don’t believe that it’s the appropriate time to ease LVR restrictions.
The second risk we identified is the risks in the dairy sector, and these have increased. If the lower payout levels persist, we could see some increase in loan defaults. The third risk is the continued risks around New Zealand's vulnerability to a slowdown in the Chinese economy, and we see that, of course, with their recent pricing, particularly since February, in respect of whole-milk powder and also log prices. And the fourth risk we talk about is the banking system's reliance on offshore funding. This has decreased in recent years, but banks do remain susceptible to volatility in international funding markets.

So, thanks very much. Happy to take any questions.

Twyford Thank you. Mr Wheeler, you seem to be saying that LVRs have been a success, but not successful enough that they can be lifted at this point, even though you've always said that they would be a temporary measure, and they've been in place for 12 months. Is that a fair characterisation?

Wheeler I think that's fair. We do see them as successful. House price inflation for the country as a whole has fallen from just under 10 percent to around 4.9 percent at this time. Auckland house prices have halved, in essence, from around 17 percent to 8.5. Now, not all of that's due to the loan-to-value ratios—some of that's due to the rise in interest rates—but our concern, in essence, lies around the migration flows. I mean, I think all the forecasters—and ourselves included—who have forecast migration have under-forecast it in the last 2 years. I mean, if you go back 2 years ago, net migration flows were around zero, and they're around 46,000 at the moment on an annual basis. And if you look at housing cycles in New Zealand, you see quite a strong correlation between migration influences and the house price cycle. So, if you go back to our last cycle, which started in 2002, migration played a very significant part, in particular in 2002-03. Now, that cycle led to the highest rate of house price inflation in the OECD over the period 2003 to 2007, so we're just monitoring what's happening with the migration flows at this stage.

Twyford The aggregate figures on house price inflation basically mask a two-track housing market, and I'm sure you've seen the heat map that shows that pretty much 99 percent of house price inflation's coming out of Auckland and Canterbury. So while, yeah, the national average is down, in large parts of regional New Zealand they're facing steep declines in property values, and in Auckland, in the last 12 months I think, it's a $62,000 increase in the average house price and a 9 percent increase. How can you say that LVRs have been a success when Auckland house prices have gone up $62,000 on average while LVRs have been in place?

Wheeler Well, I think if you look at house price inflation in Auckland, as I said, it was running at an annual rate of 17 percent. It's now running at an annual rate of around 8.5. Now that's taking the last 3 months over the same 3 months a year before. If you, in fact, took the last 3 months and annualised it, for example, then you would see even lower rates of house price inflation in Auckland. When we put the LVRs on, it wasn't just Auckland and Christchurch that we were worried about. I mean, we had an economy that was starting to grow quite rapidly, we have the lowest mortgage rates in 50 years, we saw very
substantial supply imbalances in key parts of the country, and, you know, you started seeing—if you take September last year, in places like Taranaki, Nelson, and Hawke’s Bay, and Otago you saw house price inflation rising at 6 to 8 percent on an annual basis at that time. So it wasn’t just an Auckland or Christchurch thing.

Twyford Have you calculated how many first-home buyers have been shut out of the market by LVRs?

Wheeler Well, CoreLogic, which is an information company in the housing sector—they’ve done quite a lot of work looking at who are the house purchasers in terms of house sales. And if you go back over the last 10 years, say, to 2005, and you look at what proportion of house sales the first-home buyer’s taken, it averages about 19 percent over that last decade—19 percent of sales go to first-home buyers. We saw that spike up a little bit around September of last year when the LVRs were being introduced, but that ratio is currently 17 percent. But it’s down from the 19 percent average over the last decade—it’s now running at around 17 percent—but what you have seen is a reduction in the volume of house sales. The house sales are down, say, 13 percent compared to where they were a year ago. So that’s down for everybody, but the proportion that go to first-home buyers are—as I say, for 10 years was averaging 19 percent, and it’s currently around 17 percent.

Twyford Is it a concern to you that, I think, the same data suggests that speculators account for 45 percent of all property purchases, compared to 19 percent for first-home buyers?

Wheeler I’d have to check that.

Witness It’s 40.

Wheeler My colleagues say it’s around 40 percent.

Twyford I think that NZIER’s presentation of CoreLogic data has been published at 45 percent. And there is a great deal of commentary and analysis around that suggests that one of the principal effects of LVRs has been to clean out first-home buyers out of the market, essentially giving speculators a free hand. Is that a concern for you?

Wheeler Well, as I’ve said, the proportion of sales that have gone to first-home buyers have declined about 2 percent as a share of the total. The issue is also around people who invest and buy multiple houses, and we have been thinking quite deeply about whether we need to introduce measures, in fact, to discourage some of those practices. Now we went out with a consultative document earlier in the year on that, got a number of views from the financial markets and from the realtors and investors, and we’re currently exploring that in-house.

Twyford Why has there been a delay with that?

Spencer This is part of our overall assessment of risk weightings in the prudential regime, so it’s not a particular reaction to the particular volume of investors in the market right now. The consultation we had over recent months—there’s differences between the banks in terms of how they handle the capital
adequacy requirements for investors, how they categorise them, how they measure them, and we’re just trying to get it right before we change the policy, but I would not characterise that as a macro-prudential measure. This is part of our micro-prudential regime, and we’re in discussions with the banks. It’s not a new development.

Twyford Why such sort of delicate and lengthy consultation with the banks? I seem to remember with LVRs that you basically sent them a press release. Is that right?

Spencer No, that’s not right. We had a consultation with the banks.

Wheeler That’s not correct. I had two meetings with all the chief executives of the banks. We discussed the concerns that we had in the housing market. We also gave some on-the-record speeches in the months leading up to this.

Peters Quick supplementary—when you say “we consulted with the banks”, what’s your description of what the word “consultation” means? Does it mean that you talked to them before you made up your mind, or you made up your mind and then you talked to them?

Spencer We talked to them before we had come to a decision. That’s the point of consultation—in fact, we are required to consult under our legislation. So we have to consult with them to work towards the best solution in terms of how a particular regulation will work.

Twyford I seem to remember reading that you were considering an income-based formula rather than a number-of-properties formula. Does that mean a percentage of income, or can you tell me what that alternative might look like?

Spencer It’s really, you know, when do you categorise a borrower as a residential investor, and we’re saying that may be on the basis of the proportion of their total income that’s coming from their investment portfolio in their total income as a definition, as opposed to just a number of houses—like having more than 5 houses.

Twyford Would that not potentially risk penalising first-home buyers more than rental investors, because the rental investors, presumably, are going to have a much bigger income?

Spencer No, it’s a proportion of your total income that is coming from the property portfolio, relative to your other income.

Twyford I wanted to ask about the effect of LVRs on regional property markets outside Auckland and Canterbury. QV report that in the last year under LVRs, 27 local authorities have experienced a fall in average prices. That’s seven more than in the year prior to LVRs coming into force. What research have you done—what data have you been able to generate on the effect of LVRs in those regional property markets, many of which had stagnant or declining prices already, and many commentators think that that decline has been accelerated by LVRs?

Wheeler I think there’s many reasons why house prices move at any point in the cycle—to do with the cost of financing, it’s to do supply issues, it’s to do with the flows in and out of a particular town and job opportunities, and the like. As I said, you know, we saw house price inflation increasing in areas other than
I mentioned the four places which had growth over 6 percent. Even now, you’d find places like Taranaki and Central Otago, where house price inflation is going at around 5 or 6 percent. If you look at the LVRs and the impact of LVRs, by and large, from the research that we’ve seen, its impact has been fairly spread over the country in terms of—if you look at the volume of house sales, they’re down about 13 or 14 percent compared to a year ago. They’re down slightly more than that in Auckland, but close enough, and throughout the country as a whole it tends to vary a bit around 13 percent. So it has been fairly spread.

The places like the rural Waikato region, the fair north, Southland, who have copped really substantial decreases in average house values over the last 12 months—do you accept that those falls have been accelerated by LVRs? And, if so, are you concerned by that because of the wider economic impact on those regions, that are already struggling because of the cuts in the dairy returns and any number of other factors?

I think it’s fair to say that LVRs have had an impact in not just Auckland and Christchurch but throughout the country—I think that’s certainly fair. The question is, if you look at house prices in New Zealand as a whole—right; I’m taking New Zealand as a whole—then by international standards and historic standards, historical New Zealand benchmarks, then they certainly look highly priced—like, the OECD has done quite a lot of work on this in terms of house-price-to-income ratios and house-price-to-rent ratios. The IMF did some work last year looking at house-price-to-disposable-income ratios in New Zealand and found that they were 65 percent, for New Zealand as a whole, above the historic average. Now, the only other country that was anything like 65 percent is Norway. Most of the advanced economies had nothing like that sort of outlying price result, if you like.

If you look at materials, say, for example, produced by Standard and Poor’s, that did an assessment of risks in the New Zealand banking system—they did it last month—basically, they said the outlook for the economic risks facing the New Zealand banks—let me just quote—“the trend for the economic risks faced by New Zealand banks is negative with significant house price growth and New Zealand’s external risks … We believe that economic risks faced by the banks in New Zealand would increase if an orderly slow-down in the real house price growth is not achieved in the next one year.” Now, that was Standard and Poor’s writing that just a month ago.

Governor, I must admit I’m struggling with that line of questioning because I think we’d all accept that having high house price inflation is not a good thing, particularly for first-time buyers, so what has obviously been achieved with the LVRs coming into play over the last 12 months, we’ve seen a decrease in house price inflation, quite significantly, across New Zealand as well as in Auckland and Christchurch. So, to me, I’m struggling with why we’re particularly concerned about LVRs, specifically when you’re talking about, we’re still achieving a 17 percent number of people getting new homes against the long-term ten year average of 19. So we’re in the ballpark—so we’re achieving those outcomes. The question I’ve got for you is if we hadn’t put an LVR in place, what would’ve been the estimated of house price inflation? Now, I note in
your May 2014 report you said that without the LVRs, you assess that the increase in house price inflation would have been about 2.5 percent. Have you got a more current view on what the impact is—a favourable impact, it must be—in terms of reducing house price inflation?

Wheeler The situation we faced when we introduced the LVRs was that we had the lowest mortgage rates in 50 years. We also had pent-up housing demand and a number of supply shortages in key parts of the economy, and we looked as if we had the potential to have high house price inflation for a considerable period. Now, those house shortages were predominantly in Auckland and Christchurch, but the risk was that we could see house price inflation carry on for many years, and we also saw banks competing very aggressively to lend to people with low deposits—so, for example, the share of mortgage lending to people with deposits less than 20 percent reached around 33 percent. About a third of the total lending generated by banks, which is roughly, I think, mortgage lending is about $4 billion a month or $5 billion a month—about a third of that was going to people with low deposits. So a lot of aggressive lending. Had that continued and had the supply shortages continued, and with low interest rates and an economy that is growing at 3.5 percent at this point in time, I think it’s probably fair to say that house price inflation would have increased, possibly quite significantly, from the 9.8 percent that it was running at. My guess is—and it’s based on some of the analysis we’ve done—that the impact of the LVRs has probably been a bit more than 2.5 percent in terms of reducing overall house price inflation.

Clark The four key imbalances that you’ve highlighted have been themes for a while—the housing market, the indebtedness of the dairy sector, our exposure to the Chinese economy, and our reliance on offshore funding. All of these things are pretty much expected to get worse under current settings. Our exposure to China is growing year to year, week to week, pretty much; our exports have actually dropped relative to GDP; and the housing market—you know, it’s what we’ve obviously been debating now. Surely at some point we might hope that the Government would stop doing the same thing and expecting a different outcome. What ability do you have to encourage the Government to consider different options, and is it sufficient, in your view?

Wheeler Well, I think we have been on the record a lot talking about the need for greater housing supply. If you take the volume of house permits and building permits in Auckland, they are running, I think, at around 7,400 a month. That’s double where they were in 2011. But, you know, if you look at the projections of the Auckland Regional Council, they basically say we need 10,000 houses a year for the next 30 years. Now, the Government’s, you know, put a lot of pressure on the Auckland Regional Council to open up—fast-track, basically—special sections—I think there’s about 40,000 at this point—but there’s been very little building done on those at present. But we’re frequently on the record talking about the need for supply-side measures in terms of the housing market. Some of the approval processes that seem to be in some of the councils—particularly in Auckland—I think are a major concern. We’ve been on the record talking about the need for diversification of our export markets and our export products. We’ve been on the record saying that the exchange
rate is overvalued. We believe it’s unjustified and unsustainable. We’re pleased
that the exchange rate against the US dollar’s come down 12 percent; TWI has
come down 5 percent, but we are on the record on a lot of things that are
related to the risks that are here.

Clark So I guess that’s true, and you are speaking out on those things. Yeah, I guess I
watch in frustration as the export to GDP ratio drops rather than rises in terms
of value and the increasing focus and exposure to China and also all our eggs
being in the dairy basket, and it feels to me like the Government’s not
listening. You probably don’t feel at liberty to comment on that, but I guess
what you’re saying is you’re putting those concerns on record, and that’s the
extent of what you can do now.

Bishop Bearing in mind the LVRs—which I think you commented this morning at
your press conference you think have had an effect on the OCR of staving off
an increase by about 50 basis points—so bearing in mind that the LVRs are in
place, albeit a temporary measure, could you provide some commentary on the
prospect of interest rates remaining lower for longer over the economic cycle,
compared to the previous cycle?

Wheeler I mean we have raised interest rates four times and then we wanted to step
back and assess the impact of the interest rates on the economy, and we
indicated that several months ago. The interest rates are still at a low level here.
You might say, well, they’re high compared to Europe or the States, and it’s
true that countries that make up two-thirds of world output have interest rates
close to zero, but an OCR rate of 3.5 percent is still low by historic standards
here, and we would still argue based on the analysis that we’ve done that it’s
still an expansionary stimulus to the economy. We think what we call the
neutral rate of interest is possibly around 4.5 percent—it’s that rate of interest
at which monetary policy is neither expansionary nor contractionary—so at 3.5
we still believe we’re providing stimulus to the economy. Now, if we hadn’t
have had the LVRs, we would have had to have raised interest rates earlier and
more steeply than what we have done to date, and we believe that that
would’ve put more pressure on the exchange rate. Now, the decision to not
ease the LVRs at this point in time was not taken because of issues around
monetary policy or the exchange rate; it was taken because of the risks that we
see about the resurgence of house price inflation. Having done so much work,
in essence, to get house price inflation down, we didn’t want to see it picking
up again.

Peters Look, why would interest rates and the OCR be judged by historic standards
when usually you’d compare it with the current world in which you’re existing
and the circumstances that pertain at the time? Because you did say we’ve got
the lowest interest rates in 50 years, hence in most of the world that’s not true,
is it? Comparatively—money being an international commodity—it’s the
highest we’ve had for 50 years.

Wheeler No, the differential between New Zealand and, say, advanced economy interest
rates is not the highest in 50 years, but it is fair to say that what matters in
terms of capital flows is the interest rate differential, and we’ve been very keen
to see the exchange rate come down.
Peters Well, keen’s one thing but 12 percent when it was massively inflated, according to the IMF and everybody else, is hardly a success story, is it?

Wheeler Well, 12 percent—I mean, it’s a very good question. What will matter a lot in getting the exchange rate down will be what happens to the US dollar. One issue is whether the US dollar is at the start of an appreciation cycle. Now when you look back in history with sort of movements in the US exchange rate, you often find that these appreciation cycles last 4 or 5 years. Now, time will tell whether we’re at the start of that sort of cycle. We’ve moved 12 percent against the US dollar, but, having said that, you know, our whole-milk powder prices are down 48 percent since February. But there’s a bit more than that to that as well, because, you know, you look at what’s happened to beef prices and meat prices. They’re a different story, but dairy’s still a third of our merchandise.

Peters And is the Auckland housing market a runaway speculative bubble, or how would you describe it?

Wheeler I think when you have such supply shortages that are there—and estimates vary about whether that supply shortage is 5,000 to 10,000 houses or out to something like 30,000 houses; there are different views about that, but no one, I think, doubts that there’s a housing shortage—and when you then have the lowest mortgage rates for 50 years and you also have a rapidly increasing population, particularly given the migration flows, then it’s inevitable that you’re going to get house price momentum. I don’t think it is a bubble at present, at 8.5 percent. I think we ran the real risk of a serious bubble had we not introduced these measures back over the last year. At that point house price inflation was running at 17 percent in Auckland; I think it would have got well above 20.

Peters So it’s definitely—in your words—not a bubble, then?

Wheeler Not at present in terms of a rate of increase, but if you said to me: “Are house prices overvalued in Auckland?” I would say: “Absolutely.”

Peters Well, how much above evaluation would it be required to be for you to describe it as a bubble?

Wheeler I guess there’s two ways to think about the bubble in a sense. Most people think about a bubble in terms of the rate of increase that’s happening at any particular time and what degree of momentum is there, and so that’s why I was referring to house price inflation now at 8.5. I think without these measures it was 17, and I think it would have gone above 20, and then I think in terms of rate of increase you’re in bubble territory. In terms of the level of house prices, that’s been building up for a long, long time.

Spencer Just on that—another characteristic of a bubble worldwide is increasing leverage; increasing debt relative to the assets in question. Right now we have—and over the past year we’ve had—reducing leverage. So that’s another reason why we would not call it a bubble.

Seymour Mr Wheeler, I’m curious about this figure of 19 percent average first-home buyers over the past decade; now 17, but you also said that’s off a smaller base. Do you have the absolute figure comparison?
Wheeler There’s a graph in the report. The source of the data is an institute called CoreLogic, and they looked at the average, which is the 19 percent since 2005. The 17 percent is what it is currently. The reduction in volumes—house sales volumes—is currently down about 13 percent, for the year.

Seymour So, it’s a bit of a drop. So then the next question is around the composition of that group of first-home buyers. Certainly what we’ve seen over the last decade, and especially more recently in the last few months, or the last year, is more and more people making first-home purchases when they have parental assistance to do it, and so you actually start to see almost a hereditary element to property ownership. I don’t know if that’s something that the bank should worry about, but have you tried to measure the source of funds that people are using for first-home purchases?

Hodgetts It’s obviously difficult to get reliable estimates of family financing for property purchases. The one thing I would say is that we have seen very little leakage, if you like, from the banking system through to non-bank lenders, so we haven’t seen a big increase at all in non-bank lending for housing. So I think overall we feel that the LVR restrictions have had an impact in terms of reducing demand—that we haven’t seen that financing occurring through other channels to a great extent.

Seymour Well, that kind of segues into the next question I have. There’s this question that’s sort of been danced around by the committee. Some of the slowdown in house price inflation is claimed to be due to the LVR; some of it due to the increase in interest rates from a 50-year low. So, you know, you’ve said at one point that you think LVR has knocked 2.5 percent off the total nationwide average price. Is that in the report? So, I mean, is there any kind of attempt to objectively measure, you know, what the effect is of different factors, including LVR? Because if we don’t know exactly what proportion LVR’s responsible for, it could be zero.

Hodgetts We have undertaken quite a lot of analysis of this, and I think we published that analysis, probably 3 or 4 months ago, which detailed the various influences that we’ve seen operating on the housing market and our estimate of the impact that LVR restrictions have had relative to a situation where we hadn’t put them into place. So we’re sort of modelling where we think house price inflation, for example, would have gone in the absence of LVR restrictions and then taking the difference between where they actually did go and where they might’ve gone, and that estimate, I think, was around 2.5 percent. Obviously, as you get further away from the point at which you introduced LVR restrictions, because there’s so much other stuff happening, it becomes harder and harder to get sort of definitive estimates of the impact, but we certainly feel that there has been a reasonable significant impact in the first year.

Seymour One last question. You’ve effectively made a decision for the institutions about their lending practices—nominally, what their portfolio looks like—by introducing an LVR. Is this new territory for the bank? Does that potentially open the bank up to some sort of liability in the future, having influenced the way that banks behave?
Spencer Well, you’re right, it’s a new policy. When we brought in the macro-prudential framework, it’s not something we’ve had before. It’s a development which we’ve seen in a number of countries in recent years, and, you know, we thought it was appropriate. We brought in a tool kit, we have a memorandum of understanding with the Minister on how we develop the policies, but we feel it complements our traditional prudential policy. We think it’s been effective, and we don’t see that we have particular—I’m not sure of the nature of your question, but — a liability coming out of this. This is part of our job.

Scott Governor, you’ve talked about the bubble of the mid-2000s compared to this rise, and you’ve described this rise in prices as not being a bubble because it seems you’ve got more tools—you’ve got the LVR as well as interest rates— and you’ve tried to put a number on the LVR component. How important is this increasing of supply of houses that’s occurring and consenting giving you confidence that this is not a bubble?

Wheeler I think what’s critical, given that I cited the IMF research just a moment ago in terms of to what extent our house price to income ratios varied from the historic averages—and 65 percent is a big alignment—a misalignment, if you like—compared with history. What’s absolutely critical is that we get housing supply increased in the country. You know, it’s encouraging, as I say, to see what’s happening in Auckland with the increase in housing permits, but it’s still a long way short of where it needs to be. There’s a lot of housing starting to get under way in Christchurch. That’s important, but I think we really need to see a much stronger supply-side response if we’re going to get greater balance into the housing market.

Peters You referred to the debt ratios in housing. The question is, you give the view that you’re looking at the whole country, and I want to know what is your data on residential property purchases by a non-resident non-citizen in informing of the understanding of the market, and if you haven’t got that information, how can you talk about debt ratios in a concrete way when there are substantial parts of the market where you’ve got no understanding of the debt ratio at all? Is that true or false? “I’m not a resident, I’m a foreigner. I’m buying in here.”—what do you know about his debt ratio?

Wheeler What I would say is we think most of the foreigners that are buying here are basically people who, by and large, have deposits over 20 percent. Now, you know, the—

Peters Sorry, why do you think that?

Wheeler Why do I think that? The first issue is, what do we know about the degree of foreign buying in New Zealand? And, you know, there’s not enough data on that, I think, is point No. 1. Point No. 2 is there was a survey that, unfortunately, has been discontinued. It was done by the BNZ and REINZ—Real Estate Institute of New Zealand—and that basically said that 6.5 percent of the buying was taking place from offshore. Now, the 6.5 percent includes expat New Zealanders and people who may well be intending to shift to New Zealand. So that 6.5 percent of the total sales taking place are from buyers from offshore. A quarter of those buyers—according to the survey that’s been discontinued, but a quarter of those buyers— were said to be of Chinese
origin, about a fifth were Australian, and just over a fifth were from Europe or the UK. So that’s probably the best information we’ve got about foreign ownership.

Peters  I don’t recall the figure being that low, with respect, when the BNZ and REINZ were running that. It was a much higher figure that they were speculating on. You say it’s 6 percent.

Wheeler 6.5 was the—

Peters  Well, when—what year are you reciting?

Wheeler  I think they discontinued the survey earlier this year.

Peters  So you’re reciting earlier this year?

Wheeler  Yes.

Peters  All right. Well then, what analysis do you have of the impact of immigration on the Auckland housing market, in particular, and, if it remains at net migration 46,000, are the LVRs going to stay on, and on and on, until somebody addresses that issue?

Wheeler  Well, we’ve said we want the LVRs to be a temporary measure. LVRs have been introduced not normally in the form of a speed limit, in the way we’ve introduced it, but they have been introduced in 25 countries. And if you look at, you know, the experience of those countries, they tend to keep them on and they become a permanent feature. In terms of the migration flows, you know, something like 80 percent of migrants indicate that they want to stay in Auckland or will settle in Auckland. To what extent people have then moved on to Canterbury and into the building sector, where—we’ve got some anecdotal evidence on that, but, you know, we don’t have strong data. But, you know, we want to remove these LVRs, or phase them out—it’s probably more likely that we would phase them out than remove them in one hit—but we would like to be in a position to be able to start that process, but we really don’t want to start that process if there’s a risk that house price inflation just starts increasing rapidly.

Peters  Just one question, that’s it. On the question of—

Bennett  Kris Faafioi now.

Peters  Well, I can’t just—

Bennett  No, we’re running out of time. Kris—

Peters  Thanks, Mr Faafioi. On the question of guaranteeing Government deposits, I see you’re pretty strongly opposed to the guaranteeing of bank deposits. Do you rule out totally the idea of deposit or savings flight from this country because of your policy of failing to guarantee banking deposits to a level or a specific level?

Wheeler  I don’t see that as a major risk.

Peters  You rule it out, totally?

Wheeler  I don’t see that as a major risk.
Peters  But I’m asking you—do you rule it out? But it’s likely to happen.
Bennett  Mr Peters, it’s Kris Faafoi.
Peters  But I want to know what the level of risk is.
Bennett  Kris Faafoi, you’ve got a question?
Faafoi  Can I start with LVRs. Given you’ve had some time to do some analysis, who
do you think has benefited most out of it: the first-home buyer or the property
investor?
Wheeler  Well, as I said, I’ve quoted the figures in terms of the impact on first-home
buyers and I think—as Mr Clark mentioned—the increase in the investors has
picked up in the last several months.
Faafoi  So the bottom of page 27 it’d be fair to say that fewer first-home buyers are
buying and more property investors are buying?
Spencer  The share has increased. The absolute number hasn’t, because total sales are
down 12 percent. So the actual number of investor sales has not increased, it’s
only the share.
Faafoi  My reading of the bottom of page 27 is that, proportionally, there were fewer
first-home buyers and there are more property investors. Is that correct? Sales
activity among investors is more—
Wheeler  Proportionately, that’s correct.
Faafoi  OK. So, you could say that first-home buyers haven’t done as well as property
investors because of the LVRs?
Wheeler  That would be fair comment.
Spencer  Of course, first-home buyers in the future who are looking to buy a house—
the house would be less expensive than it would otherwise be. Also some
investors may have less capital gain than they would have had there not been
LVRs.
Faafoi  But it would also be true that there were fewer first-home buyers because of
the LVRs?
Spencer  Yes.
Twyford  Mr Wheeler, you’ve noted that the building and new supply has been, in your
words, “so little and a long way short of what’s needed in Auckland” and yet,
under the Government’s housing accord with Auckland Council, thousands
and thousands of new sections have been consented. Why do you think there’s
been so little actual building, given that in the 80 special housing areas, only
five houses have been built since the housing accord was signed, and only 18
are predicted by the council by Christmas?
Wheeler  I think the council would give you probably a better insight into that. I think
some of it’s tied in with infrastructure development costs, I think some of it’s
tied in with delays in terms of approvals, I think some of it’s tied in to the cost
of permits or permission to undertake some of the services needed to build the
housing, but some of it is just being—it’s been slow.
Twyford: You’ve identified this as the major factor to unlock the problem. What needs to happen?

Wheeler: Well, it’s interesting. I think—you know, we’ll learn more in terms of the Productivity Commission’s report that will be coming out, where they are looking at what happens in terms of the consenting process, how it can be sped up, what are the costs associated with that.

Twyford: But the special housing areas fast track the consenting process—they solve the consenting problem, but people still aren’t building. So are you blaming the consenting process for the fact that developers aren’t actually building?

Wheeler: Well, I think it’s possibly several things, but I think that is probably part of it, yes. I think there are still delays, and that’s why the Productivity Commission has been asked to go in and look at that consenting process and the approval processes in general, and to see why these delays are occurring.

Faafoi: Can I point to page 29, the last paragraph. You’re citing a Dairy NZ estimate about one-quarter of farmers struggling to meet interest payments at the projection of $5.30. There is talk that it could go even lower than that, so have you got any commentary on what would happen to the economy in general if that were to come to fruition? I’m not economist of the year, but one-quarter of the farmers struggling to meet their payments is pretty serious, isn’t it?

Spencer: Yeah. I mean, as it says—I mean, it puts pressure on those farmers and if it goes below $5, that’s more pressure. But we’re also saying that the farmers, particularly given they had $8.40 last season, they reduced debt, they stashed a bit away—that, you know, they’re in a much better position to weather the storm for a period. If it keeps going for two or three seasons, then that’s when the pressure really comes on. But certainly for one season they’re pretty well placed to, you know, cut spending and incur a bit more debt—short-term debt—to get through that period.

Bennett: Thank you very much. We appreciate the answers and thank you for coming along.

**conclusion of evidence**
Budget Policy Statement 2015 and Annual review of the financial statements of the Government of New Zealand for the year ended 30 June 2014

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
March 2015

Presented to the House of Representatives
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Budget Policy Statement 2015 and Annual review of the financial statements of the Government of New Zealand for the year ended 30 June 2014

Recommendation

The Finance and Expenditure Committee has considered the Budget Policy Statement 2015 and conducted the annual review of the financial statements of the Government of New Zealand for the year ended 30 June 2014, and recommends that the House take note of its report.

Introduction

The Minister of Finance’s Budget Policy Statement 2015 was published on 16 December 2014, and stood referred to the Finance and Expenditure Committee. We met with the Minister on 11 February 2015 to discuss the statement and to consider the annual review of the Government’s financial statements for 2013/14, for which the Minister is also responsible. This report summarises the main points from the two documents, and from our hearing with the Minister.

We would normally have considered at the same time the Treasury’s Half-year Economic and Fiscal Update (HYEFU), which contains the forecasts used in preparing the budget policy statement. However because of timing issues, we will consider the HYEFU when we conduct the Treasury’s annual review, and will report on both those items to the House.

Part A Budget Policy Statement

Summary of Budget Policy Statement 2015

The Budget policy statement summarises the economic and fiscal outlook, and outlines the Government’s plans for Budget 2015 and subsequent years.

The Government intends to continue to focus on four priorities: managing public finances responsibly by returning to surplus and reducing debt, making the economy more productive and competitive, delivering better value for money from public services, and supporting the rebuilding of Christchurch.

The Budget will be delivered on 21 May 2015.

The minister told us that, as in recent Budgets, the priority for new spending will be on health and education. He said the Budget will contain measures to help families and children facing hardship; it will also continue efforts to improve social housing.

A deficit of $572 million (0.2 percent of GDP) is now forecast for 2014/15, compared with a projected surplus of about $300 million. However, the Government continues to expect a surplus when the final accounts are published in late 2015. From 2015/16, increasing surpluses are forecast. Net debt is forecast to fall to 20 percent of GDP by 2020, in line with the Government’s long-term objective.
The allowance for new spending in Budget 2015 will be reduced from the $1.5 billion signalled in last year’s Budget, to $1 billion. New spending in Budget 2016 will be similarly reduced, and the reductions from these two years are expected to allow a higher operating allowance in Budget 2017 than previously envisaged. Subject to economic and fiscal conditions at the time, the Government expects to be able to consider modest tax reductions and/or additional debt repayment in Budget 2017, with an operating allowance of $2.5 billion, almost $1 billion higher than previously signalled.

**Economic context**

The Minister said the forecasts show the economy on track for further solid economic growth. GDP has been growing at an annual rate of about 3.2 percent, and is expected to grow by just under 3 percent on average over the next five years. This is slightly faster than the Treasury forecast in its pre-election update. The challenge, the Minister emphasised, will be to ensure that the projected results are actually achieved, and the growth rate sustained for as long as possible.

Interest rates remain low by New Zealand standards, despite some tightening by the Reserve Bank over the past year. They are forecast to remain around their current levels until late 2015, before rising. Canterbury’s rebuilding continues to contribute to economic activity, and business investment is reasonably good. Job growth of about 80,000 over the past year is expected to continue.

A feature of the present situation is that New Zealand’s relatively strong economic performance compared with other developed countries has brought persistently strong net inward migration. This includes fewer Kiwis leaving, and more choosing to stay rather than seek jobs elsewhere. The net inflow is expected to peak at 52,400 people for the year to March 2015. While job growth has absorbed some of the increase, there has also been a record proportion of the population in the labour force; as a result, the unemployment rate has increased, to 5.6 percent in 2014. For 2015, unemployment is forecast to fall to 5.4 percent.

The international picture shows several risks, with slower growth in Australia’s economy, falling global prices for many commodities, uncertainty regarding the withdrawal of monetary stimulus in the United States and Europe, and risks to China’s financial stability.

**Fiscal priorities**

The budget policy statement ranks the Government’s fiscal priorities in the following order:

1. returning to surplus in 2014/15 and maintaining surpluses subsequently
2. reducing net government debt to 20 percent of GDP by 2020, and repaying net debt in dollar terms in 2017/18
3. further reducing Accident Compensation Corporation levies
4. beginning to reduce income taxes from 2017, with a focus on low- and middle-income earners
5. using any further fiscal headroom to get debt down to 20 percent of GDP before the target date of 2020.

The Minister commented that New Zealand’s recovery is unusual in that inflation has remained lower than expected. This poses a challenge for achieving surplus and reducing
debt: because the Government’s tax take is based on nominal, rather than real, GDP, its revenue is lower than it might otherwise have been. Nevertheless, he believes the fiscal position is sound, and the target the Government has set is likely to be achieved, despite some fluctuations.

Although the Treasury is now forecasting a deficit for the current financial year, the Minister says that the Government continues to expect a surplus when the final accounts are published in late 2015. We note that changes are not unusual between forecasts and the actual results. When the accounts for the six months to December were recently finalised, the Crown recorded an operating deficit substantially less than the Treasury had forecast.

**Better public services**

The Minister emphasised that the Government’s focus is not simply on living within fiscal allowances, but on getting better results from public services, so as to keep the fiscal situation under control in the long run. He commended the Public Service not only for meeting tight fiscal targets in recent years, but more importantly, for managing to get better results from the funding provided.

**Housing**

We discussed the issue of housing affordability at some length. The Minister said the Government is focused on increasing the supply of housing, working with local councils. He believes the problem is that planning rules and other factors have led to a relatively small proportion of lower-value housing coming onto the market. According to the Productivity Commission, 25 years ago about 30 percent of new housing stock was in the lowest-priced quartile; now, it is only 5 percent.

Some of us recalled a comment by the Governor of the Reserve Bank that much more needed to be done in the housing market; this seemed to suggest the Government was failing in its efforts to improve supply. The ANZ bank had estimated the shortfall in Auckland to be 18,000 dwellings, and projections from the number of building consents suggested less than half that number were in the pipeline. The Minister disputed this estimate; the advice he had received suggested that 10,000 consents for new houses a year were needed to start to catch up and stabilise prices, and that consents were now at about 8,000 and increasing. He said the Government was already doing more, but stopping short of removing consenting from the Auckland City Council. It was working with the council, giving it legislative tools to deal with housing, and the council was performing considerably better. At the same time, the council was fast-tracking development of its new unitary plan.

The Minister said the challenge lies in the pipeline effect, as it takes quite a long time to acquire land and get a house built, even with accelerated processes. He agreed with the Reserve Bank that more needed to happen more quickly, and in his view, it was happening. The special housing areas are picking up speed, and developers were getting the message that they need to act soon to bring forward their own projects.

**Social housing**

The Minister said that from the Government’s point of view, the next phase of activity would be the redevelopment of the Crown’s own estate. The Government owns 7 percent of the housing stock in Auckland; together, it and the council own most of the underutilised housing land, where there is potential for more intensive use. Over the next
three or four years they are likely to become the major suppliers of medium-density housing to the Auckland market.

**House prices and regulation**

We note that the Reserve Bank has warned of the possibility of a sharp correction in the housing market, and asked whether that meant a housing bubble about to burst. The Minister said the term “bubble” is unhelpful as it cannot be measured. He believes double-digit house price inflation cannot continue forever, because supply will increase in response, as is now happening with the Government’s encouragement, which will take the upward pressure off prices. So over the next two to three years or so, he expects changes in pricing. The Reserve Bank’s concern relates to the risk for financial stability if the market were to become highly speculative and people took on excessive debt, leading to the sort of situation seen in Ireland and Spain.

Asked whether he supports macro-prudential measures such as limiting lending to people with multiple investment properties, the Minister said that such decisions are the responsibility of the Reserve Bank. The Government supports the bank using the tools available to it within the agreed macro-prudential framework. Under the terms of the agreement with the bank, the Government could intervene if it thought using any specific tool was a particularly bad idea, but it had never done so, leaving it to the Reserve Bank to use the tools at its disposal sensibly so as to maintain financial stability. Meanwhile, the Government focuses on areas within its control, such as its own State housing stock, and the legislative structure within which councils make their decisions.

**Foreign buyers of housing**

Some of us are concerned about the number of house purchases by buyers from overseas, noticing that such buyers are being actively targeted in advertising. The Minister said it can be hard to tell at an auction whether a purchaser is from overseas or not. Rather than trying to constrain the demand for housing by imposing restrictions, the Government has chosen instead to focus on increasing supply.

**Foreign investment**

Some of us are concerned about the quality of scrutiny by the Overseas Investment Office of proposals for foreign investment in New Zealand. It appears that a number of investors have not met the office’s milestones for reporting, as they are required to do for five years. Some of us propose a cross-party audit of foreign investment in New Zealand over the decade since the Overseas Investment Act came into force.

The Minister said the Government expects the Overseas Investment Office to take reasonable steps to ensure that its agreements and conditions are honoured. As to whether it might require more staff to follow up reporting, the Minister said he had no advice to suggest this was needed, but the office was free to put a case for more resources to its responsible Minister. He did not consider that a cross-party audit would add great value.

The Act Party member considers that New Zealand’s foreign investment regulations are excessive, particularly in relation to land, noting that the OECD has ranked us 48th out of 54 countries in terms of ease of inward investment. Given the economy’s need for foreign capital, the member considers that the Government should seek to minimise the chilling effect of the regulations.
The Minister told us he thinks the balance is about right. The rules reflect New Zealanders’ concern about foreign investment by applying rigorous testing, while maintaining the country’s attractiveness to investors. His impression is that the regulations are a “reasonably significant” deterrent to those not seriously committed. He believes the most important way the Government encourages foreign capital is by ensuring sound economic policies, a high-quality regulatory environment, predictable government, steady economic growth, and a welcoming community.

**Skycity international convention centre**

In the light of recent news reports that the estimated cost of Skycity Entertainment Group’s planned convention centre in Auckland has increased by about $130 million, we asked the Minister whether provision had been made in Budget 2015 for government expenditure on the centre. The Minister said no specific provision had been made, and putting in extra taxpayers’ money would be the Government’s least preferred option.

The Minister said he considered it premature to speculate on any discussions or negotiations between Skycity and the Minister for Economic Development. A contractual agreement had been entered into for the convention centre, and the agreement specified that no further government funding would be sought. He added that it was quite common for parties to test the bounds of an agreement with the Crown.

Some of us recall that in 2013 the Treasury had categorised the Skycity convention centre as a fiscal risk to the Crown. The Office of the Auditor-General and the Treasury were also critical of the advice provided by the Ministry of Economic Development (now the Ministry of Business, Innovation and Employment) leading up to the original decision to negotiate with Skycity Entertainment Group about a convention centre.

**KiwiRail**

We asked the Minister whether he is concerned about KiwiRail’s potential burden on the Government’s accounts, and whether options such as privatising the Cook Strait ferry service or bringing in foreign ships or crews had been considered, to get the business onto a more sustainable footing. The Minister told us he has always been concerned about the fiscal impact of KiwiRail; the Government has contributed about $1.1 billion to its operations over the last four or five years, and it is still unclear whether it can sustain itself without Crown input of $150–350 million a year to fund its shortfall. He said all sorts of options had been canvassed over the past decade, no doubt including alternatives to the ferries, but he was not aware of specific consideration of such options at present. He added that the Treasury was again examining KiwiRail’s costs and revenues, and was working closely with the board to improve its understanding of the business. Ultimately, however, the Government would expect the board to use expert outside advice if there were real operational difficulties.

**Climate change**

We note that an important United Nations conference on climate change will be held in Paris in November–December 2015, with the aim of agreeing on new emissions targets. In its briefing to the incoming Minister, the Treasury reviewed projections of greenhouse gas emissions and potential targets, and concluded that, on New Zealand’s present trajectory, the cost to the Government over the period 2021–2030 would be somewhere between $3 billion and $52 billion. This was based on New Zealand potentially exceeding
its emissions target by 315 million tonnes, and covering the gap by buying credits overseas. We sought the Minister’s comment on this potential fiscal cost.

The Minister agreed that the outer boundary of such cost estimates would threaten long-term fiscal sustainability. However, he emphasised their uncertainty, noting that the estimates covered such a wide range because the price of carbon had fluctuated so enormously since the emissions trading scheme was introduced. He said he is optimistic that lower-emissions technology will develop quickly over the coming decade, and believes no one can predict how costs will evolve.

Some of us observe that the price of carbon is an important factor in the uptake of low-emissions technology, and maintain that the Government’s policies have made its uptake less likely, by driving down the price of carbon domestically. As a result, New Zealand is becoming less efficient in its use of carbon, and producing more carbon per unit of GDP than previously. Data from the United Nations Framework Convention on Climate Change indicates that New Zealand’s performance has been among the worst in the world; it has increased its greenhouse emissions intensity by 13.8 percent since 2008, while most other countries had reduced their carbon intensity. To some of us, this seems a case of New Zealand becoming less efficient in terms of carbon intensity, which does not seem good economic strategy.

The Minister said that all the climate change discussions in which he has been involved over the past decade have entailed efforts to balance the costs borne by households and businesses with the goal of using carbon more efficiently; the same issues remain relevant for the Paris conference. He noted that New Zealand’s unique circumstances as a developed country with a strong agricultural base present challenging hurdles. He believes there is at least now a better understanding of issues such as the forestry cycle, and the fact that a large proportion of this country’s emissions come from agriculture.

The Treasury added that its briefing to the incoming Minister was not intended to suggest a choice between cutting emissions or setting a higher target; its advice was that the Government should consider before the Paris conference what New Zealand’s emissions-reduction target should be, as it is important for the economy to be environmentally sustainable, while increasing productivity in the agriculture sector. In its view, having sound policies regarding climate change is vital; a price on carbon is one option, but reducing greenhouse emissions is not the only goal.

**Part B Financial statements of the Government**

**Fiscal position for the year ended 30 June 2014**

The financial statements of the Government provide a consolidated view of the revenue, expenses, assets, and liabilities of all Government entities. The following are its main features.

The Government deficit, as measured by the operating balance before gains and losses (OBEGAL), was $2.9 billion for the year to 30 June 2014 (1.3 percent of GDP), down from $4.4 billion (2.1 percent of GDP) in 2013. Excluding the effects of rebuilding in Canterbury, the deficit was about half the comparable figure for the previous year.

Core Crown tax revenue increased by $2.8 billion as economic activity and employment grew, to total $61.5 billion. This was about $0.4 billion lower than forecast in Budget 2014, mainly because domestic consumption was less than forecast.
Core Crown expenses increased slightly, by $1.2 billion (1.7 percent), to $71.5 billion. The main factors in the increased spending were higher payments on New Zealand Superannuation, reflecting indexation and an increase in recipients, and new spending from Budget 2013, primarily for health and education. As a proportion of GDP, core Crown expenses were 31.2 percent for 2014, compared with 33.1 percent in 2013.

The Crown’s net worth increased over the year; this was largely the result of increases in the value of assets (property, plant, and equipment, and financial assets), with increased liabilities from borrowings partly offset by lower earthquake liabilities as claims were settled.

**Net Crown debt**

The Crown’s net debt increased by $4.1 billion in the year to 30 June 2014, to $59.9 billion or 26.2 percent of GDP. The commentary on the financial statements notes that while debt has continued to grow, the rate of increase has slowed in recent years as cash deficits have become smaller. The result for 2014 also included $2.3 billion in proceeds from the Government share offer programme (Genesis, Meridian, and Air New Zealand), compared with $1.6 billion received for Mighty River Power in 2013.¹

We note that the Crown’s net debt has more than doubled since 2010, and some of us suggested that this level of debt was not prudent or sustainable. The Minister said that by international standards, the Crown’s degree of indebtedness is not too bad; however, while it is sustainable, it is not desirable. The Government aims to have it reduced by 2020 to 20 per cent of GDP, which it considers prudent. On the current trajectory it would fall below 20 percent thereafter.

**Gains and losses on financial instruments**

We note that a net loss on financial assets of $1,502 million was recorded as at 30 June 2014, and asked why this had changed so dramatically from the forecast $117 million net profit. The Treasury explained that the difference represents market movements in exchange rates, share prices, and interest rates since the forecasts were prepared. Because of their volatility, such variables are not included in the forecasts, but a number of strategies are used to mitigate their actual impact. The Treasury said that such risks are generally managed on a net asset basis, taking into account both assets and liabilities (including derivatives). It pointed out that when these are factored in, the Crown made an overall gain of $4.8 billion on financial instruments in 2013/14, which was $1.2 billion higher than forecast.²

The Minister of Finance added that the focus is always on the Crown’s operating balance excluding such gains and losses—the OBEGAL—precisely because the valuations of such financial instruments fluctuate so much. He pointed out that when they were included, the Crown’s overall operating balance had actually been in surplus for a couple of years.

We note that the total Crown operating balance, inclusive of gains and losses, was a surplus of $2.8 billion for 2014. As an illustration of the volatility involved in valuations, this can be compared with a surplus of $6.9 billion in 2013, on the strength of even larger gains on

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¹ Financial statements, p. 16.
² Financial statements, p. 60.
financial instruments ($11.3 billion), but a deficit of $14.9 billion in 2012, arising from valuation losses amounting to $5.7 billion.\(^3\)

\(^3\) Financial statements, p. 14.
Appendix A

Committee procedure
We met on 11 and 25 February 2015 to consider the Budget Policy Statement 2015 and the annual review of the Financial Statements of the Government of New Zealand for the year ended 30 June 2014. We heard evidence from the Minister of Finance and the Treasury.

We received five submissions, and heard oral evidence from one submitter.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Stuart Nash
Dr Russel Norman
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Welcome Deputy Prime Minister and Minister of Finance, and thank you for coming to the committee today. We’re doing two scheduled hearings: the Budget Policy Statement, and also the Financial Statements of the Government of New Zealand for the year ended 30 June 2014. So, because of time constraints, we’re intending to run them together, effectively, and I’m pretty sure the questioning would take that format anyway. So we’ll leave it in your hands to kick it off. And, if you want to give us an introduction, and then we can open up for questions.

Thank you, Mr Chairman. I will make a few introductory comments. Both the half-year update and the Budget Policy Statement issued in December confirm that we’re on track for further solid economic growth, with job growth and probably lower interest rates for longer. And the key challenge ahead is really about the sustainability of growth—that is, given that it’s at reasonable levels, there’ll be significant benefit to the economy and the broader community if we can sustain that level of growth for some time.

Treasury forecasts suggest that New Zealand’s growth potential—that is, the speed limit for the economy—is a bit higher than they had previously estimated. We’ve been growing a bit faster than that speed limit, at around 3.2 percent.

A number of positive indicators: GDP growth is expected to average just under 3 percent over the next 5 years—that is a picture of solid, sustainable
growth, but, of course, it’s a forecast and there’s plenty of work to do to achieve that; interest rates are staying lower for longer; disposable incomes have risen by 9 percent in real terms over the last 4 years—probably the most important measure for many households of economic progress; recent job growth of around 80,000 in the last year is expected to continue—217,000 more people employed now than 5 years ago. A few years back there was a forecast of 170,000 new jobs from the Treasury regarded with some scepticism at the time—I think in about 2010 or 2011—and the economy’s pretty much hit that forecast, just in the current year. Unemployment has risen a bit recently on the back of a very high participation rate—in fact, a record-high participation rate—of 5.7 percent.

A couple of features of the outlook: first, is that strong inward migration has persisted longer than I think most people expected, but there is strong job growth that’s accommodated that extra migration—but not quite, which is why unemployment’s risen. And the other effect, of course: the participation rate. The second issue that’s had a lot of focus is around housing affordability, and you’ll be familiar with the Government’s strong focus on increasing the supply of housing. Just by way of a measure of how much work there is there to do: 25 years ago the Productivity Commission—oh, noted that 25 years ago 30 percent of new housing was in the lowest quartile of properties by value. If you look at the whole stock of housing, 30 percent of the new housing was of a value that was the lowest quartile of existing property values. Today, that’s only 5 percent. It’s dropped from 30 percent to 5 percent. So the real hard end of this problem is that a combination of, certainly, planning law and other factors has led to relatively smaller proportion of lower value housing coming on to the market. But we’re working closely with councils to change that, and starting to make some real progress.

Another factor I think to draw attention to is—it’s encouraging—is continuing business investment running at reasonably good levels. A big part of the Government’s programme is to build confidence in a way that encourages business to invest. It’s a much larger proportion of GDP than housing—about four times the size. So while there’s been a sharp uplift in housing investment—and that’s a good thing; we need to see that to meet demand—business investment has had less of an uplift but it’s on a much bigger base, and in the long run it’s more important, because that’s what provides capital deepening and the opportunity for higher incomes.

And, of course, you’re familiar with low inflation, dropping oil prices. This does make the fiscal situation for Government a bit more challenging: inflation has always been the politician’s friend, and the taxpayer’s enemy, and the saver’s enemy, but—this is an unusual recovery because we’ve got a recovery with quite low nominal growth—growth and nominal GDP, and we tax nominal GDP. So, in previous recoveries, at 3 percent growth you could have 5, 6, 7 percent growth and nominal GDP, and we’re talking about well under 3 percent over the next few years, and that will continue to pose challenges for the programme to reach surplus and also to start reducing debt. However, we’re fundamentally on track. I think the direction
for New Zealand is that we’re fiscally sound, headed in the right direction, even if there are going to be some fluctuations. The Budget Policy Statement confirms that allowance is—the allowance for Budget 2015—is going to be about a billion.

I must, as a final comment, compliment the Public Service. Over the recent years it has met all fiscal targets—and they’ve been pretty tight by any international standard—and continue to do so. But more importantly they’ve been able to get better results, and I think, increasingly, the focus of our management of the business of Government is about getting results as much as living within the allowances. And, of course, what we’re starting to learn is if you get results, there’s less need for Government services, and that’s in the long run what’s going to keep the fiscal situation under control.

Finally, today I’m announcing that the Budget this year will be on Thursday, 21 May. It’ll focus firmly on continuing to build on the progress we’ve made across productivity, Better Public Services, rebuilding Christchurch, and, particularly, to lock in the benefits of a growing economy. I’ll leave it there, Mr Chair.

Robertson G Thanks for that, Mr English. What provision has been made for Government expenditure on the Skycity convention centre of up to $130 million?

English Well, I couldn’t—there’s been no specific provision for Skycity convention centre. There’s—you know, we’re moving into a Budget round where there’s capital allowance and an operating/spending allowance, and if there was anything that came out of Skycity negotiations, then that’s where it’ll be dealt with. But, certainly, any extra taxpayers’ money is the least preferred option.

Robertson G Is that an option, though, that you’ve been discussing with the Prime Minister and the Minister of Economic Development?

English No.

Robertson G So you’ve had no discussions at all about putting Crown money in?

English There’s been some commentary about it, which I’ve seen, but I’m not party to any negotiation, or whatever, about it. But, the Minister for Economic Development deals with that, and, as I said, more taxpayers’ money is the least preferred option.

Robertson G Does Treasury still hold the view, and do you still hold the view that you had in 2012, that any use of Crown money—and this would represent a significant fiscal risk for the Government—I would have thought in those circumstances you would have been involved in the discussions. Does Treasury still view it as a significant fiscal risk?

English You’d need to ask the Treasury about that. I mean, there’s a commercial agreement —there’s a commercial agreement in place, and we continue to operate on the basis of that commercial agreement—is what occurs. Any issues have been raised, and as I said any extra taxpayers’ money is the least preferred option.
Robertson G  What are the other options then, Mr English, that you’re pursuing?

English  Of course the preferred option is that it’s executed the way that you know—consistent with the agreement.

Robertson G  Do you think from the Treasury—and I’m happy for the Treasury to answer this, or you personally—is it your view that this arrangement and deal has been well handled by the Government? Is it something that you and the Treasury are comfortable with: that taxpayers are now facing the prospect of a $130 million bill for something that was meant to be free of charge? Is that something you or the Treasury are happy about?

English  Taxpayers being—I’m happy with how the Government’s handled it, yes.

Robertson G  Really?

English  But the taxpayer getting bills for things is not unusual. We get that all the time—that’s part of the business, dealing with demands in all sorts of respects.

Robertson G  What about a Treasury response on that?

Robertson V  I don’t have a comment on whether the Government’s handled this well. You’re referring to our advice which we released in 2013 on the Skycity convention centre, and that’s on record in terms of what we’ve pointed out as the risks at that point in time.

Robertson G  And that continues to be your position today?

Robertson V  We haven’t given further advice from that.

Robertson G  Presumably now that there’s a number around—$130 million—you still would consider that to be a significant [Inaudible] fiscal risk for the Government?

Robertson V  As the Minister says, that’ll be thought about through the Budget process.

Cosgrove  Sorry, could I put it more simply: do you stand by your previous advice?

Robertson V  In terms of Treasury’s advice? Yes.

Peters  Well, when you say that this is sort of common for the resources of the Crown to be required, it’s not common for the resources of the Crown to be required when it’s a private operation, is it? Or is South Canterbury Finance and an uncapped guarantee the kind of thing we can expect from this Government?

English  I think in the—what I mean by that is it’s—the Crown’s always dealing for demand on its resource. And in this case, there has been contractual arrangements—those have been well hashed over by everybody, including the Auditor-General—around regulatory concessions and the building of a convention centre. So the party to those processes has got a view about what it should look like and what it might cost. That’s a matter for discussion with the Government, consistent with the terms of the contract.

Peters  This outfit made a profit of $66 million, I think, announced today. Which part of subsidising Adelaide fits your plan?
Look, the agreement around Skycity has been—is, I think, well understood—

There’s nothing in the agreement about blow-outs to the taxpayer.

There’s ongoing discussions, and they will be consistent with the nature of the agreement, and, as I said, we’ve got no great desire to put more taxpayers’ money into it.

When you were approving the plans for this thing, I mean, how much were you shown—to the extent that we expedited a bill through Parliament to facilitate it—and all of a sudden we find out that what you’ve approved is an eyesore. How did that happen?

The Government went into this whole thing with its eyes open. Some of these things are matters of opinion, some of them are matters of speculation, and some of them are people trying to get a bit more out of the Government, but that’ll all be dealt with in the way we always deal with these things, which is realistic discussion with the participants.

Don’t you think that you guys are a bit too much in bed with this outfit? You hold your conventions there, you hold your political launches there, you’ve got $60,000 from them—so did Mr Dunne, so did Mr Banks. I’m looking at all the people over here now. Don’t you think this is looking a bit corrupt and tawdry?

Mr Peters, I think—if we have the questions around the Budget Policy Statement, OK?

This is about the Budget and a blow-out. You’ve got a—you announced a surplus before the last election. Now it’s blowing out to 560, 570. You’ve got this on top of it. You’ve got serious problems here, and you tell me that’s not budgetary? Well, what would it be—fairyland?

The minister’s capable of answering.

No, I’d like Mr English to answer the question.

No, I don’t agree with any of that. The Government’s done a deal that was designed to—like a public-private partnership rather than the Government fronting up to pay for a convention centre, as it is in Christchurch, and that was a reasonable deal, and we’d like to see that executed. But I think you’re getting a bit ahead of yourself here. I mean, all there’s been is some comments about what it might look like and what it might cost to look perfect, and that’s it. That’s a long way from—that’s a long way from a change in the contract.

Yes, but if the Prime Minister makes a statement like that—and you just told us that no discussion has taken place with you—who’s getting ahead of who and what? I’m just asking the question.

But you’re getting a bit ahead of the process of discussion and negotiation about the nature of the contract.

Mr Peters, Mr Robertson’s got a question.
Peters: I just want to finish off this. Mr Robertson doesn’t mind if I just ask this one.

Robertson G: He can have one more, and then I’ll come in.

Peters: In the interest of collegiality, I just want to ask this question: how could I be getting ahead of myself when I’m following a Prime Minister’s statement which has actually shocked the media of this country and all the other commentators, including the head of the chamber of commerce in Auckland? I want to know: how did he get to that sort of figure and level of discussion when he hasn’t even talked to the person who handles the finance of this country, namely you?

English: Look, anyone’s free to ask the Prime Minister about his point of view. And he’s always very open to describing how he gets to where he does get to.

Peters: So I keep bouncing from cloud to cloud here.

Robertson G: Just to be absolutely clear, Mr English, you’re not ruling out putting in additional taxpayer money into a deal that was meant to be free to the taxpayer?

English: What I’ve said—I’ll just stand by what I’ve said, and that is that any further taxpayers’ money is the least preferred option.

Robertson G: No, I’m asking you whether or not you’re ruling it out, putting in further taxpayers’ money.

English: Again, that would be getting ahead of the process to rule it in or rule it out.

Robertson G: There’s a negotiation going on right now. You might not be part of it, but it’s going on right now. So you’re not ruling out putting further money in?

English: As I said, it’s getting ahead of the process. I’m not going to play the ruling-in, ruling-out game. We want a convention centre in Auckland. There’s an agreement to put a convention centre in place, and I don’t think we should get ahead of ourselves.

Robertson G: You just did a really, really bad deal that the taxpayer now has to pay for.

Norman: Mr English, the National Party Government is not ruling out giving $100 million-plus to a casino is what’s on the table right now, and you’ve just acknowledged that you’re not ruling that out.

English: No, I didn’t say that. I said I’m not going to play the silly game of ruling in or ruling out. We’re not in a position.

Norman: It’s not a silly game. This is $100 million of taxpayers’ money. It’s not a silly game, Mr English. You’re responsible for the spending of taxpayer money.

English: No, the $100 million isn’t, but your silly game of ruling in, ruling out, I’m not going to play.

Norman: The taxpayer wants to know: are you planning to spend $100 million of their money to give to a casino?
English: Well, the taxpayer—there’ll be a fully transparent process when someone knows—when someone knows to tell them. When someone knows to tell them, they’ll be made aware of it.

Norman: You’re proposing to give $100 million to a casino. That’s not a silly game.

English: No, I have made no such proposal to give any money to anyone, and that is your silly game. You’re trying to say I’ve proposed $100 million for the casino. I’ve never said anything about it.

Norman: So when Mr Joyce made the original agreement, did you seek an assurance from Mr Joyce that the casino would never come back to the Government and ask for more money?

English: That was the nature of the agreement. So you’d need to look at—

Norman: So you sought an agreement specifically from Mr Joyce?

English: Well, it’s not a matter of assurances from Mr Joyce. It’s a matter of what’s in the contractual—

Norman: So why don’t you enforce the contract?

English: Well, that’s a matter for the Government—that’s a matter for the Government. That’s a position it can take. I’m just saying there’s the contract.

Norman: So you’re saying you’ve got a contract that you could enforce that requires you to give no money to them, but you’re thinking about rolling on it?

English: I’m not offering you legal advice about the contract. I’m saying it’s well within the Government’s power, simply, to say that we’re—it’s our wish to execute what’s there. Putting in taxpayers’ money is certainly the least preferred option.

Norman: Since when does Bill English subsidise a casino?

Bennett: That’s not a question.

Norman: Yes, it is.

English: Well, it’s not a matter of Bill English subsidising a casino.

Nash: I change the subject slightly. The Government’s fiscal policy is reducing total debt to prudent levels, yet net debt increased by $4.1 billion to just under $60 billion last year—that’s over double the 2010 level. Gross debt’s nearly $82 billion. What does the Government consider to be a prudent level of debt?

English: The thing is we’ve pointed out in the longer-term fiscal objectives—somewhere under 20 percent. So we’ve been aiming to get down to 20 percent of GDP net debt by 2020, and we think that’s prudent. And by any international standard, it’s not too bad. On the current sort of trajectory—current policy settings—it would continue to decrease beyond 20 percent, and we’d be happy with that.
Nash: So at the moment, it’s not really sustainable to pay $4 billion a year in interest. At least I think it’s about $84 million every week in interest at the moment just servicing that debt.

English: Well, it’s sustainable; it’s not desirable.

Nash: One last question, if I may, for now. In this financial statement it’s got net gains and losses on financial assets. There’s a $1.5 billion loss when you were forecasting a $117 million gain. What’s that about?

English: Look, I haven’t got those figures here. I’d need to get the Treasury to tell us about that.

Nash: Could the Treasury perhaps answer?

Robertson V: Sorry, what was the question?

Nash: So on page 60 of this, there’s a—

English: Sorry, of which document?

Nash: Financial Statements of the Government. There’s a net gains and losses on financial assets. There’s a $1.5 billion loss, and there was a forecast of a $117 million profit. What’s gone on there? Why was there such a massive loss?

Robertson V: It might be best that we come back to you on that in terms of [Inaudible]

English: Generally—I mean, as you know, the measure that the previous Government and this Government used is this operating balance excluding the gains and losses. So those big shifts—we don’t—they’re specifically excluded because they move around so much with valuations of overseas share portfolios, discount rates, and that sort of stuff. So it’s not unusual that it would be fluctuating.

Nash: Yes, but $1.5 billion is quite a lot of money.

English: So I think Treasury should come back—Treasury should come back and explain just where that’s gone. But you’ll find in recent years there’s been some quite large upswings, and if you use our full total definition of operating balance, because of those upswings, we’ve been in surplus for a couple of years, I think. But just because—just changes in asset valuations, they’ve been, for the last 10 years, kind of put to one side.

Nash: One last technical one. Just curious, but what’s the $5 billion in donations and ex gratia payments consist of?

English: I don’t know. Again, you’d have to come back to you with detail about that.

Nash: Can you answer that? Because there’s a line of $5 billion, and it’s headed “Donations and ex gratia payments”.

English: I’m sure there’s some grateful recipients, but it sounds like a classification problem to me.

Peters: It’s a rather large sum of money. Doesn’t anyone here know what that means?
Robertson V So, I mean, we can give you—I mean, I don’t have the detail on exactly all of them, but they are things like NGOs, in terms of what the Government provides through that mechanism. But we can come back to you on the specifics of that. That’s—

Robertson G Sorry, can you just say that again, Vicky? Is that NGOs?

Robertson V NGOs.

Robertson G Wouldn’t that normally be accounted for through departmental expenditure? It wouldn’t be seen as a donation in a line item?

Robertson V Yes, that’s just the way it’s described, those kind of [Inaudible]

Cosgrove Minister, how would you sort of characterise the quality of the casino deal, given that it was supposed to be a deal where the taxpayer didn’t take a bite, where there’s supposed to be a big, flash palace, and now the Prime Minister’s described it as an eyesore, hence the need—the potential eyesore—hence the need for $130 million potentially, which presumably means you guys didn’t have a look at the design or look at any of that detail? And if that money’s executed, it goes on the top of subsidising an entity that made $66 million last—just reported. So how would you characterise the quality of that negotiation? Also, given your track record with Solid Energy—knowing, doing nothing—Rio Tinto, $30 million, and you personally, yourself, in that negotiation never actually asked for a jobs guarantee, how would you sort of reassure the taxpayer that you guys are having quality negotiations with these sorts of things?

English That process has been quite transparent. The Auditor-General looked—

Cosgrove Sorry, which?

English That process was quite transparent, as it was with the other things that you listed. The Auditor-General—including Auditor-General scrutiny of the Skycity deal. So we were satisfied with the deal. We wouldn’t have agreed to it.

Cosgrove Do you think those sort of negotiating strategies and tactics would provide a—would go down well in the private sector, or do you think if those sorts of strategies had been put in place, heads would have rolled in the private sector?

English I don’t know what sort of strategies you’re talking about. I mean the Government set out—

Cosgrove Well, the fact that you negotiate a deal that, technically, for the shareholder—which is the taxpayer—is free, and potentially you now could be up for a substantial—or the shareholder; the taxpayer—could be up for a substantial amount of money. The fact that you subsidised a multinational company on the basis of a jobs guarantee that you yourself admitted on National Radio in an interview with me you never bothered to ask for a jobs guarantee, and you let its SOE go down the swanny after having over a year and a half of information; you just sat there and did nothing. How do think somebody—shareholders—would react in the private sector with those sorts of so-called quality negotiating tactics?
English I just disagree with your description of all of that.

Cosgrove So you did ask for a jobs guarantee?

Bennett No, the Minister has answered the question and he’s disagreed with it, so—

Cosgrove So you did ask Rio Tinto for a jobs guarantee when you gave it the $30 million?

English No, we didn’t.

Cosgrove Oh, OK, so that’s a fact.

English And I explained why that was at the time. Look, you might have a view about how it should have been conducted. We came to a view that’s turned out to be—

Cosgrove Well, I’m just old fashioned—I think if you do a deal in the private sector and you sign the contract, you should enforce the contract. It’s just maybe I’m just out of touch and old fashioned.

Bennett Maybe. Mr Cosgrove, just be quiet, and Mr English can say what he was going to say.

English I just disagree with his description of all that stuff.

Peters Look, you began with a $42 million subsidy by way of the extra pokie machines you allowed by legislation—which is pretty substantial, you know, because it’s annualised, and even—take out all the compounding effect you’re heading to sort of $1.3 billion to $1.4 billion over the next 27 years, minimum. It has to be much higher than that of course. Then you’re adding in possibly $130 million. This is a huge payment to a free enterprise that stood up and said: “We’re going to provide you with a convention centre; we just want you to facilitate the place and some of our utilities like the pokie machines.” Can you conceive of any other circumstance where this would sound remotely reasonable for the taxpayer?

English Again, I think you are getting a bit ahead of the circumstances and events. Now, it’s not unusual for people to want to test agreements with the Crown—that happens all the time. Whatever they agreed to in negotiations, they’ll still try and test it. And they do. It’s about to happen with the Christchurch City Council.

Peters At the moment you’re resisting. Is that what I am witnessing here?

English I am not negotiating with it but, as I said, we would certainly resist the idea that there should be substantial new taxpayers’ money go into it.

Peters Oh, so you are resisting it?

English Of course we’d resist that; why wouldn’t we? I mean, there’s been an agreement to produce a convention centre, and putting in more taxpayers’ money would certainly be the least preferred option.

Robertson G A supplementary on that: is that the advice that you are giving Mr Joyce then, that from your perspective as the finance Minister you don’t want to see any taxpayer money go into this.
The Government—it is not a matter of between me or Mr Joyce or any of your officials or anything. The Government will have a position and that’s what the Government will push.

No, I am asking you. You’re sitting here now, you’re the finance Minister, you’ve presented to us about your desire for fiscal responsibility and credibility. I’m asking you, as the finance Minister, is the advice that you’re giving your colleagues that they should not be putting any money into this deal?

I am always giving my colleagues advice not to put any money into things; that’s my default setting. Except with the respect to our most vulnerable and complex families, where sometimes we need to put more in. But the Government will take a position on this, and it will be the Government position.

Sorry, with respect, Mr Chair, I did ask a very specific question and I want to know whether you have given that advice on this deal.

Mr Robertson, he answered it; he did answer it.

No, he did not, Mr Chair; he gave a general answer.

There has been no proposition.

I mean—to come back to the beginning of my questioning. Your answers today are designed to try and protect your position as somebody who likes to take credit for fiscal responsibility, but what you’re actually asking us to believe is that you’re not involved in any of the discussions that are currently going on—you’re not being updated, you’re not contributing—

You’re not listening to my answers. You’re way ahead of events. There’s no proposition turned up in the system to put more money into the convention centre. You guys seem to know more about it than anyone else does.

Well, what was the Prime Minister talking about then?

There was no proposition.

I mean, it’s a fair question though. You’re saying there’s no formal proposition, right? And yet there’s this public discourse about it led by the Prime Minister—so where is it coming from?

I don’t know. You’d have to go and see who said what, when. All I’m saying is that the Government will have a position. It’s got an agreement, and yet there’s got to be pretty high hurdles of moving away from that agreement, and we’d certainly not be preferring not to put taxpayers’ money in.

And yet you’re telling us you’ve had no conversations with John Key or Steven Joyce about this issue.

Oh, there’s been some general conversations but not a proposition.

Have there been any conversations where they have said to you there could be more money required?

Nothing that hasn’t been in the public arena.
So there has been conversations. Hang on, hang on—so that’s a yes. You’ve had conversations with Steven Joyce and John Key where the mention of more money going to SkyCity has been mentioned.

As I said, nothing that hasn’t been in the public arena.

So you have had the conversations?

There’s issues in the paper, issues under discussion all the time; this one’s been dealt—been around.

I’m not asking about the paper; I’m asking about your conversations with Steven Joyce and John Key. I don’t care what’s in the paper. Have you talked about putting more cash into SkyCity with Steven Joyce and John Key, or either of them?

Not that sort of discussion, no. There’s been—of course there has been discussions about the fact that there’s an issue, and it’s popped up one way or another. That’s it. There’s no proposition.

So you’re asking us to believe that after Cabinet on Monday, the Prime Minister bowls out to the press conference and talks about $130 million of expenditure that might have to happen in order to prevent a possible eyesore, and you, the Minister, Joyce, and he have just sort of idly crossed each other over the tea trolley and not actually had an in-depth conversation about what that sort of signal might send? The Prime Minister has just run off at the mouth, as it were?

As I’ve said any number of times, I think you’re getting a bit ahead of—

No, I’m quoting the Prime Minister’s words. This is the Prime Minister. Did he just run off at the mouth? He didn’t ring you up and say: “I want to talk about $130 million because the boys down the road have rung me up, what do you reckon?” He’s just gone out and spewed out a figure for the taxpayer, is that right?

No, I wouldn’t describe it as that. I mean, you can talk to the Prime Minister about what he said but—

You had no input into that?

We would expect that if there’s a proposition, that will be looked at.

So you had no input into the Prime Minister’s comment?

The Prime Minister comments extensively without my input. He—

You had no input?

He has a track record of being pretty effective in his comments.

Given the timing of the Prime Minister’s statement on this eyesore, as he puts it—some would call it an absolute obscenity actually—but given the timing of it, was this on the Cabinet agenda last Monday?

I wouldn’t comment on that. The Prime Minister chairs Cabinet.

So he comes out of the Cabinet meeting, gives the public a press statement and it wasn’t on the agenda?
I’ve just said I wouldn’t comment on it. The Prime Minister’s the chair of Cabinet, and he comments on Cabinet.

OK, OK, let me ask you this question: are you concerned about the fiscal impact for you as Minister of Finance with what’s going on with KiwiRail and the Cook Strait ferry service for a start?

I’ve always been concerned about the fiscal impact of KiwiRail. I think we’ve put something like $1.1 billion into it over the last 4 or 5 years, and, as you know, an ongoing question about whether it can sustain itself to the extent that it falls short, then we have to find anything from $150 million to sort of $350 million a year to fill the gap.

You had any discussions about privatising the Cook Strait ferry service?

No. I’ve seen it referred to as an option, I think, in various assessments of KiwiRail over the years—over 4 or 5 years. But I’m not aware of any focused discussion about it with shareholding Ministers.

Foreign ships and foreign crews? No discussion about that?

No, I haven’t seen anything. I haven’t seen anything like that. I mean, look, this is a business where it’s a real challenge to get it to a sustainable basis, and we are now, I think, on about our third round of having a harder, deeper look at what drives KiwiRail costs and revenue. And in that process any number of options get canvassed, and probably have been for 10 years before that. So, I wouldn’t be surprised if somewhere in the paperwork there aren’t options that range from—or cover the whole range of possibilities including alternatives for the ferries. But, as you know, there has been quite a bit of disruption in the service. That’s no good for customers. They’ve got to find a settled, sustainable solution, which seems to be on the way. That’s about where it’s up to.

Treasury’s never sort of sat back, or stood back, and said: “Look, there’s such a disaster going on down here. Why don’t we have a look at all the aspects—its management, the qualifications of people, the safety regimes, the changes that they’ve made, the—how should I say it?—almost daily stoppages.” Surely somebody said: “Look, alarm bells should be ringing here. What are we going to do about it?”

Much as the Treasury is full of competent and capable people, their knowledge of the operational aspects of the ferries is probably not enough that—I’d rely on their opinion about it, but they do need to—but they are working progressively more closely with the board of KiwiRail. I mean, I think the Government’s—Treasury’s understanding of the business is now much greater than it was 2 or 3 years ago. And that’s a context in which issues such as the operational efficiency of various parts of the business will come up. But we would—the board—we would expect the board to rely on expert alternative opinion about the ferries if there were some real operational difficulties. We wouldn’t expect them to rely on the shareholders’ or Treasury’s opinion about it.

I want to move on to housing, Mr English. In response to the Reserve Bank Governor’s comments that much more needed to be done in terms of the
housing market, it sounded to me like a judgment on the Government’s failure on the supply side of the equation. We’re looking at a situation where in Auckland—just looking at the ANZ here, talking about an 18,000-dwelling shortfall in the Auckland housing market. Even with the kind of consents that you’re projecting that’ll come through, you’re looking at less than half of that being there. The Reserve Bank Governor’s right, isn’t he? Much more needs to be done, and the housing policy you’ve adopted up to now has failed.

English No, that’s not what the Reserve Bank Governor said, and I think he’d be disappointed with your characterisation of his comments in that way.

Robertson G He did say much more needed to be done, didn’t he?

English He did say more can be—more should be done on the supply side, and we’re doing more. I mean, we’re doing about as much as we can short of taking the job off the Auckland City Council. What we’ve found is that working with them has proven useful. They’ve reorganised, they’re performing considerably better, they’re trying to deal with this issue at the same time as they’re doing their unitary plan on a fast-forward process—trying to do it in 3 years instead of 10, their new unitary plan. So we’ve found that by working with them, providing them with legislative tools, we’ve been able to get considerably better results.

The challenge with housing supply is always the pipeline effect, and that is it just takes quite a long time for anyone who wants to develop new housing to start with procuring the land through to actually getting the houses up—that just takes time, even with fast-forward processes. So I think we’re seeing a fairly solid build-up of volume through the pipeline. It needs to get up to over 10,000 consents, and I think the Auckland City Council—when everyone else is much more aware of the need to achieve that, to help to stabilise house prices. And the Reserve Bank has the same view as us. It’d be great to see more of it happen faster. The good news is more of it is starting to happen faster.

Robertson G With respect, the Reserve Bank Governor knew all of that when he made that statement last week, and the reality is that the moves you’re making to improve consent times and all of that, actually, will still only deliver less than half of the 18,000-house shortfall. Surely there is actually an argument here for building houses, for the Government’s role and actually actively doing more in supply? The Reserve Bank Governor is talking about all of the initiatives you’ve just mentioned and still says much more needs to be done.

English Yes, well, you wouldn’t want to—just to get the numbers right, the advice is somewhere over 10,000 a year would start a bit of catching up, and it’s currently running at a bit under 8,000 and building up. So it’s not the difference between 8 and 18; it’s the difference between 8 and 10, but of course, we want to get there. I think the next—so the special housing areas are picking up speed pretty quickly. Other developers are now getting the message that a lot of supply is coming and if they want to capture their margin, they need to act now, and I’ve spoken myself to developers in
recent times who’ve said that’s their shift in their attitude, and that’s exactly what you want to see. You want them to feel that, see the supply pipeline building up pretty rapidly, and, therefore, bringing forward their own projects before the gas goes out of the crisis too much.

The next tranche of activity, from the Government’s point of view, will be around the redevelopment of its own estate. The Government owns 7 percent of all housing stock in Auckland. Between the Government and the council, we own most of the underutilised housing land—and I don’t mean parks and reserves and stuff; I mean sites that have some housing on them but nothing like as intensive as it could be. So over the next 3 or 4 years, I’d imagine Government will become one of the major suppliers in medium-density housing to the Auckland market, and Auckland City Council will probably be the second major supplier of medium-density housing to the Auckland market.

Robertson G When the Reserve Bank Governor talks about a sharp correction; do you believe that means the housing bubble’s about to burst?

English Look, I don’t use terms like “bubble” because it’s pretty hard to tell when you’ve got one, but I just repeat what I said the other day: double-digit house price inflation can’t go on forever, and it won’t, particularly with the kind of supply reaction—the kind of supply reaction those high prices bring on. You’ve got a combination of the market responding to those high prices by getting more supply in, and Government trying to make that easier for them to do. So just by reason of greater supply coming through faster, you’re going to see, over the next—who knows?—2 to 3 years, changes in that—the dynamics of the pricing—but I’d, you know, who knows whether you’re in a bubble?

What we do know is that if it gets way out of line with the norms, you end up—you can end up with a mess like Ireland and Spain, and I believe that’s what motivates the Reserve Bank. It’s their concern about financial stability and excessive levels of debt in a highly speculative—if people are speculating, they’ve got to keep in mind asset prices can go down. Most New Zealanders believe housing goes up forever. Other countries believed the same thing, and it didn’t work out too well.

Robertson G Do you support the use of macro-prudential tools like limiting the number, or limiting lending to people with multiple investment properties?

English We put in place the macro-prudential framework with the Reserve Bank, so there’s this memorandum of understanding about who does what, and we support the Reserve Bank using a range of tools available to it.

Robertson G That specific one?

English The judgement—you know, to some extent—It is actually their responsibility.

Robertson G Sure, but I’m asking if you support the use of that specific tool.

English Under the arrangement, it’s not a matter of whether I support it or not. I suppose if the opportunity to influence them—if I thought—if the
Government thought it wasn’t a good idea and thought it was a seriously bad idea, but otherwise we haven’t done that, and they are free to make sensible use of those tools according to their remit, which is to look after financial stability.

Robertson G Just one last question on that: do you think it’s time now for them to do that?

English Again, we leave those judgments to the Reserve Bank. Our focus is on the bit we control, which is the legislative structure around council decisions, and the council are the ultimate decision makers. We can change the law, and we can influence them, and we’re trying to use that as positively as possible, and the next tranche of activity will be the Government lifting the rate of development on its own State housing areas.

Norman Just to change the subject again to climate change. Treasury produced, in its briefing to the incoming Minister—looked at some further projections around greenhouse emissions and potential targets and the cost to the New Zealand Government. In that, they concluded that from the 2021 to 2030 period, the cost to the New Zealand Government, looking at our current trajectory, even if we just kept our current targets without increasing our targets, is somewhere between $3 billion and $52 billion—the cost to the government. Because our emissions are so way above that target, we’d have to buy credits offshore, and depending on the cost of those credits, will have a dramatic impact on the cost to the Government. What’s been your response to Treasury’s report that the fiscal cost to New Zealand could be between $3 billion and $52 billion if we continue with our current trajectory of increasing greenhouse emissions?

English That’ll all get—that will be one of the considerations. The potential fiscal cost will be one of the considerations in the Government’s discussion about its sort of post-Kyoto targets, and in that sense, nothing’s particularly changed. I mean, the cost last—all the discussions I’ve been part of for the last 10 years have been trying to balance costs to households and business with climate change effectiveness, and in the future the same issues—the same issues will arise as we—in the run-up to this Paris conference, there’s a discussion about what our targets should be.

Norman This isn’t about the cost to households; this is about the cost to the New Zealand Government. So if we continue increasing our emissions way over our target—we’re way over target now—we’re going to have to buy credits offshore, basically. We won’t have any other options to meet our targets, and so there’s a huge gap. I mean, Treasury identified a 315 million tonne gap that we’re going to have to cover somehow. If it’s $10 a tonne, that’s a $3 billion cost; $150 a tonne, it’s going to balloon out, right? To $50 billion potentially. So in your calculations, it’s not just about cost to the household and cost to the environment, it’s also about the fiscal impact on the New Zealand Government. Are you factoring that in when you’re saying: “What are we going to do?” Because if we don’t cut our emissions, it’s going to be incredibly expensive for the New Zealand taxpayer.
Yes, we do have to pay attention to the Government’s long-term fiscal sustainability, and this will be a factor. It’s quite a tricky issue to deal with, partly because those estimates are so wide: $3 billion to $50 billion. Who knows what that means? And we know in the fairly short history of the ETS, the prices fluctuated enormously. So that’s one—one factor’s the uncertainty about what the prices will be. Another is the sort of increasingly positive track for technology that looks likely to assist with emissions reduction. So that’s another factor in the discussion.

What’s our view? If we’ve got to take a longer-term view, I, for instance, am increasingly optimistic about lower emissions technology becoming pretty ubiquitous reasonably quickly over the next 10 years. So those are all—I don’t think anyone else is more certain about it than we are about what’s going to happen, but certainly the outer bounds of those estimates would be a pretty concerning cost.

Do you accept that price is a significant factor in the uptake of technology? Because I agree with you: technology, I think, is going to have a huge impact. But obviously price makes a big difference as to whether that gets uptake. So you’ve—your policies have driven down the price domestically, dramatically, and so that means the uptake of that technology is much less likely. So you’re kind of factoring in a kind of high-carbon-intensive economy. The reason why I say that is I’ve been doing the numbers—looking at units of GDP versus a tonne of carbon, right? How intensive our economy is in terms of that. It’s getting worse. Our economy is getting less efficient in the use of carbon under your administration than it was previously. So we’re producing more carbon per unit of GDP than previously. Aren’t you worried about that trajectory?

I’d be interested to see those calculations. We’ve probably—I think most people probably assume that, on average, because of the existence of the ETS—even if the price is low—and a pretty strong focus on sustainability across a lot of businesses and organisations, they probably assume it’s getting a bit better, but I’d be interested to see the calculation.

I’d be happy to provide them. But it’s a long-term strategic risk to the New Zealand economy, don’t you think? If we’re going to end up with this very carbon-intensive economy when the whole world is putting a price on carbon, it leaves us at a bit of a dead end.

Well, I wouldn’t say a dead end, but I agree—in the circumstances you describe—it is a fiscal challenge, or could be a fiscal challenge. I wouldn’t say it is because we don’t know for sure.

And an economic challenge.

Yes, that’s right. And we’ve got this—I think there’s a—at least now we have a better understanding of New Zealand’s unique circumstances, which is to do with the forestry cycle and the large proportion of a developed country’s emissions that are agriculturally based. And they both pose fairly challenging hurdles to get over.
Are you happy with the quality of foreign investment in the country at the moment?

For people to invest—foreigners to invest here they’ve got to get through the OIO. That sets some quality bars. The courts lifted the bar over the Crafar farms case. So if they get through that process, we welcome the investment.

The thing is, they get through the process but then there’s a 5-year reporting period where every year they’ve got to report on the milestones they said they would meet. My understanding is there are a number of investors that haven’t actually met those milestones or even reported to the OIO. Do you think we should be doing an audit on this—non-political, but just to satisfy Kiwis that actually the quality of foreign investment in this country is of a standard that we welcome?

We’d expect the OIO to take reasonable steps to ensure that its conditions and agreements are honoured by the investors. I hear occasionally about people who may or may not have met their conditions, and it’s the job of the OIO to follow up, because they’re agreements made in good faith and they should be kept.

And if they just haven’t got the staff or they’re not actually following up, what do you think we should be doing about that?

That scenario hasn’t been put to us. They are free to come forward and, say, in order to put a case that monitoring’s going to require more resource, and that it’ll be weighed up with everything else. But I wouldn’t see that as an excuse for not monitoring, and my understanding is they are monitoring. They have taken action as being, in recent years—some sales, forced sales. OIO have forced some sales, as I’m pretty sure I’ve been told, where conditions haven’t been met.

One sale.

Is it one? Yes. And that should be—illustrate to investors that the Government will take action if they are in some egregious breach of their conditions.

Would you support an audit? A cross-party audit of foreign investment over the last 10 years since the Act came into place?

I don’t know. I haven’t thought about that proposition, but I think OIO should be doing its job regardless of what other parties think.

So if a proposition was put to you for a cross-party audit you’d consider it?

I don’t know what a “cross-party audit” means. It sounds like a bunch of politicians doing trips around the country looking at golf courses.

Can I ask a question from the opposite point of view on this topic, which is that the history of our country is a history of foreign investment. One of our biggest challenges is getting capital. The OECD has ranked us 48th worst out of 54 as a place that’s easy to invest in, mainly due to restrictions on investing in land. Is the Government doing anything to actually make it
easier for people to invest in New Zealand? Because it’s actually something that we need.

English The OECD does have a view which I think is a bit more negative than is the case. I’ve had a discussion with one OECD official about how it’s rated, and they just find the Overseas Investment Act very complex. So there’s something like 23 tests. I think the impact of it isn’t so much that people put in applications that then fail, it’s just that they look at it, see the costs, because the fees are pretty high—we’re getting complaints about the fees—and just don’t apply. So that’s probably the impact it has. Now, in all of this—

Seymour Has the government tried to survey or test the size of that chilling effect?

English We had a bit of a look at it 4 or 5 years ago, and I think it’s—the impression I have—I was the MP for the Queenstown area, so you hear a lot about this stuff there—the impression I have is it’s a reasonably significant deterrent for people who aren’t determined. You’ve got to be pretty keen to actually invest in New Zealand to get through that process.

But we’re trying to get the right balance here. I mean, we do want keen investors committed to New Zealand, and we’ve got a lot of foreign investors who are, and do a good job. They bring in a lot of capital. I’ve just had, down south, a company essentially be bought out—a Kiwi company—with a significant injection of capital going with that purchase, and the community will benefit from it. So we think the balance is about right. It reflects New Zealanders’ concern about foreign investment, because they get pretty thoroughly tested, on the one hand; but on the other hand we are an attractive jurisdiction for foreign investors to come.

Probably the thing we do most that encourages foreign investors is just run sensible economic policy. If you’re an investor in New Zealand, regardless of whether you’re foreign or domestic, we’ve got a high-quality regulatory environment, a predictable Government, steady economic growth, and generally a welcoming community.

Peters Look, just two or three questions. First of all, did you feel like saying something between November and January when banks were hiking interest rates up?

English Did I feel like saying something?

Peters Did you think that it wouldn’t be a time for you to say of this: “Something’s very disturbing here.”? We’ve got deflation. You talked about interest rates lower for longer. And, of course, the boast of your administration is: the lowest interest rates in 50 years. Despite the fact that, internationally, that is not the truth. Either in the EU, USA, UK, Japan, China, the whole hundred yards, it’s way different—lower than what you’ve got here. But the banks were rarking it up between November and January, and there wasn’t a word at all from this administration. Why was that?

English Generally, because we can’t influence interest rates directly and because the governor of the Reserve Bank has independence in the conduct of monetary policy, we try to—we are somewhat restrained in giving opinions
about the track for interest rates. I mean, as it’s turned out, the downwards pressure has resumed.

Peters Exactly, but for all those that got caught on the rejigging of three months, it went up.

English Yes, but to be fair, that’s what everyone thought was going to happen then.

Peters Have you seen the advertisement near the Auckland international airport?

English See the what?

Peters The huge advertisement at the Auckland international airport about the number of houses—the availability of housing in New Zealand for purchases offshore. Have you seen it?

English No, I haven’t.

Peters Has anybody brought it to your attention?

English I mean, do you—if your question is: has anyone brought to my attention the fact that New Zealand residential housing is marketed offshore? Then, yes. I regularly get emails from all sorts of people showing me ads and pamphlets, and all sorts of stuff.

Peters You were talking about the tools you were leaving to the Governor of the Reserve Bank—well, the offshore buying has been huge, and it’s in the recent Bayleys report, just a few weeks ago. It’s also in a Herald article in late January by Phillip Field—something the Herald has discovered rather belatedly: that there’s a crisis fuelled by offshore buying. But, anyways, there’s one tool. Then you’ve got high net migration, mostly going to Auckland. Again, fuelling demand in both housing and rentals. When do you propose to do something about that?

English Some of these things we regard as measures of success. So New Zealand’s high net migration, which is I think the highest since 1994, is some indication that, particularly, Kiwis who were considering leaving have decided to stay home, and that’s a good thing. We all wanted to achieve that. That has added to some pretty—there’s other factors that are part of the strong demand for housing that, in my view, are probably much more significant. Interest rates are a bit lower than people thought they would be, their real wages are rising, they’ve got a bit of confidence about where the economy’s going; these are all things that make them more likely to go out and pay a bit more for a house.

It’s a bit hard to know exactly what impact any of those particular factors has, including the presence of some offshore buyers in the market. And the anecdotal evidence around that indicates that it’s a bit hard for people to tell who is an offshore buyer when they go along to the auction. So what we’re doing about it is—you’ve got a choice: you can try and constrain the demand somehow. We’ve tended to avoid that, although the macro-prudential measures have some impact, and there may be more to come; and we’ve just focused on supply, because in the long run that will be the dominant influence.
Look, that’s true, but then why don’t you loosen restrictions that are presently existing and double the number of immigrants coming in? Because if it’s a measure of success, and it’s good for the economy, why don’t we enjoy the full flush of it all? Just open up the gates.

Well, it’s not so much that—the number of immigrants coming in has gone up somewhat, but the biggest shift has been the number of Kiwis not leaving, and we don’t want to—we’re happy about that.

In the BPS you use the words that you’re going to “rigorously test” Government’s expenditure and the value of it. Could I ask you what your view of this example is? Are you aware that EQC, which you mention in the BPS, is recruiting loss adjusters, paying them in advance for approximately 1 week a month’s work—if there’s no work, they still get paid—and the rates of pay are 30 percent higher than the top rate for commercial loss adjusters, and double that of the top rate for residential loss adjusters. So you’ve got an agency here that is paying people basically to do nothing—if there’s nothing to do, they still get paid—and a year’s salary, double and 30 percent extra for commercial residential top rates, you know, sort of, year’s salary for 1 week a month’s work, which might happen or might not. Do you think that meets your test of rigorous fiscal management?

Look, on the face of it, that’s—I mean, I’ve seen that story and I’d be interested to know what’s behind it—

It’s confirmed by EQC.

And I haven’t spoken to them directly; I expect the Minister would find out what the story is—

Have you spoken to the Minister?

No, I haven’t directly about that. Bear in mind that whatever the details of that arrangement, one of the consistent complaints about process in Christchurch is that EQC are coming up with all these over-cap properties as they get into the more complex, harder end of the earthquake-damaged homes. I mean, even if you get 90 percent of them done, the last 10 percent are going to be the most difficult. So without being able to confirm it, I imagine they’re trying to get a high level of expertise readily available to deal with stuff as it arises. But it’s a fair enough question and we should get an answer to it.

Would you give us a commitment to rigorously test your Minister in charge of EQC, perhaps, to get an explanation and make that explanation public? Because I think we’d all like to know.

I’ve found the Minister of EQC is quite capable of rigorously testing anything—

The difficulty is to date he hasn’t bothered to ask.

He only needs a small invitation to do so.

To date—

Well thank you very much, Mr English. We’ve—
Cosgrove  Excuse me—
Bennett  No, we’ve done the—
Cosgrove  No, we haven’t, we’ve got 3 minutes to go.
Bennett  We started early, so—thank you very much—
Robertson G  It’s not quarter to. Mr Chair, we have allocated until quarter to 1 for this
debate and then we’ll keep going.
Bennett  —and we’ve got Treasury as well to come—
English  I can probably do 3 more minutes, Mr Chair.
Bennett  You can do 3 more minutes? We’ll do one more question.
Peters  Do you need protection from the Chairman here? With all your experience,
do you really think you need protection from the Chairman?
English  Oh, sometimes, I mean you guys can be pretty ferocious.
Robertson G  Mr English, I want to take you back to Skycity, Mr English, for one more
question. When you said that putting more money in was the least preferred
option, does that mean that walking away from the deal is a more preferred
option than putting more money in?
English  Well, “least preferred” means what it is. Everything else is a bit more
preferable.
Robertson G  So walking away is more preferable to you than putting more money in?
English  Look, again, I wouldn’t want to get ahead of the Government having a
position, but certainly more taxpayers’ money is the least preferred option,
so the logic is every other option—
Robertson G  So walking away—
Bennett  I think we’ve had enough of that. Thank you very much, Mr English; we
appreciate the time spent. Thank you.
Cosgrove  Point of order. I’ve got a procedural matter. Forgive me, I’m not going to
labour this—we have an agenda, which you wrote, which stipulates the
times that items of business conclude. Whether you deem it to be
appropriate to start early is a matter for you, but we still have time on the
clock, and actually technically we still do, with the Minister of Finance. And
your argument that we’ve got Treasury next is correct, but Treasury was
programmed in once that time had elapsed. So it is inappropriate for you to
cauterise time because of your own mismanagement. If it says the Minister’s
going to be here until quarter to, you wrote it, you should adhere to it.
Bennett  Thank you. Yes.
Robertson V  I’ll just keep it brief and, really, it’s just to note in summary some trends
since our December update and to really note that the trends that we saw in
our half-yearly update are more pronounced.
So, activity in the economy’s increasing, supported by domestic demand, as
you know, and, at the same time, inflation, which is already low, has
dropped further. For many New Zealanders the combination of strong growth and low inflation is, of course, positive. And we expect employment will continue to grow. People will have more buying power from their incomes and prices will stay down. Interest rates will remain low. For the Government, though, low inflation does mean that we expect less tax than we might have otherwise done in a growing economy.

There are still risks, and this is what’s been reinforced in the last few months—that we’re living in a time that offers New Zealand a lot of opportunity, but also comes with a lot of uncertainty. In this context, important to continue to embed improvements in the Government’s financial position, growing economy, shore up our prospects for a sustainable growth and higher living standards over the long term. This will continue to be Treasury’s focus for the year. Thank you.

Nash
One question: I mean, you said consumers are going to have more buying power, but in your document it says that wages aren’t meeting—keeping pace with—inflation. But if wages aren’t keeping pace with inflation, then they’re going to have less buying power. It says in your document here: “some of the principle drivers of tax revenue, e.g. compensation of employees and private consumption, grew at a slower rate than overall GDP, causing a related tax-to-GDP ratio to decrease by approximately .3 percent”.

Robertson V So, there’s two things that are important to note there. So, real wages are increasing, and, in terms of the impact of low inflation, that has both positives and negatives in terms of consumer buying power. So, for example, petrol prices have decreased, and that means that people can drive their cars for longer at the same cost. But, we also make an assumption that they will spend the savings they have on consumption goods. So, in terms of people’s buying power, they actually can buy more with the real wage increase that they’re seeing.

Norman So, just going back to climate change: Treasury’s paper pointed to a 315 million tonne hole, if you like; that if we were going to even have the same targets as now—5 percent below 1990 levels—in 2021 to 2030, there’s a 315 million tonne overshoot. Now, in Treasury’s document you kind of suppress the relevant prices—in the document you released—but since then we’ve kind of learnt what they were. So, in your advice to the Government are you saying to the Government don’t make a decent target, or are you saying: “Why don’t we reduce our emissions?”. Because it’s kind of like you’ve got two choices here, right? If you want to avoid this fiscal risk, this $3 billion to $50 billion fiscal risk to the New Zealand taxpayer, you can either say our target’s going to be higher, so we’re not going to cut our emissions, or you can say, actually, we’re going to try to cut our emissions.

Robertson V So, couple of things there. One is that you mentioned the upper end of that band, which—there was a large band that we mentioned in terms of the potential cost to Government of that. So, that’s one point.

I think what our briefing really—what we’re saying is in climate change it’s actually not an either/or here. You actually do have to have—as the
Government goes into Paris, some, you know—look at what it needs to consider, in terms of what New Zealand’s target will be. We also think for a growing economy sustainability is absolutely critical, and we do think that’s still a thing that Government should have aims around. So, we don’t say, reduce your targets there and stop your emissions; we actually think it’s important for the New Zealand economy to be sustainable in that way.

Norman In this context, greenhouse emissions per unit of GDP is kind of relevant, and New Zealand is—I’m just looking at the UNFCCC data now—it’s pretty much the worst in the world. So, our growth since 2008 is 13.8 percent. That is the greenhouse emissions per unit of GDP. And pretty much everyone else has cut their emissions per unit of GDP. So, everyone else is becoming more efficient, in terms of carbon intensity, and New Zealand’s becoming radically less efficient. How is that a good economic strategy?

Robertson V I think, as you know, the biggest input into our emissions is agriculture. And, I think, it’s true to say that that is an area that New Zealand needs to continue to look at how we have increasing productivity in our agriculture sector as well as being sustainable. So, I think—we know our profile’s quite different from some of the other countries’ data that we see. And our strong agricultural part of our economy means that that profile is going to be different.

Norman But even in the transport sector, which is the fastest growing sector, other countries have strategies to reduce their transport emissions; we have strategies to increase our transport emissions. So, aren’t you concerned that having an economy which is now a real outlier in terms of the increase in emissions per unit of GDP—I mean, a wild outlier when you look at the UNFCCC numbers—that is a systemic risk to the New Zealand economy, to be so inefficient, in terms of carbon, compared to all of our competing countries?

Robertson V What we would say is that having good, sound policies around climate change and emissions is really important.

Norman So, does that include a price on carbon?

Robertson V That’s one option.

Norman So what are the other options? Because every report I’ve ever read says the most efficient way to reduce greenhouse emissions is to have a price on carbon—everything I’ve ever read says that. Is that not the case?

Robertson V As you know, you have to trade off with that, right? So, if you just want to reduce emissions, then you will have cost to the economy in doing that. So, that is our advice here is, look, you just have to balance those. And, in terms of the briefing for incoming Ministers, making sure that they understand what those balancing factors might be.

Norman In fact, what your report said is there’s a cost to the Government of not reducing emissions. There’s a $3 billion to $50 billion fiscal risk of not reducing emissions is actually what your report said. Because, even if we maintain the current target, the fiscal risk to the New Zealand taxpayer is
enormous with this strategy of increasing emissions. So, aren’t you providing advice that says we should reduce the fiscal risk to the New Zealand taxpayer by actually trying to cut emissions?

Robertson V Other than our briefing to the incoming Government, we haven’t as yet provided further advice in terms of what they may—the Government may—decide in that area.

Norman So, in terms of a competitive economy, do you or do you not think having low greenhouse emissions and lowering greenhouse emissions per unit of GDP is the goal that we should have, or not?

Robertson V I would just say that it’s not the only goal that we have in terms of growing the economy.

Norman That wasn’t my question, thank you very much. My question was that is that a goal you think we should have—

Bennett Mr Norman, Mr Norman! She—

Norman No, she didn’t answer the question. Do you think that’s a goal we should have?

Bennett We had an answer. There’s been an answer, Mr Norman, so—

Norman No, there hasn’t, Mr Chair.

Bennett There has.

Norman So, do you think that one of the goals should be to reduce greenhouse emissions—

Bennett Mr Norman, it has been answered, have you got a new question?

Norman —per unit of GDP or not?

Robertson V Only where—I don’t think that is a sole goal in itself.

Seymour The thesis here really is that we may need—we, as New Zealand—may need to transfer funds off-shore if we get seriously behind the rest of the world in terms of the carbon intensity of our economy. That’s the threat. But how could that happen? We’re absorbing the same technology as the rest of the world, we’re of similar industries, etc.—agriculture, the rest of the world wants to buy food from us. So I don’t quite see how it’s plausible that such a large gap is going to open up. The rest of the world’s going to decarbonise and then charge us for continuing at the same level of carbon we have now, or worse. The whole thing doesn’t quite seem plausible in real terms.

Bennett I think the point’s made. Thank you very much. We appreciate staying afterwards as well.

**conclusion of evidence**
Reserve Bank of New Zealand’s Monetary Policy Statement, March 2015

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
April 2015

Presented to the House of Representatives
Reserve Bank of New Zealand’s Monetary Policy Statement, March 2015

Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, March 2015, and recommends that the House take note of its report.

Introduction

This report summarises the contents of the Reserve Bank’s monetary policy statement released on 12 March 2015, and the main issues we discussed in our meeting with the governor that day.

The statement announced the decision of the Governor of the Reserve Bank to keep the official cash rate (OCR) unchanged at 3.5 percent. The OCR has been at this level since July 2014, after four increases of 25 basis points each over the previous four months.1

Following the announcement, the New Zealand dollar appreciated by about a cent against the US dollar, to nearly 73 cents, suggesting that the markets had expected the Reserve Bank to indicate some future easing of interest rates. Instead, the bank said it expects a period of stability in the OCR, with any change—either up or down—dependent on emerging economic data.

Reserve Bank’s reasoning

New Zealand’s economy remains strong, and inflation is low. GDP is estimated to have grown by more than 3 percent in 2014, and growth of 3–4 percent is forecast for the next two to three years. The momentum comes from low interest rates, increasing construction activity, high net immigration, rising house prices, still-high terms of trade, and the boost to consumption spending from growth in employment and real wages. The high exchange rate, however, continues to be a factor weighing against growth.

The major development since the last MPS in December has been a dramatic fall in world oil prices, which are now about 50 percent lower than their peak in June 2014. The fall has been positive for New Zealand’s economy, increasing the purchasing power of households and lowering costs for businesses. The effect of lower oil prices is expected to be a reduction of about 0.9 percentage points in annual Consumers Price Index (CPI) inflation by the March quarter.

Annual CPI inflation was 0.8 percent in the December 2014 quarter, and is expected to fall to around zero for the March 2015 quarter before increasing gradually as the economy expands. Monetary policy remains focused on ensuring that inflation settles at 2 percent over the medium term.

1 The OCR had been held at the record low level of 2.5 percent for three years, before being increased to 2.75 percent in March 2014, then to 3 percent in April, 3.25 percent in June, and to its present rate of 3.5 percent in July 2014.
Because monetary policy focuses on the medium term, the Reserve Bank says it is not responding to the effects on inflation of the fall in oil prices. It will, however, watch closely how the fall affects wider price- and wage-setting behaviour. It sees current behaviour as consistent with annual inflation settling at 2 percent over the medium term, in line with its policy targets agreement, but notes that the outlook for monetary policy could change if price-setting decisions reflected the recent very low inflation results. A special section on page 5 of the monetary policy statement discusses the importance of inflation expectations and price-setting behaviour for monetary policy.

Weighing up these various forces and the risks and uncertainties in the international outlook, the Reserve Bank expects a period of stability in the OCR. Its forecasts now imply no increases in interest rates over the next two years, with 90-day rates projected to remain at 3.7 percent. It indicates that future interest rate adjustments could be either up or down, depending on the emerging flow of economic data.

**International financial conditions**

Volatility in international financial markets has increased in recent months following the sharp fall in oil prices, continued uncertainty about the global economic outlook, and policy easing, sometimes unexpected, by a number of central banks. The monetary policy statement notes that these developments have fuelled concern among investors about global disinflationary pressure.

While the US Federal Reserve has stopped its quantitative easing and is expected to raise interest rates sometime after June, a number of other central banks are undertaking monetary stimulus. The European Central Bank has just started a major programme, purchasing US$60 billion a month of government securities. The Reserve Bank told us that quantitative easing to date has amounted to US$6.5–7 trillion, and is likely to be more this year than at any other time since 2011.

**The outlook for inflation**

Annual CPI inflation has averaged just 1.1 percent since the beginning of 2012. The low rate has mainly been caused by international factors—particularly low global inflation and the high exchange rate—leading to negative inflation in the tradables sector (an annual average of minus 0.8 percent over the past three years). Inflation in the non-tradables sector has been higher, averaging 2.6 percent over the same period, although still below its long-term average.

The Reserve Bank expects the fall in oil prices to reduce tradables inflation to about minus 2.6 percent for the March quarter. Inflation in the non-tradables sector is expected to rise to about 3 percent over the next few years as the economy expands. Overall, CPI inflation is expected to fall to zero for the March 2015 quarter before gradually increasing back to the 2 percent mid-point of the target band.

**Inflation and the policy targets agreement**

We discussed with the governor whether the Reserve Bank’s policy targets agreement (PTA) with the Minister of Finance is still serving its purpose. The agreement requires it to keep inflation within a range of 1–3 percent in the medium term, with a focus on keeping average inflation near the 2 per cent mid-point. However, going by the bank’s forecasts, inflation could be below the mid-point to the end of 2016. Noting that inflation is
exceptionally low in other countries too, we wondered if a “new normal” is emerging for inflation globally, so it might be time for the thinking behind the PTA to be revised.

The governor acknowledged that New Zealand’s inflation rate has been below the mid-point for some time, but noted that it had only more recently moved below the 1–3 percent target band. He said the bank’s projections indicate it will increase back toward 2 percent, although this will take some time.

The governor said he still believes 1–3 percent is the appropriate target for New Zealand, with the mid-point a relevant objective to work towards. However, he acknowledged that inflation rates since the global financial crisis have puzzled central bankers around the developed world. Inflation expectations proved slow to adjust in 2009 and 2010, with rates falling more slowly than expected. Now that the world, for a number of reasons, has moved to a period of low inflation, central banks are watching closely to see how expectations adjust.

Objectives of monetary policy

Some of us believe the policy targets agreement has a myopic focus on inflation, and should include a wider range of considerations, as in Australia and the USA, especially with inflation now so low. The governor noted that while the agreement sets a price stability objective, it does also require the bank to have regard to the efficiency and soundness of the financial system, and to seek to avoid unnecessary instability in output, interest rates, and the exchange rate. In his view there are a limited number of things a central bank can influence. It has a reasonable degree of influence over inflation—particularly non-tradables inflation—in the medium term (say, 12 to 18 months). It can also affect the rate of growth of demand and income in the short term; however, it cannot influence output growth over the longer term, nor long-term interest rates which are set by overseas financial markets.

The governor added that having multiple objectives for monetary policy can lead to complexity, noting that there has long been debate about the Federal Reserve’s twin objectives of price stability and maximising employment.

Inflation expectations

The Reserve Bank is keeping an especially close eye on people’s expectations about inflation in New Zealand, and on how those expectations are reflected in the setting of prices and wages.

We heard that the decade from 2000 to 2010 saw CPI inflation average about 2.5 percent annually, and expectations settled at that level. More recently, however, inflation expectations appear to have lowered to about 2 percent. This is consistent with annual inflation gradually returning to the mid-point of the PTA target range. The Reserve Bank’s central projection envisages this scenario.

The governor said that if expectations about inflation were to get entrenched at a lower level, the Reserve Bank “would certainly move on monetary policy”. We note that the monetary policy statement sets out one alternative scenario, where inflation expectations settled near 1 percent over the coming year—considerably lower than the target mid-point. In such a situation, the statement says, “it would be necessary for the 90-day rate to be
lower than currently projected, for annual CPI inflation to reach 2 percent and inflation expectations to be anchored at the target mid-point over the medium term”.

**Interest rates and international comparisons**

The Reserve Bank’s forecasts now imply no increases in interest rates over the next two years, with 90-day interest rates projected to remain at 3.7 percent. Previous forecasts had envisaged 70 basis points of tightening over the next three years, to 4.4 percent by March 2017.

We asked whether, with inflation so low, there is scope to lower the OCR, noting that this would help to ease the high exchange rate and growing current account deficit, which the Reserve Bank has acknowledged as problems.

The governor said the bank has been considering such issues closely, especially with 20 or so central banks around the world cutting their official cash rates since January, including seven in advanced economies. The Reserve Bank has analysed their reasons, and told us that in most cases it is because those countries have very different economic situations than ours. Many are experiencing low growth and high or rising unemployment. In contrast, New Zealand is growing at 3 to 3.5 percent, and is expected to continue doing so for the next two years. Employment is growing strongly, at 3.5 percent, and unemployment is projected to fall to 4.5 percent.

We noted that New Zealand’s official cash rate is now higher than that of every other OECD country, and questioned whether the situation here warrants such a difference. The governor said New Zealand’s performance does to a large extent make it “a standout”; IMF data shows that it is the only country among the 35 advanced economies that has had a positive output gap not just for one year but two. He said the Reserve Bank still views the current OCR as stimulatory for the economy, and does not believe the cost of capital in New Zealand is constraining businesses from investing.

**Neutral interest rate**

One of the key concepts in monetary policy is the neutral interest rate: the level at which interest rates are judged to be neither stimulating nor constraining economic activity.

It is of interest that the Reserve Bank is reassessing the neutral rate for New Zealand. Up to now, it has judged the neutral 90-day interest rate to be 4.5 percent. This is equivalent to an OCR of about 4.25 percent, so it considers the current OCR of 3.5 percent to be supportive for the economy. However, the bank is less sure whether this assessment is correct in the current world climate, where interest rates and inflation appear to be settling at low levels.

We will be interested in learning the outcome of the Reserve Bank’s work in this area over the next few months.

**The housing market**

House price inflation increased in January to an average annual rate of 6.5 percent nationwide, with Auckland experiencing the fastest increases, of nearly 13 percent on an annual basis. The Reserve Bank says the current shortage of housing, high net immigration, and low interest rates mean that house price inflation is likely to continue increasing in 2015 to a peak late in the year, before reducing as the supply of housing increases. It has, however,

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2 MPS, March 2015, p. 5.
said that house price increases did not have a bearing on its monetary policy decision. The Reserve Bank estimates that the shortage in Auckland might be 15,000 to 20,000 houses. It said the Auckland Council estimates that 10,000 new houses a year are needed; currently about 7,700 building consents a year are being issued.

We asked the Reserve Bank why it is not more concerned about imbalances in the housing market, given that the policy targets agreement requires it to consider asset price movements when formulating monetary policy. The bank said it is concerned about prices in Auckland, but for reasons of financial stability rather than price stability. It sees the present situation as quite different from the period 2006–2007, when the wealth effects of a rapid rise in house prices were feeding through into consumption and putting upward pressure on inflation. Such effects are not evident now—it says recent increases in consumption result from growth in incomes and employment, rather than from housing wealth—but it is concerned that median house prices are now 50 percent higher than in 2007. It believes it could take some time for Auckland’s housing supply to catch up with demand, so there will be further pressure on prices in the meantime.

The bank is less concerned about the situation in Christchurch, where house price pressures are already starting to ease, and it believes there could even be an oversupply of housing for a period. There are pockets of house price inflation in other areas such as the Otago lakes district, Nelson, Taranaki, and Waikato, but its main concern is whether supply in Auckland will increase quickly enough.

We observed that there is some tension between the Reserve Bank’s objectives, and asked whether it is reluctant to lower interest rates out of concern for the effect it would have on the housing market. The governor responded by recalling Sweden’s experience. Its central bank had raised interest rates in an effort to counter rapidly-rising property prices, but ended up with quite serious negative inflation. The Reserve Bank wants to avoid a similar experience here.

**The exchange rate**

The Reserve Bank has been saying for several years that the New Zealand dollar is unjustifiably high, and unsustainable in terms of New Zealand’s long-term economic fundamentals. The monetary policy statement makes a particularly blunt statement, that “a substantial downward correction in the real exchange rate is needed to put New Zealand’s external accounts on a more sustainable footing”.

We asked why the Reserve Bank does not seek to manage the exchange rate within a range that would be more economically sustainable for manufacturers and exporters. The governor said the Reserve Bank is actually a relatively small player in the foreign exchange market. Any intervention it could undertake would be small compared with the total flows. At times it can have some influence, but it is not a straightforward proposition.

The governor said that you cannot control the exchange rate and target inflation at the same time. If the bank were to try to fix the exchange rate, it would mean changing monetary policy and surrendering the inflation target. Some countries do this: Hong Kong, for example, pegs its currency to the US dollar and accepts the outcome for interest rates and inflation. Switzerland attempted to peg both inflation and the exchange rate but it was unsustainable; it incurred massive losses of US$60–70 billion. Singapore takes a hybrid approach, using the exchange rate to target inflation, but this can entail uncomfortable appreciation of the currency to achieve the target.
Some of us regard the governor’s explanation as unacceptable.

**Oil prices**

Chapter 6 of the monetary policy statement sets out the Reserve Bank’s assessment of how changes in world oil prices affect the New Zealand economy. It sees the 50 percent decline in oil prices since June 2014 as a positive supply shock, lowering near-term inflation and boosting output. However, because the effects on inflation are seen as temporary, the Reserve Bank “looks through” them and focuses instead on inflation in the medium term. It has therefore not taken the drop in oil prices into account in deciding its monetary policy stance; nor does it intend to factor in the rise in future oil prices which it is forecasting from 2017.

We are interested in how the fall in world oil prices translates into domestic prices at the petrol pump. We note that a research paper drawn on by the Reserve Bank found that businesses are more likely to increase prices following a cost increase than to reduce their price following a fall in costs.\(^3\) The Reserve Bank said it does not have a view on whether domestic prices have fallen enough. It noted that several other factors are relevant in calculating prices at the pump: transport costs, the exchange rate, and the margins charged by oil companies.

The Reserve Bank said its modelling considers several international prices for crude oil; for domestic prices, it primarily uses figures from the Ministry of Business, Innovation and Employment. Some of us note that the oil industry has contested the ministry’s figures.

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Appendix A

Committee procedure
We met on 12 March and 29 April 2015 to consider the Reserve Bank of New Zealand’s Monetary Policy Statement, March 2015. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Stuart Nash
Dr Russel Norman
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
David Seymour
Alastair Scott
Appendix B

Transcript of hearing of evidence 12 March 2015

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Matt Docey
Stuart Nash
Dr Russel Norman
Richard Prosser
Grant Robertson
Alastair Scott
David Seymour

Witnesses
Graeme Wheeler, Governor, Reserve Bank of New Zealand
Grant Spencer, Deputy Governor and Head of Financial Stability
Dr John McDermott, Assistant Governor and Head of Economics

Bennett Good afternoon, Governor and your team. Welcome to the select committee for the Monetary Policy Statement. So we'll have a brief introduction from you and then we'll open up for questions—OK?

Wheeler Thanks very much, Chair. Look, let me introduce Grant Spencer, on my left, who’s the deputy governor and head of financial stability, and John McDermott, the chief economist and assistant governor, on my right. We left the official cash rate unchanged at 3.5 percent. Global financial conditions are very accommodative but volatility in financial markets has increased in recent months due to the sharp drop in oil prices, the continued uncertainty around the global outlook and US monetary policy, and policy easings by a number of central banks. The domestic economy remains strong. Falling petrol prices have increased households’ purchasing power and lowered the cost of doing business. Employment and construction activity are strong. Net migration remains high and monetary policy continues to be supportive.

The housing market is showing signs of picking up, especially in Auckland. However, there are a number of factors weighing on domestic growth, and these include drought conditions in parts of the country, fiscal consolidation, reduced dairy incomes, and the high exchange rate. And we believe that a substantial downward correction in the real exchange rate is needed to put New Zealand’s external accounts on a more sustainable footing.

Annual CPI inflation is expected to fall to around zero in the March quarter and remain low over 2015, reflecting the high exchange rate, low global
inflation, and the recent falls in petrol prices. Inflation expectations appear to have fallen recently, and we will be closely monitoring the impact of this trend on wage and price setting behaviour, especially in the non-traded sector.

Monetary policy remains focused on ensuring inflation settles at 2 percent over the medium term. A central projection is consistent with a period of stability in the official cash rate. However, future interest rate adjustments, either up or down, will depend on the emerging flow of economic data. So thanks very much.

Robertson Thanks, Mr Wheeler. A couple of questions around the housing issue—you make the comment that you weren’t looking at it in terms of price stability. What would the Auckland housing market have to do to make you look at it from that point of view?

Wheeler In terms of financial stability?

Robertson No, you’ve acknowledged the financial stability but you dismissed it on the other side of the shop. I just wonder what would need to happen in the Auckland housing market for it to worry you.

Wheeler In terms of monetary policy?

Robertson Yeah.

Wheeler We are required under the Act to look at asset price movements, in thinking about monetary policy settings. So we look very carefully at what’s happening in the Auckland housing market.

What we saw in 2006 and 2007 was a situation where we’d seen over 2003 to 2007, over that 4-5 year period, the most rapid house price appreciation of all the 35 countries in the OECD. So price movements were very strong in 2006 and 2007, and that’s why real interest rates were so high. We pushed up the OCR to a substantial level and put pressure on the exchange rate. We were trying to slow the housing market down to some extent, and that was partly because the wealth effects from the rise in house prices were feeding through into consumption quite noticeably and putting upward pressure in terms of inflation pressures.

If we look at the Auckland house market now, we’re concerned on the stability side because median house prices are 50 percent above where they were in 2007. We’re not seeing at this point the same wealth effects spilling over into spending and creating the inflation pressures like we were in 2006 and 2007.

Robertson I’m just curious about that because you do say that consumption is up—

Wheeler Yes, it is.

Robertson —in the economy as a whole, and you’re attributing that to other factors obviously. What’s the evidence for that? I mean, how are you drawing that distinction?

Wheeler Well, what’s driving a lot of the consumption is the growth in incomes, and the growth of incomes is closely linked to the rise in employment. So
employment has been increasing by 3.5 percent, which is, you know, very rapid for us, and that’s driving a lot of the growth in household incomes. We’ve, in fact, got the savings ratio, I think, slightly picking up, but that’s what is driving most of the consumption—is the employment growth.

Robertson So from your point of view, I mean. If we’re looking at a 13 percent—I mean, you’ve said—increase in Auckland housing inflation, 9 percent increases in rents in parts of Auckland as well—I presume that still does concern you from a financial stability point of view, and if you still remain concerned about the possibility of a sharp correction and what that would mean in the housing market.

Wheeler Yes, we worry about the supply demand imbalance in the Auckland housing market—you know, the work that we’d done in the Reserve Bank was showing that the shortage might be 15,000 to 20,000 houses. The Auckland Council was saying they need 10,000 new houses a year going forward. We follow the completion data and the permits data pretty closely, and it’s running at around 7,700—the permits at this point. So our concern is that the supply-demand imbalance won’t close for quite some time and that will put further pressure on house prices. That’s our concern.

Robertson Just one more question on a different topic: I just wonder what your view is on whether the policy targets agreement is actually still serving its purpose. We’re looking now at 5 years, 6 years of inflation below 2 percent. I’d be interested, as part of your answer, to know what the “medium term” actually means to you, because it does seem that there might be a new normal in place around inflation globally—and what consideration have you given to the fact that you are now facing a period of time where you’re well outside of the agreement and some people might be asking what the point is.

Wheeler Yeah, we’ve certainly been below the 2 percent for some time, and our projections show that we will move back towards the 2 percent; but it is going to take some time. We’ve been outside the 1 to 3 percent band for a much shorter period of time, and what’s driven the low inflation has, essentially, been low inflation in the traded goods sector, the fact that you see low inflation overseas, you see capital prices falling, you see a high exchange rate, you see a lot of exporters offshore discounting, and we’ve had negative inflation now for 3 years. So if you look at the non-tradables inflation, it’s been running at around 2.5. We think it will pick up over time to something like about 3 or thereabouts.

But I think central banks around the world, particularly in advanced countries, have sort of puzzled about inflation following the global financial crisis. You know, it hung up there higher than people expected—certainly, central bankers expected—in 2009, 2010. They expected inflation to fall more rapidly. So inflation expectations didn’t adjust quickly, and now we’re in a period where we’ve gone into low inflation for a number of reasons.

So for us, looking forward, we still think that the 1 to 3 percent target is the appropriate framework for us. The mid-point is something highly relevant for us—an objective to work towards and achieve. But, you know, we’re
going to have to look very closely at wage and price setting behaviour, going forward. If we sense that that behaviour starts to change significantly and looks as if it’s going to be more entrenched, then we would certainly move on monetary policy in those circumstances.

Norman Thank you. Mine’s kind of following up on that. I mean, any objective look at the CPI numbers says they’re in the bottom half of the band—I mean, you know, last few years and going forward—which, just on that single kind of measurement suggests that there’s scope to ease the OCR. I mean, just on that simple kind of, you know, what are the expectations going forward?

We know, and you’ve restated yourself, that, you know, the OCR is a problem in terms of the dollar, and we’ve got a dollar problem and we’ve got a current account deficit problem. So those things would all weigh on the side of easing, you know, a lower official cash rate in order—because you’ve got a bit of space on the inflation side, we’ve got a problem with an over-valued dollar, we’ve got a problem with a growing current account deficit. So just looking at it purely in those terms, it seems like there is space for a lower rate. Tell me the problem with this line of argument.

Wheeler No, it’s a perfectly fair line of argument, and we think about those issues a lot, and we’re conscious that there are central—probably 20-odd—central banks that have cut interest rates since early January, and seven of those are in advanced economies. So we’ve looked at each case. We try and analyse why they are cutting rates. And in most instances it is because their situation is quite different from ours. I mean, they’ve got situations of low growth, or a lot of excess capacity, high unemployment, or rising unemployment.

We’re in a situation where the economy’s got what we call a positive output gap. We’re growing at around 3 to 3.5 percent. We expect to continue that for the next 2 years in terms of our forecasts. We’ve got strong employment growth—it’s growing at around 3.5 percent. Unemployment we’re projecting to fall to 4.5 percent. We’ve got record migration participation rates in the economy at a historic high.

The cost of capital doesn’t appear to be—you know, doesn’t appear to be a constraint or a significant constraint for business. And if we look at monetary policy settings, the OCR at 3.5 we’d say is still accommodatory. We would still see it as expansionary, stimulatory for the economy, and at the same time we’ve got fixed mortgage rates falling. So there’s a lot of stimulus in the economy, a lot of momentum in the economy.

Now, inflation we are expecting to fall to zero on an annual basis in the March quarter. That’s primarily because of the fall in oil prices. It counts for about 0.9—so it’s a big adjustment. And if we tried to offset that, probably two things: one, we couldn’t in a short amount of time; two, we’re instructed in terms of the policy targets agreement to focus on the medium-term trends in inflation when faced with price level shifts of that sort. So we do think about the arguments you raised, we do look at what other central banks are cutting and why they are, but this is the reason why we haven’t.

Norman OK, so let me try a follow-up. I’ve got a secret theory which is that there’s a tension between your monetary policy kind of settings and your financial
stability ones, right? Because if you eased back on the OCR, you’d be worried about the impact on the Auckland housing market, presumably, wearing your fiscal/financial stability hat. How do we know that like behind the closed doors of the Reserve Bank you aren’t actually kind of going: “Yeah, well, the problem would be there’s an argument for reducing the OCR looking at, you know, these numbers, but we don’t want to do that because we know the impact on the Auckland housing market would be bad, presumably, in terms of house prices.” Is that—because there is a little bit of a tension between your two objectives, or it would appear to some people that there’s a tension between your two objectives.

Wheeler Well, we need to look at what’s happening with inflation—sorry, house price inflation for the country as a whole, which we do, and we certainly look at the Auckland housing market. But let me turn your question around a little and just talk about what happened in Sweden, you know, where the Riksbank is a highly respected central bank—it’s one of the finest in the world—and property prices in Stockholm were going up rapidly. The economy was doing pretty well, the Swedish economy. Debt levels in terms of household debt against disposable income were even higher than they are in New Zealand, and the Riksbank decided to raise interest rates and really lean against house prices in Sweden. And, in essence, they overcooked it, they overdid it, they ended up with negative inflation—quite serious negative inflation—they’ve cut interest rates twice or three times in recent months. So, you know, we’re conscious of the Auckland housing market. We’re required under the Act to look at asset prices. We haven’t raised interest rates because of an Auckland housing market concern. We don’t want to make that mistake. So hopefully that’s helpful.

Nash Most interested in your stats around the impact of the drop in the price of oil. And Mr Parker’s research—I must get the paper, actually, I wasn’t aware of it—I don’t know if that’s economics or human nature where you say, you know, people increase prices if there’s a price increase but don’t drop them as fast if there’s a decrease, and that you estimate lower oil prices are worth about $2.4 billion each year.

Just two questions, and I’ll wrap them into one. First of all, which date do you use to calculate the oil prices; and secondly, do you think that prices at the pump have actually fallen far enough compared to the price in, for example, Dubai crude?

Wheeler Well that’s—let me answer the first. We look at the prices of Brent crude and we look at West Texas and other prices, because the differential between Brent and the others can move quite a bit. In terms of the price adjustment to date in terms of petrol prices, do you have any thoughts, John?

McDermott Actually, I see you’re on page 28, and there is a picture of domestic petrol prices that have moved around—and they went to a low of 170-something, and that had come back to about 194. So where we’ve already seen the prices fall, that will now be in the calculation for the consumer price index, and we’ll see that when it comes out for the March quarter. [Interruption]
Nash: So do you use the MBIE prices?
McDermott: Sorry, what was that?
Nash: Do you use the MBIE prices or have you got your own sort of index you use? The reason I ask is the oil industry say they don’t trust the MBIE prices and there’s a little bit of contention. But I’m just curious to know if you do your own research or you use the MBIE—
McDermott: Yeah, primarily we do use those.
Nash: So with this in mind, and considering that the price has dropped about $130 down—it’s bounced up a little bit, but it’s still around about $50—do you think the prices at the pump have fallen enough considering the economic impact this sort of thing can have on the country—it’s significant, isn’t? So should they be lower than they are at the moment?
McDermott: Well they’ve actually—they fell and actually reversed upwards. I mean, the factors you have to look at, in addition to the oil price, is the transportation costs of getting the oil here, the margins the oil companies might look at, and the exchange rate. And so those are all the factors that you would need to put into a specific model for pump prices. We use that as a guide to help us around forecasting, but we wouldn’t use it to actually tell them what they should be charging at the pump. That’s their business, not ours.
Nash: So you’re agnostic on whether they’ve fallen enough? You’re just reporting as opposed to—
McDermott: Yes.
Nash: One last question—just going back to what Mr Norman’s talking about, apart from Turkey and Iceland, we actually do have the highest official cash rate, the equivalent, in the OECD. And if you look at past movements in fact, we’re the only ones to have actually moved up; every other movement has been down in terms of the last movement. I just—I’m with Mr Norman: I’m wondering if in fact it is actually too high. You’ve talked about the justifications, but—you know, you’ve mentioned that you do look at other banks—but it would appear that we’re right out of step with what’s going on around the world in terms of central banks and monetary policy. Are we really that different as an economy compared to every other OECD country?
Wheeler: I think in terms of our performance we are, to a large extent, a standout. We’re the only country—if you look at IMF data, for example—we’re the only country amongst the 35 advanced economies that has had a positive output gap not just for 1 year but for 2 years. You know, if you look at the OCR at 3.5 percent, we would still say that’s stimulatory in terms of monetary policy. You know, the OCR in 2007 got to roughly 8.5 percent. The real interest rates at that point were very high, so, no, we don’t believe we are out of line, given our economic circumstances.
Bayly: Governor, this must be a wonderful day for you and your team. How often do you get to report revised projections which show an improving GDP growth, an increasing investment growth, a decline in CPI and projections,
and a decline in the current account deficit? This must be a great day, and I think we just should reflect on that.

Cosgrove
Is there a question here?

Bayly
My first question—I was going to have two. First of all, I just want to pick up on my esteemed colleague Mr Robertson about house prices. I note on page 6 that you talk about house inflation expected to peak in late 2015 and decline thereafter. You attribute that decline largely to supply, Grant. That’s a really important statement given the concern that the committee’s had around house price inflation. Are you reasonably comfortable about that statement, because that will give us a pretty good direction on where things are going in terms of inflation projections, etc.?

Wheeler
I think there’s got to be a risk around the housing market forecasts in terms of price inflation. I mean, if you look at house price inflation in Christchurch, it’s starting to come down quite substantially and, you know, I think the supply/demand imbalance in Christchurch will be fixed. In fact, Christchurch may end up with surplus houses in the medium term. You know, there’s $23 billion of insurance payments that have been made to date, there’s probably another $12 billion to go or thereabouts—another $12 billion. The houses will be built, the market will equilibrate.

If you look outside, for the rest of New Zealand, you see sort of pockets of house price inflation at times, that come in, you know, the Otago lakes area, Nelson, Taranaki, Waikato sometimes. But the biggest uncertainty is around whether the supply will be forthcoming adequately enough around Auckland.

Bayly
Just a second point: we’ve got the ECB announcing quantitative easing—so we’re seeing that bank, basically, take over the role of American central banks in terms of promoting quantitative easing? We’ve got declining mortgage rates. So in the MPS, you announced that you were going to have a look at interest rates to determine what you believe are neutral. I’m just trying to get an update on that in terms what you believe—where a neutral setting is—because that may have changed.

Wheeler
You know, we define “neutral” in terms of whether the current level of the official interest rates, if you like—the OCR—whether that’s stimulatory or contractionary for the economy. Another way to think about it is—let’s say the economy was growing at its potential output for growth rate of around, say, 2.75 percent, and abstracting from cyclical behaviour in a long-term context, what would be the rate of interest consistent with that rate of potential output growth and the midpoint of the inflation target?

Now we did think that that’s somewhere around 4.5 percent. We’re less sure about that. There may be good grounds for it being 4.5 percent, but we’re less sure. And what we’re signalling in here: we want to do some more work around that in terms of maybe lower levels of interest rates are consistent with what I just talked about in terms of potential output and price stability. So we’ll be doing that work over coming months. But let me ask my colleague John if he’d like to comment.
McDermott: Let me give you another way to think about the problem. To a first order of approximation: if you think this economy can grow at 2.75—inflation averages around 2 percent, as we hope—that’s roughly the return, on average, businesses will get out of this economy, right? So it’s about 4.75. If interest rates were lower than that over a long period, it would mean borrowing costs would be below the returns businesses could get, on average, out of this economy, and that would give them a great incentive to invest, so that would mean interest rates would be stimulatory.

So that’s a rough order of approximation—about where you can benchmark where neutral should be. And that 4.75 is an interest rate that people in the markets can’t actually access, and there’s obviously a spread between that and the official cash rate. In the document, we portray that in terms of 90-day interest rates, which is about 4.5. So, currently, the ballpark figure’s about 4.25 on an official cash rate basis. But there’s a lot that goes into those calculations, and they do need to be refined over time.

One of the things we’ve been watching is there’s lots of monetary policy easings around the world and some of that is spilling over into New Zealand, often through the exchange rate channel. And although you wouldn’t put that into your neutral settings, it might be something that you have to lean against for a very long time if it was a very long and protracted process. So those are the kinds of considerations we’ve been thinking about.

Prosser: It occurs to me that your statement on the dollar and the value is probably the most unequivocally blunt summation of everything that manufacturers and exporters and Federated Farmers have been saying for quite some time—that on a trade-weighted basis it’s unjustifiably high, that it’s unsustainable in that a substantial downward correction is needed. And, obviously, our trade to exchange ratio is something like 35:1, so all that demand’s being driven by speculation. And, obviously, in the past when volatility was greater, that was an additional traction for them.

But it occurs to me that the Reserve Bank, being as it is the potentially largest single player in any market, could simply enter that market, as other central banks do around the world, and organise “a floor in a ceiling” to that float—not so much dictate it but bring it within a range that is more sustainable in terms of our long-term economic future. So my question, quite simply, is: given that you have that ability, and that is the answer, why don’t you just do that?

Spencer: We’re not the largest player. We’re a relatively small player, actually. So any FX intervention we undertake is really a small flow compared to the total flows in the market. We have more impact sometimes if we time it well and because we are the central bank, but it’s certainly not a straightforward proposition. To come in and have a substantive effect is really changing monetary policy, because you can’t control the exchange rate and target inflation at the same time.

If you wanted to fix an exchange rate, then we’d have to surrender the inflation target—and that’s what some countries do. For example, Hong Kong pegs to the US dollar and just takes whatever interest rates and
inflation rate comes out of that choice. But you have to sort of go one way or the other. If you tried and did both, as the Swiss, for example, did recently, where they tried to keep their inflation target but set a peg for the Swiss franc against the euro, eventually they couldn’t hold it, it was blown out of the water, and they made losses of about US$60 billion to $70 billion, which was not, you know, a nice outcome.

Prosser On that subject, it seems that the US, with exchange rates and inflation where they currently are, wouldn’t necessarily be a bad thing to be pegged against compared with what we are currently experiencing. And, of course, there’s also the example of Singapore, which does precisely what I’ve just outlined without any apparent problems.

Spencer Singapore has sort of a hybrid process where they’re targeting inflation but they’re using the exchange rate for that purpose. But, actually, at the outcome of that there’s still some very high—a lot of discomfort around the extent to which the Singapore dollar has had to appreciate in order to achieve their inflation target.

Cosgrove Are you still of the view—you said that you don’t believe a review of the PTA is warranted—that even the instruments that you have within the PTA, limited though they are, shouldn’t be reviewed? There’s a myopic focus on inflation within the PTA, basically. You don’t believe there should even be a review widening those series of considerations that you could make formally?

Wheeler No, I think, you know, as a central bank there are things that by and large you can influence and not influence. And the sorts of things that we can influence are inflation over the medium term—you know, what’s a potential inflation outcome over, say, 12 to 18 months? We have a reasonable degree of influence over that, particularly in terms of the non-tradables inflation. We can affect the level of demand, or the rate of growth of demand, the rate of growth of income in the short term—and we think about that. I mean, we don’t just sort of get into a state where we’re looking solely at inflation and the absence of what might be happening to employment, output in the economy, what might be happening to the exchange rate. We’re thinking about that all the time.

The things that we can’t influence are the rate of growth of output in the longer term. We can’t influence long-term interest rates. They’re basically set by overseas financial markets.

Clayton I suppose what I’m asking—you’d acknowledge that your counterpart in Australia has a wider basket of considerations which are formalised within their agreement than you do. And you might note that some political parties have suggested maybe we ought to formally widen that basket of considerations that you could take account of. You don’t believe that’s necessary? I suppose what a lot of New Zealanders will try and get their head around as we—under this sort of Brash era, we had a myopic view of inflation. Inflation’s through the floor and it will be projected for—I suppose I’m summarising what Russel said—for a number of years, yet you’re not [Inaudible ] and, you know, I suspect Kiwis will sit there tonight
and go: “What’s the problem?”. I think your Aussie counterpart has quite a wide, formalised range of considerations. You don’t; and you don’t believe that should be looked at?

Wheeler

No, I don’t think so. But in terms of the Reserve—the policy targets agreement, let me just mention what clause 4(b) says: “In pursuing its price stability objective, the Bank shall implement monetary policy in a sustained, consistent and transparent manner, have regard to the efficiency and soundness of the financial system, and seek to avoid unnecessary instability in output, interest rates and the exchange rate.” Now, where it gets complicated is: if you set up multiple objectives for monetary policy—and the Fed, there’s been a debate over the years about the Federal Reserve objectives, which are to maximise employment and also price stability. So let’s say they had a situation where inflation was too high in the US, and unemployment was too high. You know, what would you focus on?

Robertson

But isn’t part of the thing here that the whole way we think about inflation, globally, is changing? Is that something that you’re considering—the way that you measure inflation? I mean, if you’re looking at inflation undershooting expectations everywhere, is there something wrong with that part of the model—the way that you actually model that?

Wheeler

No, I don’t think so, but I’d be interested in John’s thoughts on that. I mean, everyone sort of puzzles about what causes inflation expectations to fall, if you like. It’s easy to say that they’re adaptive, and, you know, citizens make their judgments based on where inflation’s been and where it is at present—to what extent are they forward-looking, in terms of thinking about inflation pressures in the economy? So there aren’t any straight answers on that—there’s no clean answer. But we do look at inflation expectation data pretty carefully. We run—there’s about four surveys that we look at closely. What we will be looking at, going forward, as we currently do, is looking at the outcomes in respect of wage and price setting.

Scott

A little bit on the same track, I guess, around what is some neutral—this new neutral, and I think you said 4.5 was the long-term neutral, so we’re in an easy situation at the moment. But the markets don’t seem to agree—I mean, this morning, 9 o’clock, the currency popped up by a cent. You know, they’re expecting something a bit softer from you, because their expectation of inflation is lower than what you’ve perceived or stated in here. So I guess it’s a real challenge—I’m just sort of putting up a challenge to not only think about what’s neutral for New Zealand, but it seems to me that there’s a lot of imported deflation. There’s a lot of liquidity—unexpected increases in QE out of Europe, just in the last quarter. So, in my opinion, we’re in a really low interest rate environment for a very, very long time. You’ve got New Zealand with the interest rates that are multiples of other, you know, other civilised countries. And so, of course, we look attractive to the offshore investor. So I guess that’s just the challenge—just to go and—and you’ve questioned, anyway, already, about your different scenario, that—that is neutral. So I look forward to the result of that research that you’re doing about what is, potentially, the new neutral.
Wheeler  Just a couple of comments on that. I mean, the—if you look at the amount of quantitative easing taking place, you know, to date it's been about US$6.5 to 7 trillion. It's likely to be more this year than any other time since 2011, even though the Federal Reserve has stopped its quantitative easing. So you've seen the European Central Bank start its programme of $60 billion of purchases of Government securities a month—just started a few days ago. And that's already had quite a dramatic impact on Government bond yields in Europe. So, you know, if you look at 10-year Government bond yields for Germany, they're about 0.2. So on the other hand—and that's why, partly, the euro has been sliding in recent days, or, in fact, for quite some period, because this was expected, this programme of quantitative easing—but on the other hand, you know, the Fed is likely to tighten in the period June to September. We hope it's June—the earlier the better for us—and the market's anticipating this tightening phase by the Fed, which may be prolonged—may be prolonged, and we're depreciating against the US dollar quite steadily at this point. I wouldn't read too much into a reaction that, you know, this morning, it's just—let's just see what happens over the next week or two.

Bennett  Thank you very much, Governor and your team. We appreciate your time.

*conclusion of evidence*

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
May 2015

Presented to the House of Representatives
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Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Financial Stability Report, May 2015, and recommends that the House take note of its report.

Introduction

The Reserve Bank is required to report twice a year on the soundness and efficiency of New Zealand’s financial system. The following are the main points from its May 2015 assessment:

- New Zealand’s financial system remains sound, and continues to operate effectively and support economic growth. Banks have capital, liquidity, and funding buffers above the minima required, and their asset quality and profitability are strong.

- However, the financial system is vulnerable to three significant areas of risk: rapidly-rising house prices in Auckland, debt in the dairy sector, and global financial conditions.

- In response to the first of these risks, the Reserve Bank proposes changes to its loan-to-value ratio (LVR) policy. From 1 October residential property investors in Auckland will need a deposit of at least 30 percent for a bank loan. In other regions, where conditions are more subdued, the existing “speed limit” for high-LVR borrowing will be eased.

- In the dairy sector, 10–20 percent of farms are highly indebted, and many have negative cash flows; the risk that farmers may have difficulty servicing their loans will become more pronounced if low milk prices persist for another season.

- Internationally, interest rates have declined and funding costs for New Zealand banks remain favourable, but there is a growing risk that the present loose global financial conditions could change in a disorderly way, disrupting the cost and availability of funding for New Zealand’s financial system.

- The insurance sector has benefited from lower global reinsurance costs. Progress has been made in settling claims from Canterbury, but estimates for ultimate costs have increased, making it challenging for insurers to meet their announced target for settling all earthquake claims.

- The prudential standards for banks, non-bank deposit-takers, and insurers have been strengthened in recent years. The Reserve Bank continues to make improvements to its financial oversight regime.

The rest of this report discusses the main issues we considered during our examination of the financial stability report and in our discussion with the Governor of the Reserve Bank.
**The housing market and LVR restrictions**

We discussed at some length the changes to the Reserve Bank’s LVR policy, and the housing situation in Auckland.

The Reserve Bank has been concerned for quite a while about the risks for financial stability caused by imbalances in Auckland’s housing market. It says that house prices in the Auckland region have been increasing particularly rapidly since late 2014 (by about 17 percent in the past year, compared with around 2 percent for the rest of the country), and they have become very stretched: the median price is now 60 percent above its 2008 level. This is increasing the risk of a sharp correction in prices, which could cause financial instability. In response to this growing risk, the Reserve Bank has announced proposed changes to its original LVR policy introduced in October 2013.

From 1 October 2014, residential property investors within the Auckland Council boundaries will need a deposit of at least 30 percent for a bank loan. For owner-occupiers in Auckland, the existing “speed limit” for high-LVR borrowing—that is, the proportion of banks’ mortgage portfolios that they can lend against deposits of less than 20 percent—will remain at 10 percent. In other regions, where housing-market conditions are more subdued, the speed limit for high LVR borrowing will be eased from 10 to 15 percent. A residential property investor loan would be defined as any mortgage secured against residential property that was not owner-occupied.

**Risks for financial stability**

The governor told us the aim of the new measures is to promote financial stability by reducing the rate of increase in Auckland house prices and improving banks’ resilience to a potential downturn in the Auckland housing market. The report notes that housing investors account for over a third of property purchases, and studies have shown that defaults on investor lending tend to be significantly higher than for owner-occupiers during severe downturns.

We asked the governor to elaborate on the risks to financial stability from Auckland’s housing imbalances, as it would seem that the banking sector is well placed to cope with stresses at the moment. The governor said he thinks the risks are substantial. He cited several measures which indicate that house price inflation in Auckland is well above that in the rest of the country. In particular, a survey of investor expectations by ANZ Bank in late 2014 indicated that investors in Auckland expect house prices to increase by 75 percent over the next five years. The governor commented that such a phenomenal increase would drive the ratio of house prices to disposable incomes up hugely. He also noted that rental yields in Auckland are at historic lows, while those in the rest of the country have changed little over the past decade, suggesting that people in Auckland are investing for capital gain.

As to the risks for the wider economy, the governor said a major housing market correction could be driven by an external shock, or by changing expectations about affordability as expected returns started to reduce. He said a housing shock is often accompanied by a severe economic downturn, with rising unemployment, low wage expectations, and people left with negative equity in their homes, as nearly a quarter of mortgage-holders in the USA experienced in 2009. Such developments would cause widespread damage to the economy, with spillover effects well beyond Auckland.

Since a housing market correction would cause problems for banks, we asked why they seem sceptical of the new restrictions. The Reserve Bank said that banks recognise there is
a supply-demand imbalance and that house prices are severely stretched. While there has yet to be formal consultation on the proposed measures, the governor said banks have been generally supportive of the LVR policy since it was announced in late 2013. It has helped to reduce the risk they carry, with high-LVR lending reducing from 21 percent of banks’ mortgage portfolios to 15 percent. The governor told us he believes banks will abide by the spirit of the new measures until they are put in place in October, and noted that the new limits will be made a condition of bank registration.

**Property purchases by non-residents**

The Reserve Bank informed us that cash buyers account for 20 percent of all property sales. We asked how the new measures relate to cash purchases of property by non-residents. There would seem to be a risk that the new restrictions might make it easier for foreign speculators, using cash, to be involved in the market. The Reserve Bank said the restrictions would apply to non-residents if they sought a mortgage in New Zealand, but not to cash purchases, as its mandate only covers the New Zealand banking system.

As to risk, the Reserve Bank said its focus is on risks to financial stability; but to the extent that the measures reduce competition from investors, opening a gap in the market, there would hopefully be scope for more first-home buyers to get access to housing. It said its tools do not extend to dealing with foreign speculation, but noted that if its policy moderates speculative pressure in the Auckland market, cash investors might look elsewhere for higher returns. It accepted that one could argue both ways as to how the gap in the market might be filled.

The Reserve Bank said it would be very helpful if data were collected about property purchases by non-residents—a view it has expressed to this committee in previous reviews. It believes non-residents (including New Zealanders currently overseas) account for about 10 percent of property purchases, but said this estimate is based on a somewhat dated and unreliable private-sector survey, so it does not know the extent of foreign ownership for sure.

**Tax policy on housing**

We are interested in a comment made by the deputy governor in a recent speech, that “the Reserve Bank would like to see fresh consideration of possible policy measures to address the tax-preferred status of housing, especially investor-related housing.” We asked whether the possible policy measures envisaged would include a capital gains tax on investment properties. The governor said that tax policy is a matter for the Government; the speech did not aim to be specific, but sought to look at all the factors affecting demand and supply in the housing market, particularly in Auckland. When considering the tax preference given to housing, he said, relevant issues include the treatment of capital gains, as well as interest deductibility and the question of whether stamp duty might be appropriate in respect of foreign buyers. He said the speech aimed simply to draw attention to the various policy issues that could be considered.

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1 “Action needed to reduce housing imbalances”, speech to the Rotorua Chamber of Commerce, 15 April 2015, by Grant Spencer, Deputy Governor, p. 15.
Increasing housing supply

We agree with the Reserve Bank that measures to improve housing supply remain the key to addressing Auckland’s housing imbalance over the longer term. We explored the bank’s view on supply issues, and what impact the new policy measures might have.

We were told that loans for a newly-built house, or an apartment purchased off the plans, would be exempt from the new restrictions, as under the existing LVR rules. We asked about the situation where a new property is purchased from the builder, as many new homes are. It would seem to us that loans for such purchases should be exempt from the restrictions, as this could do more to promote the construction of new houses.

The Reserve Bank told us that if the purchaser was an owner-occupier, the existing LVR restriction would apply, so a 20 percent deposit would be needed; if it was to be an investment property, the new 30 percent rule would apply. The bank said it had considered the possibility of exempting homes purchased from a builder when developing the original policy, but the scope for loopholes was too great. It noted that since the policy was introduced in 2013, banks have drawn attention to the distinction in their marketing, and first-home buyers have increasingly been buying off the plans or at the construction stage.

We note the Reserve Bank’s view, as expressed in the deputy governor’s speech in April, that intensification of housing—building more apartments—is likely to increase supply more quickly and cheaply than housing developments on the urban fringe. The governor noted that the approval process, although still drawn-out, is considerably shorter for apartments than for greenfield developments. He observed that Auckland has a relatively low proportion of apartments for a large city: only about 25 percent, compared with 40 percent in Sydney. In his view, the regulatory impediments to intensification result in higher rentals than the cost of building an apartment would dictate in a competitive market.

First home buyers and the rental market

We noted that property investors have been critical of the Reserve Bank’s announcement, saying the new policy would drive up the cost of renting in Auckland. The Reserve Bank said this could happen, but it does not believe it is a significant risk. It says the outcome will depend on dynamics in the market, but it sees a real opportunity and incentive for owner-occupiers, particularly first-home buyers, to take advantage of the policy. If they buy their own homes and displace investors, it should take demand out of the rental sector, so rents should not be driven up.

We pointed out the efforts being made to increase Auckland’s housing supply, with several thousand new sections coming onto the market in outer suburbs, and asked whether the LVR policies could defeat these efforts and make it more difficult for first-home buyers. The Reserve Bank reiterated that there should be more scope for first-home buyers to the extent that investors are restricted in Auckland; in other regions, lifting the speed limit for high-LVR lending from 10 to 15 percent should create more opportunities for first-home buyers.

Regions outside Auckland

We questioned the Reserve Bank on its rationale for maintaining LVR restrictions beyond Auckland, given the desirability of encouraging economic growth in other regions. The governor said it has always viewed the restrictions as temporary. It monitors house price movements around the country, and has noticed inflationary pockets in some areas besides Auckland. It considers that easing the high-LVR lending limit from 10 to 15 percent was a
sensible move at this point; it will monitor the effect and, if all goes well, further easing could be expected over time.

**The dairy sector**

Incomes in the dairy sector have fallen sharply as a result of lower international prices, leaving about a quarter of dairy farmers with negative cash flows in the 2014–15 season. The Reserve Bank is concerned that the sector’s vulnerability to reduced incomes is increased by its high level of debt, which has trebled since 2003 to about $34 billion. Moreover, the debt is highly concentrated: roughly 30 percent is carried by 10 percent of farms, and half is on 20 percent of farms. The Reserve Bank is watching the debt situation closely, as it is concerned that if global dairy prices remain low, not only would the cash flow problem intensify, but farm prices could fall, compounding the problems for farmers.

Along with concern about the most highly-indebted farms, we also discussed the broader risks for the economy, given that dairy payouts affect roughly a third of New Zealand’s merchandise exports. The Reserve Bank said the current situation is not sustainable. With the spot price for whole milk powder at only US$2,400 a tonne compared with a market equilibrium of about US$3,200 to US$3,800, many dairy farmers internationally are in a worse position than New Zealand’s, which are the world’s most efficient producers. It noted that the global dynamics are complex, and much will depend on production levels in China and the United States, and on how markets are affected by the removal of European quotas and import embargoes imposed by Russia. The governor acknowledged that another year of low prices would clearly be a worry for the economy, as well as for farmers’ debt capacity.

Overall, the Reserve Bank commented that while it is concerned about the risks if low prices persist, it is reasonably confident that farmers can weather the current situation and are unlikely to default on their loans. Many farmers now facing negative cash flows have resources they can draw on from last season’s record payouts, and short-term funding for working capital has increased, even while longer-term debt in the dairy sector has remained stable. It added that it still considers some downward movement in the exchange rate warranted; this would help the returns received by dairy farmers.

**Interest rates**

Asked whether the new restrictions in the housing market would give the Reserve Bank scope to ease interest rates, thereby easing pressures on dairy farmers and other exporters, the governor said the bank is in the process of preparing its forecasts for the June monetary policy statement. It is assessing the issues that have a bearing on monetary policy and interest rates, and will discuss them with the committee on June 11, when the statement is released.

**The insurance sector**

The financial stability report notes that relatively easy global funding conditions have reduced the cost of reinsurance, benefitting the New Zealand market, although rates for the Asia-Pacific region remain higher than for others. Progress continues to be made in processing claims from the Canterbury earthquakes, with $24 billion paid out as at 31 March 2015. However, there are still many uncertainties, and several insurers have increased their estimates of their ultimate costs. As a result, the estimated total of outstanding claims has not changed much in recent months, despite the payouts made. The
Reserve Bank now estimates ultimate costs to the insurance sector from the earthquakes at $33–38 billion.

**Financial sector regulation**

The Reserve Bank continues to make improvements to its financial oversight regime. Following consultation on a discussion paper in March and April, it decided to establish a new asset class for loans to residential property investors, increasing the amount of capital that banks in New Zealand are expected to hold against such loans.

The Reserve Bank plans public consultation on its stocktake of regulatory requirements for banks and non-bank deposit-takers in the second half of 2015, and will issue a discussion document on the stress-testing methodologies used by registered banks. Consultation is continuing on possible changes to the statutory framework for the oversight of payment systems and other infrastructure used by the financial markets, with the bank modifying its original proposal.
Appendix A

Committee procedure
We met on 13 and 27 May 2015 to consider the Reserve Bank of New Zealand’s Financial Stability Report, released on 13 May 2015. We heard evidence from the Governor of the Reserve Bank, and received advice from our independent specialist adviser, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Stuart Nash
Dr Russel Norman
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Transcript of hearing of evidence 13 May 2015

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Chris Hipkins
Brett Hudson
Stuart Nash
Dr Russel Norman
Grant Robertson
Alastair Scott

Witnesses
Graeme Wheeler, Governor, Reserve Bank of New Zealand
Grant Spencer, Deputy Governor and Head of Financial Stability, Reserve Bank of New Zealand

Bennett Well, welcome, Governor and your team to the financial stability report. This is being webcast, so it is live—just so everyone is aware of that. If you want to give us a bit of an introduction and then we’ll open up the questioning from members.

Wheeler Well, thank you, Chair, and good afternoon. [Introductions] New Zealand’s financial system is sound and operating effectively but faces three significant systemic risks. Auckland’s median house price is 60 percent above its 2008 level, and house prices in Auckland have been rising particularly rapidly since late last year. The region’s house prices have become very stretched, increasing the risk of financial instability from a sharp correction in prices.

A second area of risk relates to the dairy sector. Many highly leveraged farms are facing negative cash flows, and the risks will become more pronounced if low milk prices persist beyond the current season. The third key risk arises from the current, very easy global financial conditions. There’s an increasing risk that current conditions unwind in a disorderly fashion, disrupting the cost and availability of funding for the New Zealand financial system.

In response to the growing housing market risk in Auckland, we are announcing proposed changes to the loan-to-value ratio policy. Taking effect from 1 October, residential property investors in the Auckland council area using bank loans will need to have a deposit of at least 30 percent. The existing speed limit for high loan-to-value ratio borrowing outside of Auckland will be increased from 10 to 15 percent to reflect the more subdued housing market conditions outside of Auckland. The existing
10 percent speed limit will be retained for loans to owner-occupiers in Auckland at LVRs of greater than 80 percent.

The objective of the policy is to promote financial stability by reducing the rate of increase in Auckland house prices and improving the resilience of the banking system to a potential downturn in the Auckland housing market. We believe the measures will have a significant impact. Around half of investor lending takes place at LVRs greater than 70 percent. A residential property investor loan will be defined as any retail mortgage secured on a residential property that is not owner occupied. The proposed LVR restrictions will not apply to loans to construct new houses or apartments. While the new measures aim to moderate housing demand, policies to ease housing supply constraints in Auckland remain the key to addressing the region’s housing imbalance over the longer term. So thanks very much, Chairman.

Robertson Thank you, Governor, for that introduction. The nature of our doing these meetings means that quite a lot happens between 9 o’clock and now, so I don’t—I’m going to jump into some questions that might sound like I’m not asking you about the first part of what you said, but I would like to come back, Mr Chair, to a second set of questions, if I can later. I want to be absolutely clear. What you’ve announced today and the tools that you’re invoking today will not affect non-resident purchases—non-resident cash purchases. That’s right?

Wheeler No.

Spencer It won’t affect non-resident cash purchases, but it would affect non-resident purchases where they’re borrowing from the New Zealand banking system.

Robertson So the point being that your ability to manage or control anything is with regard to the New Zealand banking system, rather than anywhere else? That’s right?

Spencer That’s correct.

Robertson In earlier statements you’ve made the point that you think it would be useful to have data on the number of non-resident purchases. Is that still your view?

Wheeler Yes, it is. I mean the BNZ and I think the Real Estate Institute ran a survey, which has been discontinued. There was quite a lot of uncertainty around the accuracy of the data but I think it would be very helpful if this sort of data was collected.

Robertson What is your estimate at this stage on the information you do have on the number of both the cash buyers there are in the market and also non-resident ones?

Spencer Well, the number of cash sales are around 20 percent. But the non-resident, we think, is purchases, maybe in the order of 10 percent. The survey that Graeme was talking about used to register numbers in the sort of 6-8 percent. We think maybe in the order of 10 percent, but we don’t have the numbers, so we don’t know for sure.
Robertson: Right, so you’re making that based on historical data and where you would extrapolate it’s got to today. Do you think there is a risk in having put forward restrictions around speculators who are using the New Zealand banking system that you might be making it easier for foreign speculators, cash speculators, to be involved in the market? Is that a risk of the policy you’ve announced today?

Wheeler: Well, you know, our main concern is about the financial stability of the New Zealand banking system. I mean, that’s our responsibility to think about those financial stability risks. So that’s where our focus is.

Robertson: Sure. But did you consider the fact that you could be, effectively, creating a loophole by which you would encourage further foreign speculation?

Spencer: Well, to the extent that there’s less aggressive competition, if you like, from investors, that gap could be filled by various parties. Hopefully, we’ll see more first-home buyers, for example, get access to the market.

Robertson: I take that point that that’s the hope, but I guess the concern is that given we don’t know the facts about foreign speculation but we can make some judgments that it is possible that there would be potentially more room for that class. I mean, I presume your response will be to say that you don’t have tools to deal with that; that’s not part of your mandate.

Spencer: No, we don’t. I mean, you can run the argument that says that if this policy moderates the speculative pressure in the market, then other cash investors may think there’s potentially less return to be had in that market, compared to other markets such as in Australia, and that may affect the motivation to fill the gap, but you can argue it both ways.

Wheeler: We think, of the 10 percent that perhaps may be represented by overseas buyers, they’re geographically dispersed—so they’re not all out of Asia, in that sense. That also includes New Zealanders living abroad. It also includes, potentially, people who may intend to come here and live. So there’s, you know—and also, the fact is that 28 percent of Auckland describe themselves as of Asian derivation, so the connections are quite strong, one would think. But it just reinforces the point, I think, that we—it would be helpful to have the data.

Robertson: And that was the point I was going make, because I’m not making any particular judgment about where the people are from, but the fact is that if you are clamping down on the kind of speculation, from a domestic point of view, there is now a gap there that potentially gets wider, which Mr Spencer’s agreed with. I’ll come back on that.

Bayly: Just a bit of clarification. So the three changes you’ve announced—none of this relates to people buying a new development—a house that’s just been built? Just to be clear, none of these rules relate to someone—they commissioned someone to build a house from them—those LVRs don’t apply to that. Is that correct?

Spencer: So for new construction, as under the existing LVR restriction, there’s an exemption for loans for new construction or for purchasing an apartment off the plan.
Bayly: OK. So what happens for many of New Zealand houses—in fact, 75 percent are built by builders, and I’m talking about 1, 2, 3-person building-type firms. Often they will take the risk, they will buy the land, build the building on spec, and then offer it for sale once they’ve built it. But do I take it from that rule that these rules would then, under that arrangement, they would be captured? I.e. so someone could buy that property.

Spencer: That’s right. If it was an investment property—

Bayly: No, even if it was an owner-occupier or investment. Yeah.

Spencer: If it’s an owner-occupier, then the existing LVR restriction would apply to them, so they’ll need a 20 percent deposit.

Bayly: So do you think, given that we want to promote the building of new houses in New Zealand, the rules around the first person to take over the ownership of that property when it’s transferred, often from a builder to the first buyer, we—don’t you think there’s a need to make sure that we promote that type of activity, because that’s going to increase the housing stock for New Zealand? And so the rules around that should be really clear, and if someone is buying it from a builder and not off the plans, then hopefully they won’t be captured by this rule.

Spencer: I mean, that possibility was considered when we brought the policy back in in late 2013, but we considered at the time that the scope for avoiding the restriction—creating a loophole—was too great and therefore we restricted the exemption to just construction loans and off the plan, rather than buying a house off a spec builder.

Bayly: Don’t you think we’ve got a slight disconnect, because here we’ve got a Government absolutely focused on increasing the supply of new properties, getting new houses into the market, and there’s a possibility by maybe looking at how those rules are applied to make sure that we’re getting people—first-home buyers often will be buying those properties—and to make sure that they’re not disadvantaged?

Spencer: Well, the banks, since the rule came in, since the exemption came in, have been marketing that product more, and more and more new first-home buyers have been buying off the plan or at the construction phase in order to obtain the exemption. So those numbers have been increasing.

Norman: The April speech that you gave—you said: “The Reserve Bank would like to see fresh consideration of possible policy measures to address the tax-preferred status of housing, especially housing investment.” I think I’ve quoted you correctly there. My question is: would a capital gains tax on investment properties meet that criterion?

Wheeler: Well, I think we wanted to—we carefully drafted that paragraph in that speech because what we were trying to do is look at all the things that were impacting the housing market, particularly in Auckland. So all the supply-side factors, and then the demand-side factors, and the demand-side factors with immigration flows—they were also the fact that interest rates were low, the fact that investors were increasing their share of transactions in the market. But we also felt that—look, taxation can be an issue in terms of
affecting demand and the supply of housing as well. And so we really wanted to just indicate that we believed that fresh consideration—and you’ve quoted the sentence absolutely correctly. So that was what we wanted to do. We wanted to bring that to attention, given that we were going to be moving on macro-prudential measures—we’d been planning these—and, in essence, we’ve left it that tax policy is very much a matter for the Government.

Norman Sorry, I’m going to repeat slightly, but what I’m trying to get at is: when you said you wanted to see consideration of possible policy measures to deal with this issue, is the capital gains tax on investment property one of those possible policy measures that you’d like to see fresh consideration of?

Wheeler We didn’t—we weren’t specific in the speech, but if you think about the tax preference that is given to housing as an asset class, and you then look at investor housing, and particularly highly leveraged investor housing, then you get into issues like interest deductibility, the treatment of capital gains, whether there are issues around stamp duty that might be appropriate in respect of foreign buyers, and things like that. So we wanted to draw attention that there were some issues that could be considered.

Norman OK. So I’m going to take that as one of the possible range—the capital gains tax is one of them, and there was a number of possible policy measures that you wanted consideration of. Is that a fair characterisation of your position?

Wheeler Without being specific on what they were, that’s a fair characterisation.

Norman All right. Thank you. The next thing is that the property investors have come out all guns blazing at you today and said you’re going to drive up the price of renting in Auckland. Do you believe that’s a likely outcome of the policy you’ve announced today?

Wheeler We don’t see that rents are likely to rise significantly. I mean, they shouldn’t rise, if new owner-occupiers, for example, take the place of investors. It really depends on how the dynamics work out there. But there is a real opportunity and an incentive for owner-occupiers and particularly first-home buyers, hopefully, to be able to take advantage of this.

Norman So instead of it going to an investor who then rents it to a family, that family buys the property, then, effectively, you’ve taken the demand out of the rental sector and they’ve just bought their own house—so what’s the difference? Why should it drive up rental prices?

Wheeler That’s correct.

Norman And so you would argue—I don’t want to paraphrase you incorrectly—that the argument that says that what you’ve done today will drive up the price of rentals in Auckland, you don’t think that’s a very valid argument?

Wheeler There is a risk that rental returns—or rental prices, if you like—could increase, but we don’t think that it’s significant. We think that there’s a real opportunity to displace investors in the transactions.
Norman: Just going back to the April speech again, in terms of the supply side, I just wanted to get whether I’m accurate in paraphrasing the speech you gave us saying that more apartments, or intensification, is likely to increase supply faster and possibly cheaper than, if you like, urban fringe developments—so the kind of one house on a block of land type of thing. Is that a fair characterisation of the Reserve Bank’s position?

Wheeler: I think it is, yes, because we’re noting that the whole development approval process is considerably longer for greenfields developments than for infill developments. I mean, it’s a lengthy and drawn-out process as it is, but it is shorter for apartment development. We also noted that a city like Sydney has 40 percent of its dwellings in apartments whereas Auckland has 25 percent. It’s relatively low for a large city.

Norman: So the fastest way to increase supply and the most affordable, possibly, is to go up, if you like, rather than out, in terms of the Auckland property market. And we all agree supply needs to increase. We need to do it fast. It seems like that’s the fastest way to get there.

Wheeler: Well, one way, perhaps, that we would think about it is to say: well, look, what is the cost of regulation in terms of building upwards? So if, for example, you had an existing apartment complex and you said “OK, let’s build another level on top.” given that the land costs were already there, you could work out the marginal cost of building that extra apartment one floor up—an extra floor up. And then you’d work out what would that apartment sell for. And you would see, you know, a huge difference. Now that rental return, if you like, or that super profits, if you like, are a result of the regulatory impediments, because in a competitive market, you would find a much closer relationship between the incremental costs of building that apartment and what it sells for.

Norman: The constraints on intensification, effectively, are restricting, are placing a constraint, on that demand. There’s more demand for those apartments than is actually being provided at the moment.

Wheeler: Yes.

Bishop: Thanks, Governor. I’m just interested in teasing out what the specific risks to financial stability are for Auckland house prices, because the banking sector has rising capital and liquidity buffers; they exceed the minimums. The banks came through the stress testing pretty well last year. Credit growth is relatively restrained, and as a percentage of GDP, credit is below where it was in 2008-09. So given all that, what are the specific risks to financial stability—which is what we’re discussing here today—from the rising Auckland prices?

Wheeler: I think they’re very substantial. I mean, if you look at mortgage commitments, you quoted a number that credit flowing to the housing sector was low. It is on a net basis, but if you look at mortgage commitments, they’re growing at around 20 percent. House prices in Auckland are growing at around 17 percent. They’ve been growing in the rest of the country over the last year at around 2 percent. If you look at
house prices to disposable income in Auckland, that ratio is 7.4 percent. But the rest of the country is 4.2 percent. If you look at rental yields in Auckland, they’re at historic lows, which suggests that there’s a lot of people basically investing for capital gain, whereas the rental yields across the country are basically where they have been for the last 10 years.

If you look at the median house price in Auckland, it’s up 60 percent since 2008. We had the highest rate of house price inflation in the OECD from 2003 to 2008. So the median house price in Auckland is now 60 percent above that. If you look at the Demographia survey that was done last year, we were 14th out of 370 housing markets around the world, in terms of affordability. If you look at the survey that was done by ANZ Bank in terms of investor expectations, late last year, basically, investors in Auckland were forecasting that house prices would increase by 75 percent over the next 5 years. Now, our job is to try and keep inflation, on average, at around 2 percent per annum. So that’s just a phenomenal increase in house prices that are anticipated, and that would just drive house price to disposal income ratios up at a huge rate.

So there’s a whole range of reasons why there are major, I think, financial stability risks around Auckland.

Robertson Just to pick up off the back of that—that very detailed answer—you don’t use the term “housing bubble”, but if there was a sharp correction, the impact would be obvious for those who are involved in the Auckland housing market. Have you considered what the spillover impact might be on the rest of the economy or the other regions of New Zealand, and what you think that would be?

Wheeler Yes, we don’t use the word “housing bubble” or “rock star economy” but, look, I’ve seen this a couple of times. I saw it in the States in 2009. You know, the US has 50 million mortgage holders—24 percent of them were underwater. If you look at Ireland 7 years after the onset of the global financial crisis, 40 percent of mortgage holders have negative equity. And if you did get a major correction in the housing market, it may well be driven by an exogenous shock or it may be driven by expectations about affordability starting to change by themselves—in essence, as expected returns start to reduce. Often a housing shock is accompanied by severe economic downturn, and so that’s where the major problems come. You get rising unemployment. You get low wage expectations, given the pressure on the labour market in terms of high unemployment. So people just get locked into a situation where they have negative equity, fears about keeping their job, fears about what sort of income potential they have in future, and it can do enormous damage to an economy.

Robertson And that, obviously, can then spill over far beyond just, in this case, the geographic region where the problem is worse.

Wheeler Oh, absolutely. It certainly would.

Robertson Just on a couple of other points, I want to move to one of the other major risks that you pointed out—I know the focus is on housing today but your
comments around the dairy sector. I mean, I guess there are two points to
draw out from that that I’d like your comment on. One is: you’re really
concentrating here on a percentage of farmers who have high debt levels
and are highly leveraged. Is that the major and significant problem here,
and/or is it the long-term, or medium-term, forecast for dairy payouts?
Because we’ve been hearing that anything below $5.50 is going to present
significant risk for more than just the group that you’re talking about for
next year’s payout. If we see that in next year’s payout, and, perhaps, even
beyond there, are we not looking at a risk that’s much bigger than just those
highly leveraged farmers?

Wheeler
No, it’s a very good question. There are two issues, I think, that are really
important. One is that 37 percent of dairy farmers have negative cash flow
at the moment, given the forecast payout of $4.50. So we’ve seen dairy debt
treble to around $34 billion since 2003 and roughly 30 percent of that is
concentrated in the 10 percent most indebted farms; 50 percent in the 20
percent in the most indebted farms. So that’s a major concern, and if you
saw the dairy price just remain at low levels for a considerable period, one,
that negative cash flow problem intensifies; two, you would probably start
to see dairy farm prices start to fall, which would compound the situation.
So the dairy debt situation is something we’d look at carefully, and we’ve
been spending a lot of time here in New Zealand doing analysis on that.

The other challenge is what happens, and it’s related to global dairy prices,
given that it’s essentially such a major part of our—it’s roughly a third of
our merchandise exports. The spot price for whole milk powder is currently
around US$2,400 a tonne. The forward market suggests that it will rise to
around US$2,700 a metric tonne by the end of the year. We think the
equilibrium price, if you like—that the price could settle at in the medium
term somewhere around US$3,200 to US$3,800 a tonne, because at the
current prices, basically, two things: we’re the most efficient dairy producer
in the world and a lot of dairy farmers internationally are not making money
at these prices. The thing that’s holding them up is the fact that cereal prices
have been falling at the same time in offshore markets.

So the whole situation’s not sustainable. It depends very much on what
happens to inventory levels in China in terms of whole milk powder; what
happens to their domestic production, which seems to be increasing this
year for the first time in a long time; what happens to dairy production now
that the European quotas are taken off. We’re seeing more drying capacity
being put into the US, and what happens with the embargoes that Russia
has imposed around dairy imports. There’s a lot of dynamics here, but if we
saw another year of low prices, that would be a worry for the economy—no
question—and also it would be a worry for farmers in terms of their debt
capacity.

Robertson
And all pointing to the need to diversify beyond it.

Scott
Given the new LVR restrictions, does that give you room—I would’ve
thought—to be able to ease the interest rate environment? Particularly given
the discussion we’ve just had around dairy farms and the rest of the
economy—it’s not just all about Auckland. And if there was to be a rate cut, really, how much of an effect will that have on the Auckland house price market? I mean, is it really that elastic, or inelastic? Is there really going to be an effect if we cut 25? Because it would be appreciated, I imagine—I’m sure—by those dairy farmers and the like.

Wheeler Well, we took this measure for financial stability reasons and we think it will have an impact on house price inflation. Look, we’re very happy to come and talk about monetary policy and those issues in the next few weeks, after the Monetary Policy Statement. At the moment we’re preparing forecasts for that June statement and just about to start a pretty intensive debate on all the issues that are there.

Norman Just going back to dairy—is there much new lending going into the sector? Because you would think at the moment, with the price as it is, there wouldn’t be a lot of banks that would be saying: “Let’s open the books and give a lot of money into the dairy sector.” So you haven’t kind of taken any action, have you? Is that because there’s not much you can do to restrict lending into the sector, because there’s not a lot going in right now?

Spencer No. You see a chart here that shows that it has been reasonably stable in recent years and is not increasing for farm purchases recently, although it has been picking up for working capital purposes as a result of the low payout. So that’s more shorter-term funding. But the bulk of the $30 billion or so is longer-term mortgage-based funding on property. So that lending has not picked up.

Norman So how does it play out if we have another year of low prices—so we’ve currently got a quarter of dairy farms are losing money—another year of a quarter of dairy farms losing money? Presumably, at some point they can’t pay the mortgage, right? And at that point the banks are going to have to make decisions as to how they respond to large numbers of their customers unable to pay the mortgage. How does that play out, if that were to happen?

Spencer Well, it puts pressure on the balance sheet. So the large number of farmers now who have negative cash-flow have significant resources, because they had a very good payout last season. So they can dip into those resources, they can cut investment spending etc. and, as I said, they can come to the bank for working, short-term funding. So that can continue for a period, but, as you say, eventually—particularly those farmers that are highly geared—those 10 percent most-geared farmers in particular potentially have difficulty servicing their loans and then there’s a difficult conversation with their banker. But from our perspective there is some degree of optimism that farmers hate to walk away from the land, and we saw this decades ago when farming sector was under pressure. And so they won’t do it lightly, and they’ll go to quite extraordinary lengths to continue to service the mortgage.

Wheeler I mean another issue in this equation depends very much on what happens with the exchange rate, for example. We’ve seen a depreciation in the exchange rate on a TWI basis in the last 3 weeks of around 5 percent—something like about 7 to 8 percent against the Australian dollar. We still
think that the exchange rate is unjustified and unsustainable, so we’d like to see more movement downwards in the exchange rate, so that will also affect what sort of returns the dairy farmers can get.

Bayly I just want to ask you—in terms of the definition round these LVRs, you’ve talked about limiting it to the Auckland City, but—slightly unclear—what do you mean by that? Is it likely to be the metropolitan urban limit, or are you talking about the Greater Auckland region, or—

Spencer It’s the super-city boundary.

Bayly You do? OK.

Spencer So it’s the new Auckland Council. So it’s quite a broad area.

Bayly OK. So in my—I represent the electorate of Hunua, and I can look at, and I can point to, 10,000 sections that are currently coming to market or on the market, contrary to a lot of views that you hear that’s not a lot of houses going to be built or will be built. I’ve got 10,000 sections in my electorate. Now, most of those, by implication, will be cheaper housing and more likely to be for first-time buyers, because of where they are. They’re on the outer, southern part of Auckland. So these LVRs, whilst I support them in principle, the issue I’ve got is that we’re trying to increase the supply of new houses, which is what’s going to deal with a lot of issues you’re talking about here, but, perversely, some of these policies—if they start restricting first-time buyers, partly through that measure we talked about before, just generally, by including the wider Auckland region, there is the potential that we’re actually inadvertently stopping these houses actually coming to market, being bought by first-time buyers, and seeing the supply of housing stock in Auckland increase. Have you got a view on that?

Spencer Well, I would say, you know, that if you look at the rate of price increases by subregion that all of those, even sort of Rodney and Franklin, etc., are sort of up there in terms of they’re not—they haven’t been increasing as much as central Auckland but they’re still ahead of most other parts of the country. In terms of the first-home buyers, this measure here that we’re introducing is aimed at investors. And so to the extent that investors are restricted more from the market then there’s more room for first-home buyers. So that should be a positive.

Wheeler And the fact that the loan-to-value ratio is going from 10 percent to 15 percent outside of Auckland I think also creates an opportunity for more first-home buyers to get into the market.

Robertson Just want to briefly go to some comments you made earlier about the Canterbury rebuild and its contribution to growth. I take the point that you’re making that the increase in investment is peaking now and, perhaps, last year. What do you believe the current contribution to growth is from the Canterbury rebuild?

Spencer It’s in the order of 0.5 percent, roughly speaking, and that was last year and this year, and then after this year it starts to diminish, gets much smaller, and a couple of years down the track is essentially zero. But it doesn’t really
go negative, so it’s not like the Australian mining boom, which stopped and then became a negative contribution.

Robertson: But it stops contributing to the growth story from now.

Spencer: Yeah. Yes.

Robertson: And at the moment you’re saying it’s around in the order of 0.5 percent.

Norman: Why do you think the heads of all the banks don’t think that there’s a problem with house prices in Auckland, and you do? Seriously. I mean—sorry, I don’t mean to sound like I’m trying to stir the pot. But from the banks’ point of view, obviously they make money from lending, right, so they want to lend more, but they must also recognise that, if there’s a big correction in Auckland, that’s a problem for the banks as well. But they all are—literally—all saying that you’ve, basically, you’ve got it wrong. I mean, I don’t know if they used those words, but they’re saying it’s not overvalued.

Wheeler: I’m not sure they’re saying we’ve got it wrong. I have heard some of them say that they don’t want to describe the Auckland market as a “bubble”, and we wouldn’t use that language either, but I think they realise that there’s a significant supply-demand imbalance, and that house prices are severely stretched. That’s certainly true from some of the conversations that we’ve had with them privately.

Norman: But do they support this intervention that you’re making today?

Spencer: We haven’t heard. Given that it was only released this morning, we haven’t actually talked to them yet, but I would say that the heads of the banks have been supportive, generally, of the existing LVR policy that was brought in in late 2013.

Robertson: Would you expect them to abide by the spirit of this up till October?

Wheeler: We believe that they will. You know, once we’re through the consultation period we will make this arrangement a condition of bank registration, and we’ll be meeting with the chief executives of the banks and the chairs of the boards very soon. They did honour the spirit of the arrangement in respect of the speed limits on loan-to-value ratios; we’d expect them to do the same here. And just coming back to the previous question, if you look at high loan-to-value lending as a share of the bank portfolios—mortgage portfolios—pre the introduction of the speed limits, that was around 21 percent of the total portfolio. It’s now around 15 percent, so it’s had quite an impact, first in slowing the rate of house price inflation—but that washes out over time—but secondly, it’s left the banks with less risky mortgage portfolios.

Bayly: Just another—the other area I want to talk about is this loan-to-value ratio outside of Auckland. In the report, you talk about very low house inflation rates outside of Auckland. Also, you previously talked about the Christchurch supply issue largely being dealt with, and therefore Christchurch is getting to the state where the housing supply is coming back into line with demand. So I suppose my question is, given we want to see
economic growth in the regions, why are you still persisting with having any form of housing restriction outside of Auckland?

Wheeler Well, we’ve always said that macro-prudential instruments are temporary, and they’re not permanent, and we’ve followed house price inflation carefully, as you would expect, and it varies across the country. I mean, if you look at some areas like Otago lakes or Nelson or Taranaki, you sometimes see a lot more variability compared to the rest of New Zealand, for example. But we felt that going from 10 to 15 percent in the LVR ratio was something that would be a sensible thing to do, and we just wanted to see what the impact is. And if it all goes well, and we see continued moderation in house prices, then you would expect, over time, for that to ease further.

Norman Learning by doing.

Bennett Yeah. Well, thank you very much, Governor, and your team, and I appreciate your work.

Wheeler Thanks very much.

**conclusion of evidence**
Reserve Bank of New Zealand’s Monetary Policy Statement, June 2015

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
June 2015

Presented to the House of Representatives
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Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, June 2015, and recommends that the House take note of its report.

Introduction

This report summarises the contents of the Reserve Bank’s monetary policy statement released on 11 June 2015, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

The statement announced the Reserve Bank’s decision to reduce the official cash rate (OCR) by 25 basis points—a quarter of one percent—to 3.25 percent. The OCR had been held at 3.5 percent since July 2014.

The Reserve Bank indicated that further easing of the OCR may be appropriate. Its forecasts for 90-day interest rates imply an additional cut of 25 basis points within the coming year; however, it emphasised that any future cuts will depend on emerging data.

The Reserve Bank commented that despite some weakening in the exchange rate since April, the New Zealand dollar remains overvalued. The dollar fell about 2 cents against the US dollar in response to the OCR announcement.

Reserve Bank’s reasoning

Inflation has been low for some time, with the Consumers Price Index now near zero as a result of low global inflation, the strong exchange rate, and a fall in world oil prices. While GDP continues to grow at an annual rate of about 3 percent, strong growth in the economy’s supply potential has limited the extent to which this growth has translated into increased inflationary pressures.

Under its policy targets agreement the Reserve Bank aims to keep average CPI inflation between 1 and 3 percent over the medium term, focusing on the 2 percent midpoint. The bank’s previous projections in March 2015 envisaged inflation approaching the midpoint of the target range around mid-2017. However, the fall in export commodity prices that began in mid-2014 is proving more pronounced than expected. Weaker prospects for dairy prices and recent increases in oil prices have increased the risk that inflation will take longer to return to the target midpoint, as growth in income and demand will be slower.

The Reserve Bank therefore considers a reduction in the OCR appropriate to counteract the expected weakening in demand and ensure that medium-term inflation increases towards the middle of the target range. It says that further reduction may be appropriate but this will depend on how key economic data evolves.
Interest rates

Unusually, expectations in the financial markets had been evenly divided as to whether the Reserve Bank would cut or hold the OCR at this review. We discussed how the markets were reacting to the announcement, and how the governor would respond to criticism that the cut would add fuel to the already-overheated Auckland housing market. The governor said he would not expect fixed-term mortgage rates to change substantially, as the markets had already been pricing in the expectation of a 50-basis-point cut in the OCR at some stage over the next 12 months. He noted that floating mortgage rates were reduced immediately in response to the announcement, but said this was to be expected. He pointed out that he and the deputy governor had signalled in speeches since February the conditions under which the bank would lower interest rates, so the announcement would not have come as a surprise; the question had simply been whether the first reduction would occur now or later.

We asked the governor whether, with hindsight, he felt it had been a mistake for the Reserve Bank to have increased the OCR as it did in 2014, with four hikes between March and July that year totalling one percent. The governor said the situation had changed a great deal since March 2014. Then, the terms of trade had been at a 40-year high, migration was increasing, and house prices were rising in other parts of the country as well as Auckland. It appeared that an output gap would be building up, creating inflationary pressures. At that stage nobody was forecasting that the world oil price and dairy prices would drop so dramatically.

Future change in the OCR

The governor said factors that the Reserve Bank will consider in deciding on any further OCR reduction include growth in the economy, signals of inflation expectations such as wage and price pressures, how commodity prices fare in future dairy auctions, and, importantly, exchange rate movements. He noted that the exchange rate is an important conduit for overseas forces; for the past three years, low inflation internationally has pulled down inflation in New Zealand. A lower New Zealand dollar would help the present situation by raising tradables inflation, which has been negative for the past three years.

We asked how much a future OCR cut would depend on improvement in Auckland’s supply of housing. The governor said the bank will be watching house price data closely, and supply would be a critical part of the equation.

Recent developments

We note that the Reserve Bank’s move on interest rates has essentially been precipitated by the deterioration in New Zealand’s terms of trade, with weaker dairy prices and higher petrol prices causing a significant decline in national income. The international dairy price has fallen about 30 percent since early March, lowering farm incomes, while oil prices have started to rise again after a 60 percent drop. In March the Reserve Bank had expected lower petrol prices to translate into about $400 extra of disposable income per household; now it predicts the effect as only about $200. Because of these changes, the Reserve Bank judges that monetary policy should be more stimulatory to encourage a pickup in domestic demand and inflation.

The Reserve Bank sees little evidence that export prices will recover soon. We note that its projections for the terms of trade and the current account deficit are significantly more pessimistic than those in the Treasury’s Budget economic and fiscal update. The governor
said the prospects of export prices rebounding seem dimmer now than a few months ago, when the Treasury's forecasts were prepared. Another factor in the outlook is that investment in Canterbury's reconstruction is likely to increase more slowly than over the past two years.

**The housing market**

The governor acknowledged that house price inflation is “very much an Auckland problem”. He noted that house prices have increased by 17 percent in Auckland over the past year, but just 3 percent in the rest of the country, on average. A house in Auckland now costs about 7.5 times the average household’s disposable income, compared with about four times income elsewhere in the country. While cities around the Pacific Rim have seen rapid house price increases, a recent survey ranked Auckland as the 15th most expensive out of 380 cities.

It was because of the risks from these imbalances, he said, that the Reserve Bank had taken steps in May, announcing changes to its loan-to-value ratio policy which will tighten restrictions on mortgage lending to residential property investors in Auckland. The governor said the bank believes the changes will have a reasonably significant effect, reducing house price inflation in Auckland by somewhere between 2 and 4 percent in the first year. The tax measures announced by the Government in the Budget would also help, he said. However, the governor emphasised—and we agree—that increasing housing supply in Auckland will be the critical factor in arresting house price inflation. It is of concern that the most recent data from the Real Estate Institute of New Zealand shows a 20 percent rise in Auckland's median house price over the past year.

Some of us were disappointed to learn that the Reserve Bank has not modelled the likely effectiveness of the Government’s recently-announced tax changes, and note that there appears wide scope for investors to avoid the tax. The governor said any regulatory intervention raises issues around incentives and avoidance; the bank would be discussing analysis of the measure’s effects with the Treasury.

We sought the governor’s views on whether house prices are likely to ease gently, or whether there could be a sharp correction. He said adjustments in asset prices are hard to predict, but if Auckland’s house prices continue to increase at the rate of the past few years, the risk of a sharp correction would become quite acute. He would like to see Auckland’s house price inflation moderate substantially so it was more in line with the rate of income growth. Ideally, he said, house prices would grow less rapidly than incomes. He reiterated that increased supply is critical in Auckland, noting that as housing numbers in Christchurch have increased, house price inflation there has fallen to below 5 percent.

Some of us noted that with wages growing by only about 2 percent a year, it seems unlikely that house prices will slow below this rate. The governor said that on average across the economy, income growth has been about 4 to 5 percent, but he accepted that disposable incomes have come under pressure in many economies as rents and housing costs increase.

**The exchange rate and current account balance**

The fall in commodity prices and expected weakening in demand have seen New Zealand’s trade-weighted exchange rate decline by 7 to 8 percent from its peak in April. The governor told us he was pleased by this movement, which will help farmers and exporters, as the Reserve Bank has been signalling for some time that it considers the dollar's strength unwarranted by economic fundamentals. However, as the monetary policy statement
emphasises, he considers that it remains overvalued and a further significant downward adjustment is not only justified, but necessary to put New Zealand’s net external position on a more sustainable path. Some of us observed that similar comments by the Reserve Bank over a long period had had only a modest effect on the exchange rate, whereas the dollar had dropped immediately in response to the cut in the OCR.

As we noted above, the Reserve Bank sees little prospect of export prices recovering soon. It is forecasting deterioration in the current account balance from 3.8 percent of GDP in the year to March 2015 to 6.9 percent of GDP in the March 2017 year. We note that the Treasury forecasts a milder deterioration in the current account balance, to 4.9 percent of GDP for the year to March 2017.

We asked what the Reserve Bank would consider to be a more balanced exchange rate. The governor said the bank avoids commenting on what might be an appropriate value. However, he noted that the IMF has previously said it was overvalued by about 15 percent, while the Peterson Institute for International Economics said in May that it was 7 percent overvalued, before factoring in the recent drop in dairy prices.

**Employment and migration trends**

The monetary policy statement explains that although the economy has been growing strongly, inflationary pressures have been lower than expected, and unemployment has fallen more slowly than expected, in part because of strong growth in the labour force, which has increased the economy’s supply potential. Over the year to March 2015, the labour force increased by 3 percent—about 73,000 people. The Reserve Bank attributes about half the increase to strong net immigration, about a third to increased participation in the labour force, especially by women and older people, and the rest to natural increase in the population.

We discussed possible reasons for the increased labour force participation rate. The Reserve Bank suggested that Christchurch’s rebuilding activity and previously high terms of trade had created good employment prospects, enticing women and older people back into the workforce. However it conceded that an alternative reason was also possible: that households are finding themselves under pressure, and need two incomes to service their mortgage. It noted that the current participation rate of about 69.5 percent is high internationally, and a record for New Zealand.

We note that the Reserve Bank is projecting a significant decline in net immigration over the coming year. As this is one of the key assumptions in its forecasts, we asked about the justification for it and the implications if the expected reduction does not occur. The Reserve Bank said the nature of forecasting entails drawing big implications from a lot of detail. It has observed some decline in student visas and work permits, and it expects a drop-off in the inflow of construction workers as the pace of Christchurch’s reconstruction work starts to ease.

**Global uncertainty and volatility**

In our report on the last monetary policy statement in March, we commented on the increased volatility in international financial markets and uncertainty about the global economic outlook as a result of the disruption and unprecedented levels of liquidity which have followed the global financial crisis. We noted that the current world economic climate may require a rethink of traditional economic relationships, with interest rates and inflation appearing to be settling at low levels.
The June monetary policy statement points out that such volatility and uncertainties have increased. Although growth in New Zealand’s major trading partners is projected to remain around the historic average of about 3.75 percent over the next few years, this reflects in part the changing composition of our trade, as New Zealand deals more with faster-growing Asian economies. Among countries, performance is mixed, and concern is increasing about the possibility that growth in some economies may be permanently lower. The Reserve Bank notes that volatility in financial markets is likely to increase further as the US Federal Reserve starts to raise interest rates from about September, and negotiations continue over Greece’s debt.

We were interested in a special section on page 29 of the monetary policy statement which discusses the heightened uncertainties. The Reserve Bank notes, in particular, the challenges it and other central banks are facing in gauging such things as an economy’s “neutral” interest rate level, its potential output, and other key factors affecting inflation. We note that there is probably a greater than normal degree of uncertainty in the Reserve Bank’s projections as a result of such issues.

**Reserve Bank’s policy objectives**

We asked whether the Reserve Bank sees any potential conflict between its dual objectives of price stability and financial stability. The governor said it is a valid question. The Reserve Bank’s aim is to see macro-prudential policy and monetary policy work in harmony to the extent possible. It thinks carefully about the objectives of any policy measure, and what it is trying to target. He said that the measures taken on loan-to-value ratios had been for macro-prudential reasons, prompted by financial stability concerns around Auckland’s housing market, while its OCR decision had been based on a wide range of economic factors and how they affect inflationary pressures.

Some of us believe clearer guidance may be needed as to the Reserve Bank’s functions, as the existing regulatory framework does not appear to cover some of the real-world situations the Reserve Bank faces. The governor noted that a variety of models apply internationally: some countries such as Australia separate the functions of monetary policy and prudential oversight, while others combine them. The UK, he noted, has recently brought both roles back into the Bank of England.
Appendix A

Committee procedure
We met on 11 and 24 June 2015 to consider the monetary policy statement. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Stuart Nash
Dr Russel Norman
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Transcript of hearing of evidence 11 June 2015

Members
David Bennett (Chairperson)
Hon Clayton Cosgrove
Joanne Hayes
Brett Hudson
Jono Naylor
Alfred Ngaro
Dr Russel Norman
Grant Robertson
Alastair Scott

Witnesses
Graeme Wheeler, Governor, Reserve Bank of New Zealand
John McDermott, Assistant Governor, Reserve Bank of New Zealand
Bernard Hodgetts, Head of Macro-Financial Stability, Reserve Bank of New Zealand

Bennett Well, good morning, everybody, and welcome to the Finance and Expenditure Committee, and welcome, Governor and your team. We’ve got the report in front of us. If you want to give us a brief introduction, then we’ll open up for questions, OK?

Wheeler Thanks very much, Mr Chairman. Look, good afternoon, and on my right is John McDermott, who’s the bank’s chief economist and assistant governor, and on my left is Bernard Hodgetts, who’s the head of the macro-finance department. As you know, we reduced the official cash rate by 25 basis points today, to 3.25 percent. Growth in the global economy remains moderate, but volatility in financial markets has increased. We think the economy is probably growing at an annual rate of around 3 percent, supported by low interest rates, high net migration and construction activity, and the decline in fuel prices. However, the fall in export commodity prices that began in mid-2014 is proving more pronounced. The weaker prospects for dairy prices and the recent increases in petrol prices will slow income and demand growth and increase the risk that the return of inflation to the midpoint would be delayed.

Inflation has been low due to falling import prices and the strong growth in the economy’s supply potential, and wage inflation and inflation expectations have been subdued. With the fall in commodity prices and the expected weakening in demand, the exchange rate has declined from its recent peak in April but remains overvalued. A further significant downward adjustment in the exchange rate, we believe, is justified. In light
of the forecast deterioration in the current account balance, such an exchange rate adjustment is needed to put New Zealand’s net external position on a more sustainable path. We felt that a reduction in the OCR is appropriate, given low inflationary pressures and the expected weakening in demand and to ensure that medium-term inflation converges towards the middle of the target range. So we expect further easing may be appropriate, but this will depend on the emerging data. Thanks very much, Chair.

Robertson

Thanks very much, Governor. What do you say to the people who say you are now pouring petrol on an overheated Auckland housing market? I know you raise, in your comments today, that supply is what’s needed, and I think we all agree with that, but supply takes time to come on stream and you’re taking this action, which has already been responded to today by the banks.

Wheeler

Well, we thought a lot about the Auckland house price situation. As you know, we’ve been concerned about house price inflation in Auckland. It’s been running at 17 percent—at least, they were the April numbers—but the rest of the country’s got house price inflation, on average, at around 3 percent. If you look at Auckland house prices, the median house price is about 60 percent above where it was in the beginning of 2008. The rest of the country’s nothing like that, on average, and if you look at the house price to disposable income - ratio, it’s around 7½ in Auckland and around four for the rest of the country. So it’s very much an Auckland issue, and that’s why we moved on the macro-prudential side in respect of investor-related lending and the 30 percent deposit requirement.

Those measures, and the measures that the Government’s taken in respect of the tax side and the disclosure side— they won’t solve the problem. I mean, they will help, we think, reduce house price inflation in Auckland, and that would be important, but we really believe that more supply is needed to solve the Auckland problem. We will see, because of this OCR cut, floating-rate mortgages cut straight away. You would expect that; we did expect that. In terms of the swap market, in terms of fixed-rate mortgages: basically, the market was pricing in a 50 basis point cut over the next 12 months, and that’s, basically, what our forward projections show.

The issue was: when would that cut process start? When would the cut in interest rates start? And the market was 50 percent swayed either way whether it would start with the June MPS. So, in essence, half a cut was already built in the market expectation, so, you won’t see, I think—we haven’t seen the swap rates for, say, 2-year swaps move a lot. I mean, they’ve moved about 12 basis points. So you wouldn’t expect fixed-term mortgage rates to change substantially, partly because it was built in to the market curve.

Robertson

Is your feeling that we’re likely to see house prices moderate, or are we looking at the sharp correction/bursting of the bubble? What’s your take on which of those is most likely from here?

Wheeler

I think what I’d like to see, if I could put it that way—I’d like to see house price inflation in Auckland moderate substantially and get much closer into line with the growth of income and then, to be frank, over time to grow less
rapidly than incomes in the economy. You know, the risk: if Auckland house prices continue to rise rapidly, the risk of a sharp correction just becomes more acute.

Robertson And, presumably, you’ve factored that scenario in. I mean, I know what you’d like, but what is the likelihood?

Wheeler Well, you know, it’s hard to predict when adjustments in asset prices occur, but if you look at, as I say, house price to disposable income ratios or house price to rent ratios, they’re very high, in historic terms, for Auckland. They’re high internationally, as well, if you look at Demographia data. So the worry would be: if it continued to increase at the sort of rate that it’s been going at for a period of time, then you would have to think the risks of a substantial adjustment are serious.

Robertson Because you, presumably, have modelled what happens if supply doesn’t increase at the rates that you’d like it to?

Wheeler I mean, it’s critical that supply increases. I mean, you’ve seen what’s happening in Christchurch: as you’re starting to see housing numbers increase, you’re seeing house price inflation come down to below 5 percent now. Supply will fix the problem in Auckland; it’s getting that.

Robertson In the interests of the chair giving me time, I just want to move on to your projections around the future health of the economy. I mean, your projections around the current account balance and the terms of trade are significantly more pessimistic than what Treasury and the Government forecast in the Budget. I presume that’s largely built around your view that dairy prices simply aren’t going to rebound?

Wheeler Yeah. It’s the fact that we’ve built in the terms of trade into this set of projections, compared to, say, the March projections. We’ve got them 7 percent lower, and most of that is maintained throughout the forecast period. Now, a lot of that’s the dairy price, you know, at $2306 a metric tonne for whole milk powder. It’s down about 30 percent since early March. Some of it’s the rise in petrol prices. You know, when we were doing the March MPS, we felt that the fall in oil prices would translate into disposable income per household of about $400. Having seen petrol prices rise, we think that’s around $200. So those effects are important in terms of the impact on the current account.

The other way to look at it is to sort of say “Well, the current account reflects savings investment patterns in the economy.”, and what’s happening is, you know, the contribution from Canterbury reconstruction probably peaked last year and this year. Total investment increases over the next 2 years, but nothing like the rate of increase that we’ve seen this year and last year. At the same time—so you’ve got increased investment, but farmers will be saving less because they’ve had a $7 billion hit to their income, so savings in the economy will be slowing in terms of rate of growth. Investment will be rising, and that’s what causes the current account deficit.
Robertson: Do you feel like you’re now sort of—you know, obviously your job is to manage price stability, but you’re now sort of trying to lead the way in the overall financial stability and health of the economy. Is that now a major conflict for you, to try to put together the two objectives of the bank?

Wheeler: You want macro-prudential policy and monetary policy to work in harmony to the extent possible, and, you know, that’s why we moved first. I mean, we started to get worried about the Auckland housing market some time back, and that’s why we moved on the speed limits. That’s why we also moved on the micro-prudential measures in terms of what sort of capital adequacy the banks have for lending to investors, and then we moved on the 30 percent deposit requirement. Having seen house price inflation low outside Auckland, we raised the speed limit for outside of Auckland.

So we’ve tried to be active on the macro-prudential side, particularly targeting Auckland, but, you know, monetary policy—we have an objective in respect of the PTA to get inflation back towards the midpoint. When we did the March forecast, we were saying we, basically, wouldn’t be back to that midpoint until mid to late 2017. If you then overlaid this cut in the terms of trade—dairy price falls and petrol price increases—it would’ve been significantly beyond that. So that gave us scope, we felt, to cut interest rates.

Robertson: I have to ask this: do you think you got it wrong when you put it up last time?

Wheeler: No, I don’t think so, and we’ve, obviously, given quite a lot of thought to that. But, look, when we started to raise rates last year, which was in March—and we did it March to July—the terms of trade for New Zealand were at a 40-year high. They were at a 40-year high, migration was increasing, house prices were starting to rise—not just in Auckland but in other parts of the country—and, like a lot of other forecasters, we were anticipating that there would be an output gap that would be building up and would create inflationary pressures. What we didn’t foresee, but I don’t think any forecasters did, was that the price of oil would decline over 55 percent from June and that dairy prices would fall 55 percent.

Robertson: Yeah. I guess on the dairy price end of things, there have been projections about global supply outstripping demand for some time. I think, you know—I mean, your forecasts looking forward now, effectively, take that into account, whereas the Government’s books don’t at the moment, and that, as I see it, is the gap that’s now been created between your projections and Treasury’s projections—[Interrupt] Treasury controls the lights in this building!

Wheeler: Yeah, there is a difference between us on the current account deficit—between Treasury and ourselves. They have a smaller current account deficit than we do—

Robertson: And that is about their overly, in your view, clearly optimistic view of the dairy rebounding?
Wheeler  Well, I’m not sure I’d get into those sorts of terms. I wouldn’t use them, but it’s just different scenarios about what the terms of trade might be doing, but let me see if John’s got some thoughts on that.

McDermott  Also, timing matters. We’re coming out with our forecasts much later than Treasury, so we have more information about how things have evolved, and that would be—

Robertson  Not that much later.

McDermott  It’s enough to know about what’s going on in global supply, and that looks to be increasing relative to what we might have known even a few weeks ago, and that will lower the prospects of a rebound in those prices.

And the other thing you did mention, of course, in terms of the overall analysis—if you look at the bank’s forecast over the last year, or, actually, a bit longer, the growth forecasts have been pretty close. So in terms of generating activity and how interest rates go through financial markets and impact on lending and activity, that’s been pretty much spot on. The interesting thing is that has not translated into inflation, and that’s just not a New Zealand phenomena; that’s global. And so there’s something interesting in that space, and a lot of it’s coming through tradable prices, which are incredibly low; not the non-tradable prices.

Scott  Governor, coming back to some of the points Grant was raising around house prices and, really, just asset class prices, and reflecting on the Fed Reserve commenting around how high asset classes are—so Auckland house prices are but one of many asset classes that have been commented on as being high—or overvalued, if you like. Can you just make a few comments on those other asset classes and how you think about the relative value of those asset classes, whether it be Sydney house prices, equity indexes, the Nikkei or the Dow Jones?

Wheeler  Sure. I think if you look around the Pacific Rim, given that you’ve got the cheapest financing that the world, as we know it, has ever seen—and the data goes back over a number of centuries in the bond markets, for example. You look at house prices in the Pacific Rim—you know, you can take Melbourne, you can take Sydney, Singapore, Hong Kong, Vancouver, Toronto, San Francisco, LA—you’ve all seen inflated house prices, or rapid house price movements. If you look at equity markets, you’ve seen very substantial movements in the Japanese market. You’ve seen a very large increase in the last several months in the Chinese market. Price/earnings ratios in many markets and in the US are probably around 16 to 19 at this point. If you look at bond prices, they’re, basically, at record highs. In other words, the world’s never seen, until recently, bond yields as low as they are. So if you went to Europe right now, there’s, I think, nine countries in Europe that have negative yields on sovereign bonds for 2-year maturities. You’ve seen a contraction in the spreads between different types of risky assets—so between, say, corporate bonds and sovereign bonds, or junk bonds and sovereign bonds. You’ve seen that compression as investors have bid up prices to try to get enhanced yield. Now that’s started to change in Europe and in other parts of the world, partly because you’ve seen
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German 10-year bond rates rise quite significantly—and, having said that, to about 1 percent for 10-year bonds just over the last few weeks. So there’s a feeling, I think, that this has been overdone, and you’re starting to see some greater volatility in fixed income markets now and, to some extent, currency markets.

Scott I note that—and I appreciate you’ve got the international developments chapter before the domestic, and, you know, we’re in a different place to where we were 12 months ago, when we were hiking rates, and now we’re lowering rates. Even the commentary is talking about maybe this and maybe that. Can you just expand on that volatility of the markets that you’re seeing? And although you’re painting a picture today of what you foresee, can you give us some insight as to, you know, the variability of your projects outcome?

Wheeler In respect of the economic forecast?

Scott Yeah. Whether it be immigration—perhaps you could talk about immigration? You’re suggesting that is going to come off. You know, how wrong can you be, given the volatility of the market place?

Wheeler Well, I think if you look internationally across different economies, you’d see a fairly mixed picture in terms of recent indicators coming out of the US. You saw quarterly GDP growth decline, I think, 0.7 percent on an annual basis in the first quarter, but you saw 280,000 jobs created, in the data last Friday, or so. You see mixed indicators coming out of Australia, and there are some concerns, I think, about the weakness of some indicators in China and world trade volumes. The growth in world trade has been slowing. Go to Japan or you go to the euro area, you’ve seen some more positive indicators in the last 3 or 4 weeks.

So we’re in a situation where growth internationally is probably roundabout the average of what’s it been in the last 2 to 3 decades, which is roughly around 3.75 percent internationally, but you’re starting to see a pick-up in volatility that may increase because you’ve got two issues coming up that the markets will focus on. One, in particular, will be the fact that the US will probably raise interest rates, maybe in the period around September or a little beyond—doing that at a time when the Bank of Japan and the European Central Bank are doing large amounts of quantitative easing. That will, almost certainly, one would think, create some volatility in capital flows and, therefore, exchange rates and possibly interest rates.

The other uncertainty is around Greece, which is very much a day-by-day story, in terms of the negotiations taking place. But why don’t I hand over to John on some of the assumptions we’ve made about migration and the like?

McDermott Your question at the end was “How wrong can you be?”. You’re not in this game because there’ve been any certainties. There’s huge amounts of risk, and we highlighted that in box B at the end. It reflected on—there’s lots of interesting developments going on in international financial markets; particularly, around what interest rates are doing. They’re not operating in
quite the same way they were before the global financial crisis. Every central bank is trying to recalibrate where neutral is, and we’ve had a look at that and we certainly moved a lot earlier. Whether there’s room to move again, we’re not sure. There’s not a lot of evidence or clear evidence on that.

Every central bank has been worried about where trend growth rates are—big tensions in Europe about whether the shocks that everybody’s suffered has resulted in what people would call hysteresis. So it’s the fact that you never get back to where you might have—or, even worse, the growth rates might be permanently lower. I think people were referring to that as secular stagnation. So there’s lots of these unanswered questions which we don’t know yet.

Interestingly, for New Zealand, the one surprise we’ve been having is how well this economy’s been performing by generating jobs. There’s more jobs being generated than we anticipated a year ago, and that has allowed this economy to run at a speed without generating inflation. We’ve had to absorb that into our thinking. It’s not something you learn quickly. It evolves over time, and you have to start thinking about how you form a plan—what is that plan? If the plan’s working, you follow through on the plan; if it’s not working, you have to adopt to that. So that’s sort of the framework we’ve been trying to adopt.

Scott Just building on that flexibility in the workforce that you’re talking about, can you explain this increase in females and older people as a bit of a surprise? In hindsight, can you explain why they’ve jumped into the workforce? And the second part of the question is: do you think it’s a permanent or a sustainable increase in those groups’ participation?

McDermott I think we can theorise, and one of the things—with rising incomes, with rebuilding Christchurch creating activity, with the high terms of trade that we did have, it created a lot of prospects, good prospects, and that encouraged people into the workforce. And once people have a job, they build skills, they’re more employable, and you get this very virtuous circle, which is almost the opposite of what we’re seeing in Europe, where once you’ve been out of the workforce for more than a year, skills deteriorate.

Norman Well on that, can I suggest an alternative thesis, which is that when the house price inflation is running at 17 percent a year and wages are increasing by less than 2 percent a year, households are under enormous pressure to maximise their engagement in the paid workforce. So one of the things that’s happening is people are being pushed into the paid workforce because houses are out of control and you need two incomes to service a mortgage if you live in Auckland now?

Wheeler Yeah—I mean, it’s possible. If you look at participation rates, they’re at an historic high in New Zealand. They’re, I think, about 69.5 percent, and that’s high internationally. And what’s sort of led to the increase is, as John said, it’s, basically, been female participation and older people. Some of that added worker effect—i.e. people just sort of going out and looking for jobs—is a result of the economy that’s been doing well. So they go out and
look for more opportunity, but it could well be the reason you’ve mentioned as a factor. It could well be.

Norman And you were saying earlier that you wanted Auckland house price inflation to be underneath wage growth, which means that you’re looking for a house price inflation in Auckland of under 2 percent—is what you’d like to see happen—which may come as a bit of shock to Aucklanders, who have become pretty used to 10-plus percent per year.

Wheeler I think over time, if you look at the house price to disposable income ratio, it’s around 7½, and if you look at the Demographia data—one can pose questions around it, but internationally it places Auckland in the most expensive 15 cities in the world out of a survey of 380. So the question is: do you want the house price to disposable income ratio to keep growing beyond 7½, and what I was saying is that I would like to see house price inflation in Auckland moderate and over time to grow less than the rate of growth of income.

Norman Which is currently around 2 percent—or 2 and a bit percent.

Wheeler Well, incomes over the last year have been growing at around—if you look at it on the economy-wide basis—about 4 to 5 percent. A lot of people haven’t had wage increases of any significance, but if you look at it for the economy as a whole, then you’ve seen that sort of income growth.

Norman OK, but the issue from a household point of view is that they’re having to spend more and more of their disposable income on housing, effectively, or servicing the mortgages around housing. That’s got to be having all these kick-on effects to the rest of the economy because everyone’s just got less disposable income to spend on other stuff because you spend more and more of your money to the bank, essentially, to service the mortgage. How does that affect the economy over time, when we kind of get this increasing level of indebtedness relative to income, so that we all have less and less money to spend on other things?

Wheeler No, it’s a fair point. I mean, this is a generalisation, but I think it’s true: if you look at people across international—across advanced economies, so let me put it that way—people who rent tend to have lower incomes, on average, than people who own houses. So they tend to have higher marginal propensities to consume, you know, because the marginal propensity to save increases as income rises. So that means that if they’re having to pay rents, and rents are going up, or if they’re on low incomes and they own a house but interest rates rise, then, you know, given that they tend to have high marginal propensities to consume, then it will crowd out consumption activities elsewhere.

Norman Just getting back to Grant’s questions, which is the dual kind of functions—internationally, or at least in the past, the big debate has been inflation targeting versus other kinds of things, whether you call it GDP growth or employment or output or whatever. It was always seen as “What’s the trade-off between inflation versus, say, GDP?”—is one kind of thing. And now it’s kind of, for you guys, it’s been replaced by the debate about inflation
targeting versus financial stability targeting—in a sense, is the kind of juggle that you’re having to deal with at the moment. And so one of the questions is: in the past what we did with the Reserve Bank of New Zealand is we said “Don’t worry about output or GDP; just focus on inflation.”, and we didn’t even think much about financial stability. It wasn’t really even discussed very much in the past, because we didn’t really think it was a big problem. It was all about inflation.

Whereas now, you’ve got these two things that you’re trying to deal with, and I was trying to get at this last time we had this meeting, which is: do you weigh them up one against each other each time you do one of these things, or do you separate them in your mind? Because, you know, you’re doing Monetary Policy Statements one month, and then the other quarter or whatever you’re doing Financial Stability Reports, and it’s like: when you’re doing each of those things, are you thinking about the other, and are you trying to kind of compromise, or are you doing two independent functions which you view, yourselves, as kind of you’ve got to make two independent decisions kind of unrelated? Because it goes to the heart of whether one regulator should be doing both of these functions, if you like. Is that a fair question?

Wheeler No, it’s a very good question, and we think about a lot of things about policies, in terms of assignment issues: what’s the objective of the policy and what’s the appropriate target? And to give an example: I mean, if we’re thinking about financial stability issues, we will think—in the case of the Auckland housing market—we’ll think about the supply and demand side factors that are driving that market. We’ll think about what it is that we can do, given our regulatory authorities and given our instruments—monetary policy instruments; how we could, you know, try to generate an outcome that would help in respect of financial stability. It would mainly be through the macro-prudential side. Hopefully, monetary policy can support the macro-prudential, and vice versa, but there will be situations where there may be a potential conflict. But look—

Norman Like today. I mean, like today’s decision is potentially a conflict, right?

Wheeler Well, in respect of Auckland, you know, you’ll probably see banks throughout the country lower their floating-rate mortgages and maybe a little bit, maybe just a little bit, on their fixed-rate mortgages. But, you know, for the country outside of Auckland, house price inflation is running at around 3 percent on average. So the issue is: what are the supply and demand dynamics around Auckland?

Another thing we think a lot about is what’s happening to the general state of the economy, for example. We don’t just sort of say: “Well, inflation’s low; therefore, let’s cut interest rates.” We also think very carefully about what is the supply side capacity of the economy, what’s happening to demand, what’s happening to unemployment and employment growth. So we’ve got an interesting position right now, in essence. You’re seeing a lot of factor accumulation take place in the economy, right? You’ve seen the labour supply increase by something like 3.25 percent—so it’s very rapid.
Now, half of that’s been migration. About a quarter of it is labour force participation, like we just talked about, and some of it is natural increase.

But that, plus along with the capital formation that we’ve seen through high investment—some of it Canterbury, some of it Auckland—has built up the supply side capacity of the economy. So that it means that it can accommodate the demand growth in the economy without inflation pressures. So let me put it this way: if the labour force is increasing say 3.25 percent, employment’s increased, also, roughly 3.25 percent. We haven’t seen wage inflation start to accelerate. If we hadn’t seen that supply increase and we hadn’t had the strong migration—the strong labour force growth—and we’d had the strong employment growth, we would have seen strong wage price inflation, wage inflation.

Norman I guess my point is maybe—I appreciate that, but it’s like you have these two formal responsibilities—you know, financial stability, price stability, if you like—and I just feel like a formal statement from the bank as to how exactly they see those two things being together when they make these two—because you make these two different reports, right, with different targets, presumably. How exactly it fits together, I think, probably would be useful, because from the point of view—as a legislator, it’s like: what should the legislation say? What is the guidance that should be in the legislation, and what is your actual practice, in a sense? Because you’re evolving your practice to deal with a real-world situation, right, but is the law properly reflecting the real-world situation that you’re finding yourself in? I don’t know. It kind of seems to me that there’s this kind of evolution, which you’re dealing with in an informal way, which is fine, because you’ve just got to, but it’s like: is the kind of regulatory framework that’s sitting around that, is that keeping pace with the reality that you’re facing?

Wheeler I think there’s, you know, different models internationally around all this. In some countries, you see the financial stability issues outside the central bank; in others, you see it inside the central bank—just like you see general prudential oversight and regulatory responsibilities for the banking system in general sometimes outside the bank, as in Australia with APRA. In many other countries, it’s inside the bank. In the Bank of England, they’ve been brought back into the bank, for example.

Cosgrove You made reference to the potential impact of the Government’s Budget-announced tax on property gains held for less than 2 years. Have you done any work or analysis that would indicate what that impact would be, positive or negative, and the effectiveness of that policy, and over what time frame?

Hodgetts We haven’t explicitly tried to model the impact of those tax changes. What we’ve been putting our attention on has been the impact of the LVR changes that we’ve recently announced, and, as we’ve said, we think those will have a reasonably significant effect on the Auckland housing market—we think, reducing house price inflation in Auckland somewhere between 2 to 4 percent over the first year of operation. The tax measures that have
been announced we think would likely add to that effect, but we haven't tried to model that as yet.

Wheeler

I think the other thing that's quite important is the register. The register of foreign interests and, basically, the tax numbers that need to be collected. I think that's really quite important.

Cosgrove

Are you likely to do any modelling on it? Because I'm a little bit amazed that—I mean, you do make reference to—talk about it may have an effect, or whatever, but I think New Zealanders would like to know, with some authority from the bank, what their forecast going forward would be or what their modelling is. Do you intend to do any analysis of it?

Wheeler

That's a good question. I mean, I think that's something we'll be taking up with Treasury.

Cosgrove

Have you looked at any other international comparisons?

Wheeler

Not that I'm aware of, but let me ask Bernard, because I stand corrected.

Hodgetts

It's a fairly unique set of changes, I guess, that—I mean, it would be hard to find sort of comparable sorts of changes internationally that you could model the New Zealand experience off, but, I mean, it's something we'd certainly have to take a closer look at.

Cosgrove

Because there's been some commentary about, to be blunt, hold out for 2 years and 1 day, or whatever, and I'm sure the tax lawyers will be looking every day on how you can express your intent as a purchaser in such a way that you don't incur the ire of the Inland Revenue. So there's bound to be the odd loophole that somebody could drive a truck through, and I think, you know, New Zealanders would want to know, well, is this just a nice piece of spin or will it actually have some sort of positive or negative impact? And they'd probably look to you guys, I suspect, as independent analysts in that respect.

Wheeler

No, it's something, as I say, we'll talk with Treasury about. You know, with any regulatory intervention, whether it's tax or anything, you're going to get a water's edge problem, you're going to get an incentives issue, you're going to get an avoidance issue, and you just hope that the cost-benefit equation, if you like, is favourable.

Cosgrove

Hope's an interesting term to use.

Bennett

Governor, you've been very good in the past of signalling changes that you may have, and today's probably come as somewhat of a surprise to some people that it hadn't been signalled in advance. Has there been any change in circumstances in recent months that has caused you to come to this conclusion today?

Wheeler

I don't think anyone in the markets was surprised that we produced a set of interest rate projections that involve a decline in the 90-day track. So I don't think anyone was out there saying “Gee, we think the Reserve Bank will produce a set of forward projections that are unchanged from March.”, and the market had built in a 50 basis point cut over the next 12 months, and that's what our projections build in as well. So the issue was always going to
be: when will that process start and how much will the Reserve Bank lower its track by? So that’s where the uncertainty was, and, as I say, the market had built in a 50 basis point reduction over the next 12 months. The market was split, both in terms of the interest rate market and the currency market, split roughly 50-50 about whether the Reserve Bank would cut interest rates in the June MPS.

We’ve been signalling since early February—I gave a speech in Christchurch that was on the record about the conditions under which we would lower interest rates. At that time, we felt that the OCR would probably remain unchanged for quite some period, but that was before we saw the 30 percent decline in dairy prices, it was before we saw half the petrol price increase wipe out the $400, if you like, of disposable income enhancement, and we’ve seen continued moderation in some inflation indicators since February. So we talked about those conditions in February. John talked about them in April. We talked about them in the OCR decision in April. So I don’t think the market should be surprised by the decision. They were expecting a lower interest rate track; they were just unsure whether it would start today or a bit later.

Bennett So one of those factors was domestic demand. How are you factoring that in at the moment?

McDermott The big thing that’s changing our outlook for demand is what’s happened with export prices, and, actually, the prospect of them actually rebounding looks a lot dimmer than it did a few months ago. So it’s really the forecast of demand. You know, internally driven demand is weakening. So to offset that, we now have a lower interest rate profile so that we can keep the economy on an even keel, ultimately sending the economy back to a mid-point of the inflation target. So it was the demand story that was changing. It was changing because of the export price story.

Hudson Governor, my question is on the exchange rate. You said in your comments you think it’s still overvalued. So what would you see as a fair value for the exchange rate, and what’s the basis for that?

Wheeler Well, we don’t comment on where we’d like to see the exchange rate end up, but, as I said in the press conference this morning, the IMF and some of the thinktanks around the world are less shy than we are. The IMF analysis is a bit dated. I think it was last year. They felt that the exchange rate was overvalued by about 15 percent. The Peterson Institute did some analysis in May—so it’s very recent, but before some of the commodity price falls—and they suggested that the real exchange rate was probably 7 percent overvalued compared to its equilibrium rate.

The main point is we’re pleased that the cross rate with the US, for example, is down from its peak of 88, and just before I came here it was about 70.3 or thereabouts. So that’s a good movement, and we’ve moved against the Australian dollar, and also on a TWI basis, by roughly 8 percent or perhaps a bit more over the last few weeks. But we still think that still has a significant way to go. We’ve seen quite a substantial fall in the terms of trade. The decline in dairy incomes is roughly around $7 billion; that’s 3
percent of GDP. That’s a big cut to dairy farm incomes. What the effect on the economy will be will depend very much on how they smooth their spending. But it’s very clear that dairy farmers will be—some of them—in a pretty serious way. I mean, 25 percent of them have negative cash flows at this point.

Robertson: How dependent is a future cut on your seeing more improvement in supply, in terms of Auckland housing?

Wheeler: The sort of things that we would look at would be: what sort of growth are we seeing in the economy; what’s happening to wage pressures; what are some of the inflation signals showing; inflation expectations—so, generally, what’s happening to pricing pressures—as I say, in the economy; what’s happening to commodity prices; what happens in future dairy auctions, for example; what happens to the exchange rate? If you look at inflation in the economy, you’ve, basically, seen negative tradables inflation for the best part of 3 years, partly because of low overseas inflation and partly because of the high exchange rate. So the exchange rate becomes an important transmission mechanism to raise inflation, but it’s, basically, been pulling down inflation quite dramatically. So to the extent that we see further exchange rate depreciation, that will help raise tradables inflation. And that would be a good thing. They’re sorts of indicators that we look at.

Robertson: In that list, you haven’t mentioned supply in the Auckland housing market. But I presume it is still a factor you would be taking into account in a further cut.

Wheeler: Well, we’ll certainly be following—the data that we look pretty carefully at is the REINZ data, and we tend to sort of look at the last 3 months over the same period a year before to—it takes some of the noise out of the thing.

Robertson: It’s just come out today. I was looking—

Wheeler: Yeah, I haven’t seen it yet.

Robertson: I have a copy if you want, but it’s—it’s bad. 20 percent: the median house price rise in a year. So presumably you’re going to be looking and saying “We’ve got to see some action in supply.”

Wheeler: I think supply is just a critical part of the equation. It’s just got to be.

Norman: My question was jawboning versus real cuts. The dollar did respond to your cut today, right? I mean, in a way that all the talk over a really long period where you’ve been saying, quite rightly, that the dollar’s overvalued, but it’s had modest effect compared to actual cut. Is that your kind of analysis of it?

Wheeler: Well, if you look at when John gave—as I say, I talked about, in early February, the conditions under which we would cut. Over the past year and a bit, we started out with a—I don’t really like the term hawkish—with a tightening bias, if you like. We raised rates, and then we sort of moved to a tightening bias. It was built into the forward track. Then we moved towards a more neutral statement, and then we talked about conditional easing, and that was what I was doing in February and that’s what John was
doing in April, and now we’ve moved to an easing phase. So it’s been a movement over time in that respect.

After John’s speech in April—I mean, the exchange rate prior to today had come down on a TWI basis by about 8 percent against the US and against a TWI. Some of that was the statement and the comments in the speech that John gave; some of it was what was happening in the US and in Australia, in terms of their signals.

Norman My last question is about the migration assumption, which is quite marked. I mean, it’s kind of one of your key assumptions—it would appear to be. In terms of where you think wage pressures are going to go in the future is the big drop in net migration. There’s no actual hard data, is there, at the moment for that assumption, or have I missed something? Is there a sudden big drop that I missed? I just can’t find it, and it seems to me like—you look at that graph, and it’s like normally your projections, there’s something that kind of begins it and then you draw the line out, right? And you kind of go “Oh yeah, it’s going to go like this.” and you can see it stretched out. Whereas with this one, it’s like you have done the big drop in your projections. Where’s it coming from?

McDermott This is the nature of forecasting, right? We watch lots of partial information, and sometimes you’re reading this information and you have to draw big implications from it. So that’s the nature of what we’re doing. But we have seen some student visas fall away. We have seen some visas and work permits fall away, so this is the early indication. The second thing is: the profile of Canterbury is still going to be very busy but it’s not going to be adding to growth. So construction workers and so on are not going to be sucked into Christchurch to the same degree they were. So you follow that implication, and at some point you would expect there to be a turn. Of course, we have predicted it now—

Norman You’ve picked the turn. It’s happening tomorrow.

McDermott The other thing is—the interesting thing is the number of people moving across the Tasman has been a big difference. So this has been a story in the past of Kiwis not moving. Now, of course, if things really turn out badly that might all change as well. So there’s lots of things that can move this. The other important and the really fascinating thing about the migration story in previous cycles has been the composition change. So in previous cycles, you’ve had people coming with families. They’ve been wanting houses, they’ve been wanting cars, and it’s put an immediate demand pressure on the system, which often the central bank has had to then lean against. This time the composition seems to have been younger, seems to be less families, more single people, so the demand from housing this time has been less, and there’ve been an age profile where more of them have been participating in the workforce, so it’s added to that supply. So you can’t just forecast the number and a turning point; composition matters hugely in this as well, and you have to forecast that.

Bennett Thank you very much, Governor. Thank you to your team, and we’ll just clear the room everyone. Thank you. Conclusion of evidence
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Reserve Bank of New Zealand’s Monetary Policy Statement, September 2015

**Recommendation**

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, September 2015, and recommends that the House take note of its report.

This report summarises the contents of the Reserve Bank’s monetary policy statement released on 10 September 2015, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

**Official cash rate reduced by 25 basis points**

The monetary policy statement announced the Reserve Bank’s decision to reduce the official cash rate (OCR) by 25 basis points—a quarter of one percent—to 2.75 percent. The OCR influences the interest rates offered by New Zealand banks. This was the third time the OCR has been cut in recent months. It was reduced by 25 basis points in June and July, after being held at 3.5 percent for the previous nine months.

The Reserve Bank now says that further reduction of the OCR is likely. However, its decisions will depend on the emerging flow of economic data.

**Main reasons for the Reserve Bank’s decision**

The Reserve Bank considers that a reduction of the OCR is warranted because of softening in the economy.

Since the June monetary policy statement (MPS), increasing concerns about slower growth in China and East Asia have led to more volatility in world financial markets and further falls in commodity prices. The New Zealand economy is growing more slowly. GDP growth is now at an annual rate of about 2 percent, compared with about 3 percent over the past year. The main reasons for the slowdown are the reduced export earnings from lower commodity prices, construction activity in Canterbury starting to reach a plateau, and weaker confidence (and therefore demand) on the part of businesses and consumers.

Headline inflation remains low, at 0.3 percent in the year to June. It is expected to increase to within the 1–3 percent target range by early 2016 as the previous fall in petrol prices drops out of the calculation, and as the lower exchange rate passes through into higher prices for traded goods and services.

By stimulating demand through lower interest rates, the reduction of the OCR will help the Reserve Bank’s aim of keeping future average inflation near the 2 percent midpoint of its target range.

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1 Headline inflation, as measured by the Consumers Price Index (CPI), measures the rate of price increases without adjusting for volatile or seasonal price movements (e.g. food and fuel costs). In contrast, measures of “core” inflation attempt to adjust for volatility in the headline rate, allowing the more general trend in prices to emerge.
International developments and the outlook for growth

The global economic environment has deteriorated in 2015. Prices for a broad range of commodities have fallen. Dairy prices are now 55 percent lower than in February 2014. Of most concern for New Zealand is the effect of weaker Chinese demand on the price and volume of our exports.

The bank has revised down its outlook for economic growth since the June MPS. It now expects GDP to grow by just over 2 percent in the year to March 2016, compared with 3.2 percent projected in the June MPS. Factors contributing to lower growth than expected have been the sharp decline in export prices, and construction activity in Canterbury reaching a plateau earlier than previously assumed. However the Reserve Bank also notes several strong factors that continue to support growth:

- robust tourism
- strong net immigration
- a large pipeline of construction activity in Auckland and other regions
- lower interest rates
- the depreciation of the New Zealand dollar.

It expects commodity prices to pick up again from their present extremely low levels. This, combined with a lower exchange rate and interest rates, should see growth rates improve again. The Reserve Bank’s projections are for GDP growth to rise to 2.5 percent in the year to March 2017 and 3 percent in the following year.

Risks and key policy judgements

We discussed what the Reserve Bank sees as the main risks for New Zealand at present. The governor highlighted the following, but said that the downside risks seem fairly evenly balanced at present by upside factors that continue to support growth.

Developments in China

The governor noted that China is the first or second largest trading partner for more than 100 countries, and in the past four years it has accounted for almost 40 percent of global growth. The increased uncertainty about the strength of its economy is therefore of wide concern.

Weaker growth in China, and lower demand from it, directly affects the price and volume of our exports. It also has indirect effects via New Zealand’s other trading partners in Asia and the Pacific. If weakening in China lowers their growth, it could reduce their demand for our exports, particularly to Australia, our second largest trading partner after China.

El Niño climate predictions

NIWA is predicting a 90–95 percent probability of lower-than-normal rainfall over summer as a result of El Niño weather conditions. This could have a major effect on farm production, exports, and growth. The Reserve Bank says it is watching the weather projections closely. It told us it would be of serious concern if El Niño became a major weather event that carried on late into 2016.
Other risks

Asked about other risks, the governor told us that the bank has made clear its ongoing concern about rapidly rising house prices in Auckland. We discuss the housing market in a separate section later in this report.

Judgements underpinning the projections

The Reserve Bank considers the following to be the most important in assessing the economic outlook:

- the exchange rate will drop further and remain low, boosting activity in the tradable sector and inflation
- export commodity prices have bottomed out and will recover gradually
- world growth will remain near its past average
- net immigration has peaked
- rebuilding activity in Canterbury has peaked, while house building in Auckland will continue to accelerate.

We note that future monetary policy decisions will be influenced by how closely actual developments bear out these judgements.

Inflation, expectations, and interest rates

Annual CPI inflation remains below the 1 to 3 percent target range because of the previous strength in the New Zealand dollar and the halving of world oil prices since mid-2014. However the Reserve Bank expects it to be well within the target range by early 2016.

The Reserve Bank’s previous inflation projections

We noted that the Reserve Bank has been predicting a pick-up in inflation for some time. For example, in March 2014 it expected the CPI to be 1.9 percent for the year to March 2015; the actual rate was only 0.3 percent. The governor said that previous inflation projections were based on the fact that, at the beginning of 2014, New Zealand’s terms of trade were at a 40-year high; spare capacity was being used up as output increased, and inflationary pressures were expected to build. Then, however, oil prices dropped by 60 percent—something nobody had expected—and dairy prices fell by 55 to 60 percent. These changes removed the upward pressure on inflation.

Why the Reserve Bank expects inflation to increase

We asked how confident the Reserve Bank is that its projections will be borne out this time. The governor explained that some increase in the inflation figure will happen automatically as the sharp falls in oil and dairy prices, which reduced the CPI for the December and March quarters, will drop out of the calculation. Together with the lower exchange rate, this should automatically push the inflation rate up to about 1.5 percent by the March 2016 quarter. It expects the rate to increase further as projected growth rates of 2.5 to 3 percent start to build inflationary pressure again.

Whether low inflation is a new normal

We are particularly interested in core inflation—that is, the underlying trend in prices without volatile elements like oil prices. We note that it has remained persistently low, below expected levels, for some years. We asked whether the Reserve Bank is concerned
about this, or sees some structural shift happening, since over time one would expect core inflation to match expectations about price increases.

The Reserve Bank said it focuses closely on inflation expectations, which it measures in several ways using survey data. For several years expectations were for prices to rise by about 2.5 percent a year. The bank has worked to lower this expectation, for example by making a point of focusing on the midpoint of its 1–3 percent inflation target. Recently, it said, expectations appear to have declined to about 2 percent. This is roughly the level it considers appropriate. Core inflation is about 1.4 percent, and the bank would like it slightly higher. It believes the OCR reduction just announced and the signals it has given for the future will be helpful in lifting core inflation closer to 2 percent.

As to whether structural factors are at play in keeping inflation low, the Reserve Bank did not think so. It believes the low rates can be explained in part by the large reductions in oil prices and other tradables. The inflation rate for non-traded goods and services has been considerably higher than for tradables, but it is forecast to fall below 1.5 percent in late 2015. The bank attributes part of this reduction—about 0.4 percent—to lower ACC vehicle levies, and the rest to the fact that expectations about wage and price increases have dropped.

Projections of future interest rates
The governor noted in this context that the Reserve Bank is one of the few central banks in the world that provides forecasts of future interest rates. He said its projections for 90-day interest rates incorporated 50 basis points of easing, of which 25 basis points had been delivered that day. He emphasised that while the MPS stated that “at this stage some further easing seems likely”, it had carefully qualified this by saying “this will depend on the emerging flow of economic data”.

The exchange rate
The exchange rate has fallen considerably. Since April, it has dropped about 16 percent on a trade-weighted basis, and about 30 percent against the US dollar. However the Reserve Bank continues to see further depreciation as appropriate because the prices for New Zealand’s export commodities have fallen so sharply.

We asked what time lag would normally be expected between depreciation of the exchange rate and its effect on prices. We were told that the effects vary. Oil prices normally adjust within the same quarter. With other commodities, the lag is typically between six and nine months, depending on how much importers have hedged against currency movements.

Rising house prices in Auckland
House prices in Auckland continue to rise rapidly, and the Reserve Bank says they are becoming more unsustainable. Although construction is increasing, it will take some time to correct the imbalances in the housing market.

Risks from rising house prices
We recalled the Reserve Bank’s previous warnings about the risk of a sharp correction in the housing market, and note that there is no sign of prices in Auckland easing. The most recent data from the Real Estate Institute of New Zealand suggests they are accelerating, with prices rising at an annual rate of 25 percent.
The governor described the present situation as “dangerous territory”. He said that the faster prices rise, the more likely it is that there will be a steep reversal. He noted that Auckland’s house price-to-income ratio, at 9, is twice that for the rest of the country. It puts Auckland in the world’s top 10 most expensive cities.

The governor also noted that a survey by ANZ bank in late 2014 suggested that investors saw property prices increasing by 75 percent cumulatively over the next five years. He observed that if the Reserve Bank “does its job properly”—that is, stabilises inflation at around 2 percent a year—the general price level would only rise by 10 percent over that period.

**Effect of property investment**

We asked what signs there are that investors in residential housing are adding to the risks. The governor said there is evidence that property investment has increased. Two years ago investors accounted for about 33 percent of property transactions. Now, they represent about 41 percent.

More generally, the Reserve Bank noted that property investors tend to amplify the effects of cycles in the property market. While New Zealand has not had extreme property cycles as in other countries, global evidence suggests that, in a downturn, banks’ losses tend to be considerably larger on loans to investors than to others.

**Curbing rising house prices**

We sought the bank’s view on when the housing market might stabilise. We note that housing consents are increasing, signalling more supply, while demand should reduce because lower commodity prices will mean less money in the economy for purchases. The Reserve Bank said it is always difficult to pick the turning point in an asset price cycle. It expects that recent measures will tend to moderate the Auckland market. They include increasing loan-to-value ratios (LVRs) for residential property investors, and tax measures by the Government such as the bright-line test. However, it cannot predict the cycle’s peak.

The Reserve Bank added that unlike in previous housing cycles, higher house prices have not this time translated into higher-than-normal consumption and inflationary pressure. That is, it is not a monetary policy issue, but one of financial stability. This gives the bank less scope under its mandate to lean against the market using interest rates.

**The effectiveness of recent measures**

Changes to the Reserve Bank’s LVR policy designed to curb the risks posed by investors in residential property will take effect in November. We asked when results of the new measures might be evident. The Reserve Bank said it has not modelled the likely effects of its LVR restrictions on property investors, nor the bright-line tax measure being introduced by the Government, as they are new measures and it has no base to assess them against.

As to the effectiveness of the original LVR restrictions, the Reserve Bank indicated that a straightforward assessment is not possible because of the complex interplay between house prices, interest rates, and the exchange rate. It said the restrictions had had an initial dampening effect, noting that house price inflation in Auckland had been down to 6 percent for a period before the 2014 election. The governor said the Reserve Bank’s ability to lower interest rates in response to the dramatic fall in New Zealand’s terms of trade had helped the economy to adjust, despite the complications lower interest rates create for the housing market.
Employment and migration trends

Migration flows

Net immigration has been at record levels. The Reserve Bank believes it has now peaked and will reduce. We note that it has been expecting this for some time, and asked how confident it is in this judgement. We were told that one feature of the migration flows has been that they included fewer New Zealanders leaving than normal, reflecting the relative strength of our economy compared with Australia’s. Now, there are signs of an upturn in Australia’s labour market, especially in construction and services. This could change the incentives for Kiwis to cross the Tasman. However, the Reserve Bank does not expect a rapid or major outflow to Australia given the challenges its economy still faces.

We asked why the net migration inflow has not featured as one of the contributors to GDP growth. The Reserve Bank said a range of factors determine how net migration affects the economy. They include the age profile of migrants, whether they come alone or with family, whether they work or study, and whether they buy a house or rent. One feature of the recent migration cycle has been less stimulus to total demand than normally.

Unemployment and wages

Unemployment has increased to about 6 percent, from a low of 5.5 percent in the September 2014 quarter. The Reserve Bank noted that until a few months ago the unemployment rate had been falling. It attributed the change to the downturn in export prices, and noted that there was little scope for monetary policy to affect the rate in the short term. We expressed concern at the rise in unemployment, and questioned whether the Reserve Bank focuses sufficiently on employment levels in its decision-making.

Nominal wages have remained stable in the past year, as employment growth of 3 percent has been matched by growth in labour supply. However, the Reserve Bank notes that real wage growth remains strong because of low inflation.

The Reserve Bank’s governance structure and policy targets

We discussed the Reserve Bank’s governance structure, and its responsibilities under the Policy Targets Agreement (PTA). Some of us consider that both should be broadened.

Objectives under the Policy Targets Agreement

The PTA requires the Reserve Bank to focus on maintaining price stability. It expects the Reserve Bank, in doing so, to take asset prices into consideration. The bank must also have regard to the efficiency and soundness of the financial system, and seek to avoid unnecessary instability in output, interest rates and the exchange rate.

Some of us speculated that the Reserve Bank’s advice on monetary policy might be shaped differently if the parameters specified in the PTA included employment, the external balance, and economic wellbeing as secondary goals. The governor said that the Reserve Bank’s mandate gives it clarity, by making price stability the focus. However, he emphasised that the bank does think about the wider economy—aggregate demand and
employment, as well as asset prices—in making its decisions. For example, he noted that this monetary policy statement specified the softening in the economy as a key reason behind the OCR decision.

The governor noted that the US central bank, the Federal Reserve, has dual responsibilities: to maximise employment and to maintain price stability. He said this gave it a difficult balancing act, as economic forces create potential conflict between keeping inflation low and employment high. We were also told that some research in 2007 had compared the way New Zealand’s monetary policy responded to various economic conditions with the responses of monetary authorities in the United States and Australia. All three had been similar.

Decision-making on the OCR

Some of us have advocated having a wider group involved in decisions on the OCR. The governor told us that the views of many people are taken into account in developing monetary policy. In the lead-up to each OCR decision, a group of about 35 people undertakes three days of intensive discussions and economic modelling. Following this, an advisory committee of 12—including two people from outside the Reserve Bank—makes recommendations to the Reserve Bank’s Governing Committee (the governor, two deputy governors, and assistant governor). He emphasised that at no time in the past 10 years had an OCR decision been taken that was not the majority opinion of the 13 people making up the advisory committee and the governor.

As to whether the advisory committee’s input to decision-making on the OCR should be formalised in some way, the governor said that would be a decision for the Government.
Appendix A

Committee procedure
We met on 10 and 23 September 2015 to consider the monetary policy statement. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Transcript of hearing of evidence 10 September 2015

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Dr David Clark
Julie Anne Genter
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour

Witnesses
Reserve Bank of New Zealand:
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Dr John McDermott, Assistant Governor and Head of Economics
Geoff Bascand, Deputy Governor
Willy Chetwin, Manager Forecasting
Mark Perry, Head of Financial Markets
Roger Perry, Manager International Markets and Analysis
Mike Hannah, Head of Communications/Board Secretary

Bennett
Good afternoon everybody and welcome to the Finance and Expenditure Committee. We’re doing the Reserve Bank’s Monetary Policy Statement for September 2015. Welcome Governor and your team. If you just want to give us a brief introduction, first of all, and then we can open up for questions.

Wheeler
Well, thanks very much indeed, Chair. It’s great to be here again. Look, on my left is Grant Spencer, Deputy Governor and Head of Financial Stability, and on my right is John McDermott, who is the chief economist and Assistant Governor.

As you know, we reduced the official cash rate by 25 basis points to 2.75 percent. Global economic growth remains moderate but concerns about softer growth, particularly in China and East Asia, have led to elevated volatility in financial markets and renewed falls in commodity prices. Domestically, the economy is adjusting to the sharp decline in export prices and the consequent fall in the exchange rate. Activity has also slowed due to the plateauing of construction activity in Canterbury and a weakening in business and consumer confidence. We think the economy is now growing at an annual rate of around 2 percent.
There are several factors continuing to support growth. They include robust tourism, strong net immigration, the large pipeline of construction activity in Auckland and other regions, and lower interest rates and the depreciation in the New Zealand dollar. We believe that further depreciation in the exchange rate is appropriate given the sharpness of the decline in New Zealand’s export commodity prices. House prices in Auckland are increasingly rapidly—

Bennett If you just want to just—somebody’s got a phone or something there that’s making noises. Who owns that? Could you please turn it off.

Wheeler So prices in Auckland, house prices in Auckland are increasing rapidly and becoming unsustainable. Residential construction is increasing there but it will take some time to correct the imbalances in the housing market. Annual CPI inflation remains below the 1 to 3 percent target due to the previous strength in the New Zealand dollar and the halving of world oil prices since mid-2014. We believe that headline inflation will be well within the target range by early 2016. A reduction in the OCR is warranted by the softening in the economy and the need to keep future average inflation near the 2 percent target midpoint. At this stage some further easing in the OCR seems likely. This will depend on the emerging flow of economic data. So thanks very much, Chair.

Robertson Thanks very much, Governor, for that. I just want to start around the whole inflation question, and to what extent are you concerned about the persistent gap between expectations and core inflation? You have mentioned headline inflation and I have heard you on that, but is it a matter of ongoing concern to you—that gap between the expectations and core inflation?

Wheeler Well, if you look at inflation expectations, there’s a number of measures that we use. We use about seven measures, mainly survey data. One of the reasons why in the PTA we were keen to make a reference to the midpoint of the range, the 1 to 3 percent, and talk about it in terms of on average over the medium term was to try and get inflation expectations down. Now in recent years those measures of inflation expectations have tended to be around 2.5 percent, sometimes a bit higher. Where we are at the moment is that inflation expectations in general have been declining and on average the 2-year rate, which we put a lot of emphasis on amongst other ones, is around about 2 percent. So it is around where we would like to see it. Now core inflation is running at 1.4 percent So we’d like to see that a little bit higher and we believe that the sort of action we’ve taken today and that we’ve signalled may happen in terms of the future—we believe that that will be helpful raising core rates of inflation from 1.4 closer to the 2 percent.

Robertson So that’s, effectively, the strategy you’ve got—is further rate cuts to try and deal with that?

Wheeler Well, what we’ve said in terms of the forecast we’ve built in 50 basis points of adjustment and you know we’re one of the few countries that provides interest rate forecasts as a central bank. We’ve done 25 basis points today and in essence we’ve indicated, and there’s some qualifiers in the statement so it’s written pretty carefully as you’d imagine. “At this stage some further easing
seems likely”, and then we’ve said “This will depend on the emerging flow of economic data.”

Robertson And moving to that point about the flow of data in, I think it’s, box D, and you were questioned about this earlier today about what I guess the downside scenario would look like, and the two factors that you picked out of that were El Nino and China, the slowdown in China. NIWA were telling us in late July that there’s about a 90 to 95 percent chance of El Nino having a major impact over summer. What then does that mean for that forecast? Do you take that to be quite a likely direction we’re going in, given that we’re looking at a 90 to 95 percent chance of El Nino affecting us?

Wheeler Well, we’ve had discussions, as you’d imagine, around are there upside or downside risks around these forecasts and we’re forecasting growth of around 2 percent this year—2.5 percent and then 3. We think those risks are fairly evenly balanced. I mean there are some significant drivers in the economy that are driving growth and we’ve seen it. We continue to be surprised, like others are, with the migration flows. There is a large pipeline of work out there in construction activity. The TWI is down 16 percent since April. The cross with the US dollar is down 28 to 30 percent since April. These are big exchange rate movements and they will generate activity, growth activity, in the economy. If you look at tourism, you look at beef prices, you look at sheep, wool prices, Kiwifruit—there’s positive stories around that as well.

Robertson Sure, but I do want to press you on that scenario because you’ve identified China and El Nino as the factors that will drive that scenario. I’m asking how likely you think it is that that will play out, given, as I said, we know that El Nino’s as close to a certainty as you can get with the weather?

Wheeler I think in terms of NIWA, I think a lot of forecasters and market makers and policy people will look very carefully at how that weather map changes in terms of the heat map. So we’ll follow that, clearly, very closely. I think also markets are following China extremely closely given that it’s the No. 1 or No. 2 trading partner to over a hundred countries and it’s generated almost 40 percent of global growth in the last 4 years. So what happens in China matters enormously. So they are the two areas and we’ll continue to look at them very closely.

Robertson I just wondered—you mentioned the migration point before and said that you continue to be surprised. You’ve said, as you said 3 months ago, that you expected migration to plateau and come down. I just question where that assumption’s coming from, because it certainly doesn’t seem to be bearing out.

McDermott Shall I pick up on that? I mean, there’s a range of factors that influence net migration. One is job opportunities that exist in New Zealand and whether that impacts on Kiwis not leaving, which was an initial part of the uptick in net migration. The other one is particularly going to be the strength of the labour market in Australia, just because it’s where a lot of Kiwis will be going. And there again, if you look at some construction and food services, there has been an uptick in that part of the Australian economy just very recently.
And so that would at the margin start to shift the incentives for people to travel across the Tasman. That’s an assumption, but, actually, even had we got the exact numbers right with perfect foresight, what is even more important is how it flows through the economy and the composition of those numbers—what’s the age profile, whether they’re coming with families, whether they want to rent, whether they want to buy, are they out of the labour force, and those have been a bigger influence than the pure numbers themselves.

Robertson Yeah. And so just to follow up on that, I mean, because if we looked at per capita GDP in the March quarter it was actually negative. So, I mean, what is the flow through? I mean, I’m interested—you know, you don’t dwell a lot on employment and unemployment in the statement, but I am interested in what your view is around migration and its impact on wages and, generally, on GDP growth, because it isn’t flowing through to higher GDP growth at the moment. I mean, other things are supporting that.

Wheeler Well, if you take labour force growth, if you like, or labour supply—let me put it that way—over the past 12 months it’s increased by just over 3 percent, which is extraordinary, which is very fast. And that’s driven by three things. One is the natural increase—people coming into the working-age population. Two, it’s migration, which has been at record highs in terms of net migration and, three, it’s labour force participation. You know, the labour force participation rate is at an historic high, just under 70 percent. What’s lifted it has tended to be older workers staying on or looking for employment in the labour market, and also female participation is up. So all of that has led to labour supply increasing by about 3 percent. One of the reasons why you haven’t seen, you know, wage inflation pick up is because, even though you’ve had employment growth of around 3 percent, the labour supply has fully matched it, and that’s one of the reasons why you’ve seen—

Robertson That’s more than fully matched it.

Wheeler Yeah—why you’ve seen wage moderation.

Bishop Thanks, Governor. The bank’s forecasting headline inflation to return to the target range by early 2016 but, with respect, the bank’s been saying that about inflation for some time now. I mean, for example in March last year you predicted the inflation rate to this year’s March year would be 1.9 percent, but it’s only been 0.3 percent. So I guess a couple of questions arise from that. The first is: how confident is the bank this time around forecasting that inflation will return towards the midpoint? And, secondly, is there a structural issue in the models that are used? I mean, are we entering a new global paradigm, really, where, you know, low inflation is the new normal, and are we not understanding, I guess, the relationship between inflation and how it relates to growth and migration in the traditional models that are being used?

Wheeler Well, let me deal with the first one, and John, maybe, might comment on the second. When we were at the beginning of last year we were in a situation where our terms of trade were at a 40-year high. They were at a 40-year high. And we had an output gap which we believed, and the IMF believed, was positive. Now that basically means—an output gap means—that you’ve used
up the spare capacity in the economy, and so what comes after that point is inflationary pressures. And what you’ve seen is that the oil price has declined by 60 percent since June last year. At that time, and for probably about 4 years previously, Brent crude, for example, tended to average about US$100 to $115 a barrel. It’s now around about US$45 a barrel. So no one anticipated that. No central bank in the world anticipated that.

The other thing that you’ve seen is a 55 to 60 percent fall in the dairy price since February last year, which has led to softening in the economy, given that it’s, in essence, a $7 billion hit to dairy farm incomes that flows through the economy. That’s also softened it and reduced inflation pressures in the economy. So where we are now is, in terms of just arithmetic calculations, the oil price had a negative effect on the December and March quarter CPIs. That will wash out of the system in terms of calculating an annual increase in inflation. So that, plus the fact that the exchange rate’s depreciated very significantly, 16 percent on a TWI basis since June—that will start affecting tradables inflation. So we think just with petrol price calculation, that alone, coming out of the inflation calculation, plus the exchange rate effects, that will automatically push inflation up, we think, by the March quarter to around 1.5 percent, and that it will continue to increase beyond that. Let me hand over to John for the other.

McDermott Yeah, and the second part to the first one was: is there a structural issue that we’re not seeing? And I think, as the Governor’s just highlighted, there’s been large movements in tradable inflation, in things that come across the border—oil pricing, and so on—and that we can fully explain. And you can look at the base level and watch it drop out of the calculations. So we’re very sure about that one. That leaves you with what’s going on with non-tradable inflation, and certainly it’s been—it has been low, but it’s been low to the degree of about half a percentage point. In the context of 20-odd years of inflation forecasting, this is a relatively small number [inaudible]. In fact, you put it in the context of the ACC automotive levies—that will take 0.4 percentage points out of the calculation. But still, it becomes an interesting fact when it keeps being repeated, and then you look across the range of factors that you might want to examine. And by and large where we think it is—it’s inflation expectations have dropped. They have come down. And if you take that into account, and the fact that we’ve got a very low starting point for inflation, I think that fully explains why we’re seeing ongoing low inflation in non-tradables.

Clark Some questions about unemployment. There’s a big jump in the unemployment forecasts from June to September 2016, unemployment going from 5.3 to 6.1 percent in the space of 3 months. Do you think the Reserve Bank is focusing enough on unemployment? And I guess I note that there’s no chart showing unemployment forecasts in the MPS—it’s only in the summary statistics.

McDermott Yeah, well, apologies for not having a chart. There is a lot of charts, and sometimes they disappear out of the room.

Clark I guess it’s about focus, right?
McDermott: Yeah. I mean, I think what’s happening is we’ve had a big, big change in export prices—very rapid change. And that will flow through to New Zealanders’ incomes, and that will impact on their spending, and that will happen all in a time frame before monetary policy can actually counteract that. And so what we were seeing a few months ago is the unemployment rate was falling as we saw the economy continue to expand. The change in direction of export prices changes everything, and then it takes, you know, 18 months to 2 years before monetary policy then has its impact on the broad economy inflation. So the changing direction of unemployment happens in that time horizon. So what happens within the next 12 months, monetary policy is very limited about what it can achieve.

Clark: Well do you think it’s OK that unemployment’s forecast to be around 6 percent in 2017, nearly a decade after the start of the GFC?

McDermott: In the next 12 months monetary policy won’t change that. No matter what we do.

Clark: This is the end—this is the forecast for 2017.

McDermott: Yeah. Beyond that horizon what we start to see is monetary policy continues to be eased. Eventually—excuse me—you’ve stabilised, you know, activity and spending and unemployment gradually comes back to a more normal level.

Clark: Where I’m going with this you probably can guess. I mean, some people have suggested that the governance structure of the Reserve Bank needs to be changed, but do you think that you would’ve increased the OCR last year by 100 basis points had your decision-making parameters been different with, perhaps, alongside the primary target of price stability, if there were secondary goals of unemployment, external balance, economic well-being?

Wheeler: Well let me deal with that. The primary focus of the bank’s responsibilities under the PTA are about price stability and that’s very clear—

Clark: Nobody’s disputing the current—

Wheeler: There’s things that we’re asked to take into consideration around about asset prices and other things. But your question was, in essence about the governance structure and I hear it from time to time. It came up this morning in the press conference. I hear it about single decision maker and all of this, and I gather the Greens issued a press statement this morning.

So let me explain how it works, how Budget decisions are actually taken. When we have a monetary policy statement, we have 3 days of intensive discussion about the economy and about the forecasts. Probably about 35 people in the room doing that. Present the forecasts, intensive discussions, a lot of scenarios run, computer models etc., “What about this?”, “What if that happens?” “How about changing this aspect of the forecast?”. At the end of the 3 days, there’s a committee of 12 people, who make recommendations to the governing committee.

Now, the governing committee comprises the four Governors, right. It comprises the four Governors. Now those 12 people that give the advice,
and they give written aspect that goes to our board afterwards. The Reserve Bank board reviews all the papers that go into the forecast committee meetings. They can get access to the press conference that we run. They can get the transcript from this meeting here today, for example. They get the advice given to the governing committee by the 12 members of that committee. That committee includes two outsiders, and it has for a number of years. We rotate, we change from time to time the outsiders, but it has two outsiders.

So in the end, a decision gets taken by the four Governors meeting in a committee, another committee separately from the 13. Now, as I said this morning, there hasn’t been one example in more than 10 years that I’m aware of, not one example of a decision being taken that was not the majority decision of the 13 that gave advice to the Governor or the governing committee. That’s how we do it.

Clark  
So my question, really, is around the parameters of the process. I mean, the process, the target for you is price stability—that’s the primary target, and I’m talking about whether if there were secondary goals of employment, external balance and economic well-being that would shape the nature of the advice you receive, not how you then weigh it up.

Wheeler  
Well, let me just add one comment, and then John can add his comments. There are places like the Federal Reserve, for example, that has a dual mandate. They have a responsibility to maximise employment and also to have price stability. Now, that’s a very difficult balancing act at times, because what happens, for example, if you’ve got unemployment too high and inflation is too high? Do you tighten monetary policy or do you ease monetary policy? Right, there’s a potential conflict there.

So we’ve got clarity in terms of the responsibility for price stability but to please take a look at relative price effects, take a look at asset prices. Now, when we make monetary policy decisions, are we thinking about the level of aggregate demand or the rate of growth and unemployment in the economy? Of course, we are. Every central bank in the world that is a flexible inflation targeter, as we are, certainly thinks about all those things. And if you look at the statement that we made, one of the reasons for the cut in the OCR today is we talked about the softening in the economy. Let me hand over to John.

McDermott  
I’ll just add one point, because part of the question was around parameters of what the goals look like. So the last time we went through a review of monetary policy in 2007, we asked “What’s the types of decisions and reactions the New Zealand central bank would take relative to similar events that would take place in the US and Australia?”, given particularly the US has this dual mandate, and we have a lexiagraphic-type mandate. We’re inflation first. Other considerations are second. By and large, at that time, the monetary policy reactions of all three countries looked very similar to any given development. We can’t replicate that research, because as soon as the US went into a zero [inaudible], the reactions just simply have to be different. But before 2007, the reactions to any event were similar.

Bennett  
Julie Anne’s got a question now.
Genter  Thanks very much, Governor, and thanks for your response earlier. I was going to follow up with a similar question about whether it would be useful to have a broader panel of experts from across the economy involved in the decision making. I take it from your answer, it’s already done by a committee. If that’s the case, would it then be helpful for that to be formalised in the legislation?

Wheeler  Well, that’s up to the Government to see whether it wants to do that.

Genter  Coming back to some of the other comments you made, since I wasn’t able to ask any supplementary questions, I was just curious about the lag time between the tradables inflation and the TWI declining—what sort of lag time will we expect usually?

McDermott  So the lag time between the exchange rate depreciating and then moving to a tradables—

Genter  Inflationary.

McDermott  It depends on the types of commodities. So when you think about oil, it’s within the same quarter. For other commodities and other goods it typically is between 6 and 9 months. It can vary depending on what hedging policies various importers have. So we think through the current cycle when the exchange rate got very high, some of the importers were doing less and less hedging. So it might be a bit faster this time.

Genter  This is a separate issue, but you talked about the impact on net migration of the labour market in Australia, and I was wondering to what extent you’re looking closely at that, and what sort of lag time we would expect between the labour market, things basically picking up in Australia and that having an impact on our net migration?

McDermott  Unfortunately, on that one, the lags can be very long and actually can be changed across the [inaudible] cycles, because you are now asking not just economic questions; you’re asking about whether I relocate the family, what’s the decision, what’s the schooling, where in the school year you are. It’s very easy, for example, to move in the January period so you can start your children at the beginning of an academic year. So all those factors would come into play.

Wheeler  I think it’s probably fair to say that, you know, the Australian economy’s going through quite a difficult adjustment. It’s got three major adjustments: a big terms of trade adjustment—even bigger than ours, particularly with iron ore prices and the like; it’s got a fiscal adjustment that it needs to make at some point; and it’s also got its mineral CAPEX reducing, given that it was about 8 percent of GDP at the peak, and historically it’s usually around 2 percent to 3 percent. So they’re three major adjustments that the Australian economy’s facing or at least going through, and so I suspect that we won’t see a surge of migration towards the Australian economy in the near future. I don’t think we will.

Genter  Finally, I wanted to ask about property speculation in Auckland. Clearly, you’ve been concerned for some time that overvalued house prices are a major risk to financial stability of the country. I’m wondering what evidence
you might have that speculators, in particular, or investors—residential property investors—are a risk to financial stability, if at all; and what impact, when we might start to see, if any, the impact of the increase on LVRs for residential property investors once they come into play in November.

Spencer

Well, you know, investors are the sort of cyclical component, so I think it is pretty well agreed by most that the investment component in a housing cycle will add to the amplitude—it will amplify the cycle. Then there is the question of, OK, if/when it goes down, are investors more likely to default and cause greater problems for the bank than others? You can debate that, and the evidence in New Zealand is mixed because we haven’t had, generally, extreme cycles. But in countries where you have had extreme cycles, in other words real stress downturns and drops in house prices, then losses on the investor segment of banks’ books has been considerably greater. That applied to all of the countries that had housing market downturns in the GFC. As you know, ours just came down to “moderately”.

Wheeler

Grant added the point about investors adding to the amplitude of potential cycles. I mean, 2 years ago, investors in the Auckland market accounted for about 33 percent of the transactions. Now they account for about 41 percent of the transactions.

Scott

It’s actually supplementary to the stability—talking about stability. In previous meetings we’ve talked about the housing market. You haven’t cut rates because you were concerned that it could fuel the housing market further. Obviously, the factors in the market today outweigh some of that concern. But where are we with the housing market? There’s some conflicting messages. You’ve got your grandmother and her hairdresser talking about the free lunch that they can have—of buying and investing in Auckland. But then you’ve got the reality of increased consents—a lot more consents, and talking about the less money-go-round because of lower commodity prices, less money in people’s pockets, and less consumption. So there are a couple of lines that are going to— it seems to me—that could crash. Would you comment vis-à-vis price stability of the housing market? Are we at a turning point, or do you expect to see double-digit house price inflation in Auckland?

Spencer

Well, our view is that house prices in Auckland are not sustainable. The rate of price increase of 25 percent, roughly, is clearly not sustainable, but when that actually turns, you know, it’s always very difficult to pick—with any asset price cycle—to, you know, pick the top. We expect that the actions we’ve taken with investor LVRs and that the Government’s taken with the brightline 2-year rule, with the requirement to supply IRD tax numbers—all of those things will tend to moderate the Auckland market, but, you know, the exact path is very difficult to pick.

The other issue is around the implications of all this for, sort of, monetary policy versus financial policy. In the previous cycle the house prices had a big flow-on into wealth effects, demand, spending, and general inflation pressure. This time that’s not really happening. So prices are going up but people aren’t spending that additional wealth, and so they’re not putting pressure on
general domestic demand for CPI inflation. Hence we don’t have a basis under our mandate to lean against it with interest rates, although we do have to have regard to it—to financial stability. And it is a financial stability issue.

Bennett  But they’re not spending it on the next house.

Spencer  Well, it may be going into the next house. It’s feeding on itself in the housing market.

Robertson  Hang on, can I just ask a supp on that—but as a serious point to that question, though, I mean, you’ve previously come to the committee and talked about the risk of a sharp correction in the market. Are you seeing any difference in that? Are you seeing anything in the way that lending’s happening that’s concerning you in that regard?

Spencer  I think the faster it goes up the more likely it is you’ll have a steep reversal.

Robertson  Exactly.

But I mean, you know, once again we’ve had our timing good, again, with the REINZ numbers coming out between your announcement and when you come here, and we’re seeing again nothing’s easing off in these numbers in terms of, you know, 20.5 percent.

Wheeler  That’s correct. No, that’s correct, and we look at the REINZ data, the stratified index, very closely, and the data that came out was showing a 25 percent increase for Auckland. Now if you then sort of say: “Well, look. The house price to income ratio for Auckland is at 9; it’s twice that for the rest of the country.” And a ratio of 9, puts you in, according Demographia figures, in the top 10 most expensive cities in the world, and you then—we’ve just talked about investors accounting for 41 percent of the activity in the Auckland market. Well, the ANZ survey late last year suggested that investors saw property prices cumulatively over 5 years growing at 75 percent for the next 5. We do our job properly, the price level will go up 10 percent. So this is just dangerous territory.

Seymour  Governor, just picking up on a question that Julie Anne asked, actually, about the effectiveness of the LVRs. Back in 2013 you said that the LVR speed limit is unable to slow house price inflation. Larger increases in the OCR would be required. Two years later—hindsight’s always 20-20. We’ve had, actually, the OCR drop quite a few points. House prices continue to rise, as we know. Has the LVR been effective? And one way of measuring that is, you know, could you say today that, actually, you might have had larger drops in the OCR and therefore fixed mortgage rates had it not been for the—sorry, the LVR has allowed to avoid keeping interest rates higher?

Wheeler  Well, you know, there’s a tension between house prices, interest rates, and the exchange rate, and I think that’s fairly clear to everybody. We’ve had a large fall in the real price of our export basket. So if you look at a basket of exports and take the price adjustment, over the last 18 months it’s been about 25 percent. Now, that is very, very large for any economy, so the fact that we’ve been able to reduce interest rates to try and help that adjustment and the exchange rate’s fallen as a result of commodity prices plus our monetary policy actions is a good thing.
The complication is, and it’s something that we worry about and that’s why we’ve moved on macroprudential policy, the impact of low interest rates on the housing market. Now, you’ve seen 2-year mortgage rates fall 1¾ percent since last year—over the last 18 months or so. So we introduced the LVRs. At the time we said: “We think it’ll probably reduce house price inflation in Auckland by 2 to 4 percent.” Now, house price inflation in Auckland got down to 6 percent. It got down to 6 percent before the election. That was partly because we had raised interest rates, partly because we’d introduced LVR measures, and partly because there was an election coming up with policy planks around capital gains.

Now, once the election was over you started to see house price inflation pick up again, and now we’re in this situation that I’ve just talked about—this tension between terms of trades adjustments, interest rates, and housing markets. And Grant’s talked about the amplitude—the amplifying effect of investor behaviour, and that’s what we’ve tried to address, just as the Government’s tried to address measures with its, you know, announcement in the Budget. But did you want to add anything, Grant?

Spencer I think just the other fact has just been the acceleration of net migration. So from late last year that was accelerating as well, so you had that effect plus the investments that are pushing Auckland house prices back up again after that initial dampening effect from the earlier LVRs.

Bennett OK, Andrew Bayly now.

Bayly Hopefully, you’re going to allow me two. The first one’s a continuation of David’s question. We’re bringing in the tax rules 1 October and your increased LVR’s coming 1 November. In terms of going forward—you were talking historically, but in terms of going forward, and particularly with the new tax rules, have you done any modelling around that? What the impact may be on house prices?

Spencer No, we haven’t, because it’s a new policy that hasn’t existed before. There’s no basis, really, on which to model it.

Bayly So just returning to the issue of inflation, since we last met we have had lower growth rates both projected for both New Zealand and internationally. So you’ve dropped off about half a percent over the next 3 years out of the growth projections, and we talked about the non-tradable sector, and you talked about the impact of the ACC at 0.4 percent so you can sort of see the impact is pretty small, but the tradable one is obviously where we see the massive increase for this next financial year. So I can get—I can sort of understand that. A lot of that is mechanical. But why do you continue projecting high inflation beyond that? Because with the world economy, unless there is a dramatic increase in growth rates—what’s the basis for the prolonged increase in inflation that you’re projecting?

McDermott So the first part’s right. So it creates a lot of noise in the data, so you’ve had some oil prices drop, and that will impact on the inflation numbers for a year. We’ve had the change in the exchange rate. But once inflation gets back to 2 or around about 2 our job will be to set interest rates such that the economy
grows sufficiently to keep inflation at 2 percent. So beyond the next 12 months inflation is hitting our target, based on—because that’s the plan and we need to set interest rates to achieve that plan.

Bayly Yeah. If that’s what you’re saying, then one of your only mechanisms to do that is keep the lowering OCR if you’ve got a declining growth rate or a slack growth rate around the world, isn’t it?

Spencer I mean, the other key assumption’s around what commodity prices are doing, and it is our expectation that the commodity cycle will pick back up again and that dairy prices will not stay forever at these incredibly low levels. And so the pick-up in export prices, combined with lower exchange rates, lower interest rates, maintains that growth picking up after the coming year. That’s in our projection. So we go from 2 back to 2½, 3 percent growth.

Clark When I’ve previously sat on the committee in the last Parliament, quite explicitly up front in lots of the MPSs you had risks outlined: overdependence on China, overexposure to dairy and commodity prices, and concern about housing. It seems to me you’re no longer listing them up front in quite the same explicit way. Am I to take from that you’re no longer as concerned about them or—my question is, do you think Government has undertaken enough, has put enough measures in place to counter those risks, and that they are no longer a concern?

Bennett We’ll just have a short answer, if we can, because—

Wheeler In a short answer, China is a concern. I think a lot of people are looking very closely at China, because it’s the No. 1 or No. 2 trading partner for over 100 countries. It’s accounted for about 40 percent, almost, of growth in the global economy in the last 4 years. It’s got sizable capital outflows at present. You’ve seen what’s happened with the Shanghai index. So question marks around China. It matters a lot. El Nino—if that deteriorated and became a major event that carried on late into next year, it would be a serious concern. And housing—I think we’ve been pretty clear about our ongoing concern.

Clark So if you wanted to express your frustration on a percentage from 50 percent to 100—

Bennett No, that’s it, David, OK. No. David, that’s enough. OK. So thank you very much, everyone.

**conclusion of evidence**
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Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Financial Stability Report, November 2015, and recommends that the House take note of its report.

Introduction and summary of the FSR

The Reserve Bank is required to report twice a year on the soundness and efficiency of New Zealand’s financial system. The following are the main points from its November 2015 financial stability report (FSR):

- New Zealand’s financial system remains sound and continues to perform well, but risks to financial stability have increased since the last report in May. The global outlook has deteriorated, and risks in the dairy and housing sectors have increased.

- Global economic growth has been softer in the past six months. Uncertainty over the path of China’s economic and financial adjustment has contributed to lower commodity prices and more uncertainty in financial markets. Risk is also building up in asset markets internationally as interest rates at historic lows encourage higher debt levels relative to equity.

- Banks in New Zealand have strong buffers of capital and liquidity, and have maintained profitability with further reductions in costs relative to their incomes. Lending growth to households and businesses has picked up, with the increase largely funded through domestic deposits. However, the global environment presents risks for our banking system, which remains reliant on global markets for funding.

- The dairy sector is facing a second season of weak cash flow from low international milk prices, putting many indebted farms under increased pressure. The Reserve Bank expects the banking sector’s losses to be manageable, but says banks need to make realistic provision for the likely increase in problem loans.

- House prices in Auckland have increased strongly, and are increasingly out of line with incomes. A sharp downturn in prices could challenge financial stability given the banking system’s large exposure to the Auckland housing market. Recent measures by the Government and the Reserve Bank are expected to moderate the risks, but it is too soon to judge their effect.

- The insurance industry continues to make progress on claims from Canterbury, and its resilience has improved since the introduction of licensing.

- The Reserve Bank is compiling the results of a stock-take of banking regulations and has several regulatory initiatives in train.

The rest of this report discusses the main issues we considered during our examination of the FSR and in our discussion with the Governor of the Reserve Bank.
The housing market

The Reserve Bank says that Auckland’s housing market is increasingly stretched, with a growing risk of a correction in prices, especially if economic conditions were to deteriorate. This would have serious implications for the financial system given the high level of household indebtedness.

House prices in Auckland have increased by 26 percent in the past year, and the house-price-to-income ratio is at 9.2, compared with about 5 in the rest of the country. The governor said this ratio places Auckland among the most expensive cities in the world.

We heard that much of Auckland’s housing activity appears to be driven by investor-related lending. Whereas investors previously accounted for a third of transactions, they now make up about 41 percent. This is of concern for financial stability as international experience has shown that investors have a higher tendency to default in the event of a market downturn. We discuss below some recent policy steps taken to address investor-related risks.

We explored the extent to which risks have increased since the Reserve Bank’s last report in May, and what factors could precipitate a damaging correction. The Reserve Bank said there is no specific trigger point for a correction, but a number of factors could precipitate a slowing of New Zealand’s economy, causing the housing market to deteriorate. They include a general slowdown in global growth, further deterioration in commodity prices, or a slowing of China’s growth, which would affect New Zealand both directly and through its effect on Australia. A rise in unemployment in such scenarios would also make debt-servicing more difficult for borrowers.

Policy measures in the housing market

We discussed the recent policy measures taken by the Government and the Reserve Bank to reduce risks from the housing market.

Legislative changes introduced by the Government, effective from 1 October, will introduce a “bright line” test, requiring income tax to be paid on gains from residential properties if sold within two years, and will require tax information to be gathered from property purchasers. In addition, changes to the Reserve Bank’s loan-to-value ratio (LVR) policy came into effect from 1 November, introducing tighter restrictions on Auckland investor lending, while loosening the rules for residential mortgages in other regions. Loans to residential property investors in Auckland now require a deposit of at least 30 percent, and banks must hold more capital against this asset class.

The Reserve Bank told us it believes the measures will help to moderate the housing market pressures, but considers it too early to judge their effectiveness. It says it needs to observe the effects for a few more months, and expects to be able to make an assessment once it has data from February and March 2016.

The Reserve Bank said it is pleased that the Government has introduced the 2-year bright line test. It believes the measure will be a significant influence on the market, particularly foreign investors and those who tend to turn over houses rapidly. It noted that investment has been a major driver of the market, and expects the measure to work in the right direction to slow the “churn”. Asked about the view that a 5-year test would be more effective, it said it does not have enough information to comment on any difference.
The bank said it is also pleased about the requirements for tax information to be provided on property purchases from 1 October. This will allow it to start analysing information about the relative proportions of domestic and foreign investment in property, something it has been unable to do up to now.

Asked about the relative contribution the various measures are expected to make in stabilising Auckland’s property market, the Reserve Bank said it cannot break this down, apart from noting that its modelling of the LVR restrictions suggested they would slow house-price inflation by about 2-4 percent.

Foreign investment in housing

We asked how the new rules are likely to affect foreign investment in housing, since sales from 1 October will have data collected as to whether a buyer is based locally or overseas. The Reserve Bank said that some foreign purchasers buy a property to occupy, or for children who are students here. When making a pure investment, foreign investors will generally look for the least restrictive regime in terms of potential tax liability and reporting requirements, so the new rules should be a disincentive.

Other potential property tax reform

Some of us noted a comment by the recent IMF mission to New Zealand that the bright line tax initiative is a positive step in reducing the risk to the economy from the housing market, but that more comprehensive reform is needed to reduce the tax advantage enjoyed by investment in housing. The governor observed that most OECD countries have a capital gains tax, but they tend to be very complex, with many exemptions. He said capital gains taxes raise many issues, and often do not generate much revenue. At this stage, the Reserve Bank’s perspective is that it is pleased with what the Government has done and will be keen to see its impact.

Housing pressures in other regions

There are signs that house price inflation is also picking up in Hamilton and Tauranga. We asked how concerned the Reserve Bank is about this, and whether, having loosened its LVR restrictions in regions outside Auckland, it might need to tighten them again.

The Reserve Bank said that activity in Tauranga and Hamilton appears to be driven largely by investors; probably those at the smaller end of the market with portfolios of five houses or fewer, rather than large investors with 10 or more properties. It told us it does not have any plans for further macro-prudential measures at this stage, preferring to gather a few months’ data about developments and the effects of the measures taken so far.

Immigration and housing supply

The major underlying drivers of the housing pressure are strong net immigration and a shortage of housing supply. According to the Reserve Bank, net immigration is running at about 54,000 a year, with more than half going into Auckland. Based on an occupancy rate of about 3 people per household, it estimates that 9,000–10,000 new dwellings a year are needed. While it welcomes the fact that new building consents have picked up to about 8,600 a year, it notes that this level still does not cover the net migration inflow, let alone the shortfall and natural increase in population.

The Reserve Bank acknowledges that forecasts of slower net immigration have been proved wrong in the past. It said that some of the inflow has been made up of people on single work permits, which may start to reduce now as rebuilding peaks in Canterbury.
large contributor has been the low level of departures from New Zealand. The relative strength of the New Zealand labour market compared with Australia’s plays a major part in this. The governor said there may still be quite strong flows of people returning from Australia. Based on its modelling, the Reserve Bank believes that the combination of increasing supply and a tapering net inflow may start to reduce the outstanding deficit of housing in Auckland early next year.

The rental property market

We asked about inflation in the rental market, as we note from the bank’s report that yields for rental-property investors have declined substantially since 2012, particularly in Auckland. The Reserve Bank said that rents have been increasing by about 5–6 percent a year—substantially less than property prices—which has meant declining yields for landlords. In Auckland, rental yields are at historic lows of about 3 percent a year, suggesting to the Reserve Bank that most investment is undertaken in the expectation of capital gain. Outside Auckland, rental returns are slightly below the average of the past 10 years.

Monetary policy and interest rates

We sought to explore how the increased risks for financial stability are affecting the Reserve Bank’s thinking about monetary policy and the level of interest rates. We also asked for comment on a recent statement by an IMF mission that the Reserve Bank might consider using monetary policy to “lean against the wind” and rein in the risks to financial stability if prudential policy became insufficient to contain them.¹

The governor said he would prefer to discuss issues to do with interest rates after the next monetary policy statement is released, on 10 December. However he added later that the prospect of the bank raising interest rates to lean against house prices was “probably pretty negligible”. He emphasised that macro-prudential policy actions by the Reserve Bank “can help out a bit” with the housing problem, but in the end what is needed is increased supply. He observed that the prospect of raising interest rates in the short term is not something the Reserve Bank would consider feasible in the present economic circumstances, given the risk of driving up the exchange rate.

Debt-to-income ratios

Since the 1980s, the average amount that banks lend on mortgages in New Zealand, relative to a borrower’s gross income, has increased substantially. A special section of the financial stability report discusses the risks around elevated total-debt-to-income ratios (TDTIs).

About 40 percent of residential mortgages in New Zealand are issued at a TDTI multiple of more than 5 (that is, five times the borrower’s gross income). Historically, banks were usually unwilling to lend customers more than two times their gross income. For investors, the current proportions are higher: about 60 percent of all investor lending is now at a TDTI of above 5, with about a quarter at a TDTI exceeding 7.

The Reserve Bank notes that although the present historically-low interest rates are helping to keep mortgages affordable, elevated TDTIs increase vulnerability to a decline in income or an increase in interest rates. For this reason, it says, serviceability calculations have been

an area of concern internationally. Several countries including Australia, Canada, the US, and the UK have set minimum standards for lenders.

The Reserve Bank says that its speed limit on high LVR lending will serve to curb the TDTI for some borrowers. Nevertheless it has recently begun collecting data on TDTIs from the five largest banks. It intends to monitor and report on the risks around high-TDTI lending as it collects more data during 2016.

The dairy sector

A special section of the financial stability report discusses the increased vulnerabilities in the dairy sector over the past two years, and the risk of non-performing loans. It notes that although global milk prices have recovered somewhat from their low in August, farmers face a second season of weak cash flow. With debt levels in the sector already elevated, some farms are likely to come under increased pressure in the coming year.

The Reserve Bank told us it is pleased that lenders to the dairy sector have been working with farmers to accommodate their need for working capital. It expects banks to continue to take a medium-term view in assessing farm viability. It has asked the five largest dairy lenders to undertake a stress test of their portfolios, and to set aside realistic provisions to reflect the likely increase in problem loans. Its modelling suggests that potential losses for the banking system as a whole would be manageable, even with a sustained downturn in the dairy pay-out.

We sought comment on the significance of developments in the dairy sector, given that dairy exports make up a smaller proportion of GDP than in the past. The bank said the drop in dairy prices from US$5,000 a tonne in February 2014 to US$1,590 a tonne in August (now US$2,450) had been a massive adjustment, entailing a $7-billion hit in dairy farm incomes. This was bound to be a significant concern, not just for rural communities, but also for the financial sector and the wider economy. In the governor's view, however, the medium-term prospects for the dairy sector “look fine”, given the expectation that China will continue to urbanise over the next 20 years. He agreed that other export sectors such as tourism and beef are also contributing strongly to GDP.

Financial sector regulation

The Reserve Bank has been carrying out a stocktake of the regulatory framework for banks and non-bank deposit-takers to check that the prudential requirements are operating efficiently and consistently, and not imposing unnecessary costs. It has completed consultations, and is analysing the feedback received from the market. We asked whether it had received any feedback that the level of regulation is excessive; for example, whether it has pushed up costs for financial advisors to the extent that people find them unaffordable. The Reserve Bank said the Financial Markets Authority is better placed to comment about the requirements on financial advisers. But it noted that banks have indicated that the requirement for quarterly reporting by their boards is a significant issue for them.

Stress-testing the banking sector

The Reserve Bank has been conducting some of its periodic stress tests of banks to gauge their resiliency to various financial scenarios. The last general tests were in 2014, and it is

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currently also running tests with lenders to the dairy sector. We asked what the results indicate in terms of introducing or extending its macro-prudential controls.

The bank said the tests are one of the regular ways it assesses banks’ prudential soundness, in terms of how well they can maintain their solvency, or capital adequacy, in extreme situations. Its report indicates that banks continue to hold capital and liquid assets in excess of regulatory requirements. Although lending growth has picked up, deposit growth has largely kept pace.

The Reserve Bank noted, however, that the stress tests are also helpful to it as an indication of how banks might respond to an adverse situation. It noted that if house prices were to fall, banks might cope simply by “battening the hatches” and ceasing to lend. In such a situation banks might well pass the stress test but there could be significant disruption to the financial system and the economy from low levels of capital. For this reason the Reserve Bank still seeks to make banks ever more resilient to events like a housing shock through its macro-prudential measures. It noted that its original LVR measures, introduced in 2013, have been positive for financial stability. Then, almost a third of mortgage lending was to borrowers with deposits of less than 20 percent. Now, the proportion of high-LVR loans is only about 7 or 8 percent.
Appendix A

Committee procedure

We met on 11 and 18 November 2015 to consider the Reserve Bank of New Zealand’s Financial Stability Report, released on 11 November 2015. We heard evidence from the Governor of the Reserve Bank, and received advice from our independent specialist adviser, Brendan O’Donovan.

Committee members

David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Good afternoon Governor and welcome to you and your team. We’ve got the Financial Stability Report here, so members have got it in front of them, so they’ve had a chance to read it. If you want to give us a brief introduction around some of the content of it—we’re scheduled to go till 2 p.m., but members will want to get out earlier because question time is at 2 p.m, so I anticipate it finishing at probably 10 to 2, or somewhere around there. So we’ll try and keep everything as short as we can and get to the heart of the matter as soon as we can.

Well, thanks very much, Chair, and thanks very much for the invitation to join you. On my left I’ve got Grant Spencer, who is the Deputy Governor and Head of Financial Stability. And on my right is Bernard Hodgetts, who is the Head of the Macro Finance Department.

I will keep my comments brief. New Zealand’s financial system continues to perform well, but it faces increased risks from the deterioration in the outlook for global financial stability and from developments in the dairy and housing sectors. Globally, interest rates are at historically low levels and this is encouraging higher leverage and a build up in risk in international asset markets.

The dairy sector faces a second consecutive season of weak cash-flow, due to low international dairy prices. As we know, prices have recovered since August, despite the last two auctions, but many indebted farms are coming
under increased pressure. And that pressure will increase if low dairy prices are sustained or dairy farm prices fall significantly. The banks are working with dairy farmers experiencing difficulty, and it’s important that they continue to take a medium-term view when assessing farm viability. The banks’ losses on dairy exposure are expected to be manageable but banks need to ensure that they set aside realistic provisions for the likely increase in problem loans.

Let me finish just with a couple of words on housing. House prices in Auckland have increased strongly and house price to income ratios in the region are now at levels seen in some of the world’s most expensive cities. Rising investor activity has been an important driver of price developments. A sharp downturn in house prices could challenge financial stability, given the large exposure of the banking system to the Auckland housing market. While it’s too early to judge the effect of recent policy changes, they are expected to help moderate pressure on Auckland house prices and improve the resilience of bank balance sheets to a housing downturn. So, thanks very much, Chair.

Robertson

Thanks Governor for that introduction. As you’ve said—and you say in the report—the increasingly stretched Auckland housing market is at risk of a damaging correction, especially if economic conditions deteriorate. I wonder if you could tell us to what extent has that risk elevated since your last report and what would be the indicators of deteriorating economic conditions that you think would lead to that damaging correction.

Wheeler

I think it’s fair to say that in terms of house-price pressures, as indicated by house-price inflation, that’s deteriorated in Auckland. House-price inflation is currently running at 26 percent there. If you look at house price to income ratios, they’re now at 9.2, which, as I said in the introduction, makes Auckland one of the most expensive cities in the world. For the rest of the country, that ratio is closer to 5. We’re starting to see house-price inflation pick up in places like Tauranga and Hamilton and elsewhere.

We think a lot of the activity in Auckland is being driven by investor-related lending. If we were here two years ago, they would’ve comprised roughly a third of transactions. Now it is about 41 percent of transactions, and we think what’s happening in Hamilton and, to some extent, Tauranga is driven to some extent by that investor activity.

In terms of what could help the situation deteriorate, you know—the market’s being driven by a combination of migration flows, we think probably just over half the migration moves into Auckland. We’re not building enough houses at this point, in terms of the consents, to match the net migration inflows, let alone the shortfall, or natural increase. So if the economy started to slow, that could have an effect on house prices. If unemployment rose, then that would make debt servicing more difficult. If interest rates rose, that would also make debt servicing more difficult. If migration pressures increase, that would put more pressure on house prices.

Robertson

Do you have particular indicators in mind in, let’s say, just those areas: unemployment, slowing growth, and migration? Do you have particular
levels that you think would create the conditions for the damaging correction that you’ve mentioned?

Wheeler  Not specifically in terms of levels. But, what I think would be fair to say is, if the economy slowed significantly—and then you’d say “Well what would cause it to slow?”—which would probably be linked to a slow-down in global growth, further correction in commodity prices, or slow-down in China that fed through Australia and into here, then that would lead to a slower economy and rising unemployment. Interest rates in that scenario would certainly remain low, that’s for sure.

Robertson  Given the fact you’ve highlighted that there is an increased and elevated risk since your last report to us on financial stability, what impact is this elevated risk having on your views about a potential rate cut in December?

Wheeler  Chairman, I was wondering if it is possible, to defer that sort of conversation about interest rates and exchange rates for about three more weeks, when we come back in December.

Robertson  Well, it was worth a crack anyway, wasn’t it.

Bennett  Members will be at their full attention in 3 weeks’ time.

Robertson  Given that, I’ll look at another area, which is around the spillover effects into Hamilton and Tauranga of the Auckland housing bubble. I wonder if you can talk to us about what the level you have about that and what, if any, reaction you would have, particularly in terms of LVRs and whether or not you believe you are now going to be in a position where you’re going to have to look at extending them back out again.

Wheeler  If you look at Auckland—and I’ll come to Tauranga and Hamilton in a tick—it’s a bit too early to say whether house-price inflation is starting to come off at this point. You know, we probably won’t get a feel for that until, I think, we see the February data. I know in the latest monthly data that transaction flows are down and there’s a lot of anecdotes about auction completion rates and things like that.

It may be the case that, given the Government’s measures in October and what we’ve introduced in November, that created a bringing forward of activity, so that may have exacerbated the housing price pressure. But, I think what’s happening now, what’s moving into Hamilton and Tauranga, particularly the Hamilton market, is to some extent driven by investor activity, and probably investors with portfolios of five or less houses, rather than [Inaudible].

If you look at house price to income ratios there, you know, Auckland’s about 9.2, the rest of the country’s around 5, so there’s more stretch, if you like, more capacity to absorb price increases in that sense, in terms of debt-servicing capability. We don’t have plans in mind at this point in respect to further macro-prudential measures. I mean, we want to see what the impact is of the October measures and what we’ve done in November, and also get a few more months of data to assess where things are.
Robertson: When you look at the suite of measures that you’ve brought in and then you look at the measures the Government’s looking at with the register and the brightline test—I mean, we’ve seen advice from the Treasury that they only expect the brightline test to bring in about $5 million per annum and the register—that is what it is. Are you convinced that those measures will have any really serious impact on the housing market?

Wheeler: Well, perhaps my colleagues could give some thoughts. I hadn’t seen that from the Treasury. In terms of our own measures in November, we do think that they will have the potential to slow house-price inflation by 2 to 4 percent, that was what our modelling suggested. But, let me ask my colleagues on your first point.

Spencer: I think it’s a very uncertain proposition, but I don’t think the revenue expectation is necessarily an indicator of the deterrent effect it may have, particularly on foreign investors. We have seen foreign investment drop off, anecdotally, in October, but the jury is still out on whether that’s sort of transitional.

Robertson: We haven’t passed the law yet.

Spencer: Yeah, that’s right. So, you know, we’ll have to observe it for a few more months and into early next year to get a proper assessment of it.

Robertson: Just one more on the housing stuff: a big chunk of what you’re doing here is predating things on immigration levels. What is your expectation about those over the coming year?

Wheeler: Well, like many forecasters, we’ve been wrong in our forecasts of net permanent long-term migration. It’s currently running at around 54,000, and we’d been expecting it to slow. If you look at the data on departures, which is a big part of the net increase, it looks as if that’s starting to slow. And the issue is to what extent you’ll see further inflows, which may be, at the moment, partly driven by students particularly from India, China, and Korea. But you’re also seeing people on single work permits coming in. Now, some of that may reduce with the Canterbury rebuild contribution probably peaking by now. But, you know, given Australia’s labour market, there may well be quite strong flows still coming back from Australia.

Bennett: So Governor, that always has been an issue around migration; many years ago it was said it was an issue, then some years ago it was said it wasn’t. If you look at the last monthly data—probably the highest immigration stats to New Zealand, and yet the property market in Auckland is stabilising at the lowest level of increase. How do you get that correlation, how do you say it’s a factor? When you look at the last month’s data, it doesn’t really indicate that.

Wheeler: I think, I wouldn’t put too much weight on one month’s data. I mean, I think we really won’t get a good feel for what’s happening in Auckland until probably we see the February-March data. You know, if you look at net permanent long-term migration, it’s running at around 54,000 or 55,000. Now, we think, roughly, half of that or a little more is going to Auckland. If you then look at the occupancy rate for Auckland, which is about 3 per
household, slightly above the rest of the country, then you would need something like 9,000 to 10,000 houses, or accommodation for 9,000 to 10,000 buildings, to absorb that migration. Consents are currently at a 10-year high, which is great, but they’re running at 8,600 so they’re probably barely covering, or not covering, the net migration flows. We won’t really get a good feel for Auckland price pressures, I don’t think, for a few more months.

Cosgrove  Just a supplementary on my colleague’s question on the brightline test: in terms of its potential impact, or otherwise, do you believe the 2-year hold-over period will deal with, or decrease, the housing churn, or would you share Treasury’s view that other countries who have this at a 5-year period is more likely to deal with it?

Spencer  In terms of statistics we’ve seen, we just don’t have enough information to say the difference between, say, a 2-year test or a 3-year test—

Cosgrove  5 year.

Spencer  You’d expect the brightline test to slow the churn, obviously. So there’s a potential to shift it out.

Cosgrove  So are you factoring that in to your risk analysis going forward?

Spencer  We recognise it as a factor, but there are so many variables in this equation, including the macro-prudential measures that we’ve taken, plus the requirement for the IRD numbers, plus the brightline test that, you know, it’s not actually going to be possible to determine the relevant contributions.

Cosgrove  Would you say it’s a significant factor in your risk assessments going forward?

Spencer  Well, I think it is a significant factor; it will be a significant influence on the market, and, as I said, particularly with regard to foreign investors. But, also, potentially, domestic investors and obviously the ones where the churn is greater, people who are sort of flipping houses, it will affect them more. But we don’t have the exact breakdown, we just know investment has been a stronger driver on the market over the past year. So that measure is going to work in the right direction.

Bishop  Can I ask you about the stress tests that the bank’s conducted on the banks, and particularly about the relationship between the stress tests and macro-prudential control. Because, in your statement today, you say that the banks hold strong capital liquidity buffers, maintain profitability, further reduction in cost to income ratios, lending growth to households and businesses has picked up and is being funded mainly through high domestic deposits. So, given all that, I’m just interested in the relationship between the tests that exist, that are done on banks, and the introduction of macro-prudential controls, and what the criteria and I guess the triggers are for introducing them and further extending them.

Spencer  Well, we run the banks through stress tests from time to time, the last one was in 2014, and currently we’re doing one on the dairy books. So we’ll do them sometimes on particular sectors. And really it’s one of the ways in
which we assess the prudential soundness of the banks. It’s not the sole measure, but it’s one of the ways and it’s an extreme situation—can a bank handle an extreme shock in terms of remaining solvent, in terms of maintaining its capital adequacy requirement.

But, you have to keep in mind that a bank may pass the stress test but there may be significant disruption to the economy still from relatively low levels of capital. Because when you look at the stress test and you say “OK, how have you survived that stress test?” and they say “Well, actually, we stopped lending to everyone, and that’s how we survived it.”, they batten down the hatches, which tends to happen with banks in recessions.

So, we have to be careful. The banks may have passed the stress test, but a housing shock could still be traumatic for the financial system and the New Zealand economy. Hence our desire to make the banks even more resilient to a housing shock through macro-prudential measures.

Bishop  
Take the LVRs: what’s the analysis that lies behind them reducing the risk to the financial system?

Spencer  
The analysis, essentially, is that loans with high LVRs, low deposits, are more likely to incur losses. That’s observed historically, it’s observed internationally, and it’s, you know, pretty intuitive as well. Any risk manager at a bank will agree that that’s an important driver of the riskiness of a loan.

Bishop  
Couldn’t you just argue that the banks will just transplant any risky lending to other risky areas, not necessarily high LVR?

Spencer  
Well, that’s possible. These restrictions are on the mortgage books and then we’ve got these Auckland investor loans, so, yeah, there’s always a risk, a possibility, that lending can go elsewhere. But the banks aren’t in the business of taking risk for risk’s sake. They take risk if there’s a risk-adjusted return that warrants taking the risk. And, at present, and in recent years, for example, in the corporate sector there hasn’t been much demand for credit and that’s not been a big source of credit growth, although it has picked up a bit recently. So we’re not seeing big risks coming elsewhere. The main other risk, as mentioned in the document, is the dairy sector. And the only increase in exposure there is related to working capital to help farmers through.

Wheeler  
Just a couple of points on the stress tests that we did in 2014. I mean, the stress tests are always going to be an indicative framework and they’re based on a whole lot of assumptions that you might imagine. Since we did those stress tests in 2014 Auckland house prices, for example, have come up 30 percent since then. So they’re very helpful in terms of giving us an indication.

They’re also helpful for indicating how the banks might respond. So, Grant said look, you know, if you get into an adverse situation where house prices are falling, the banks might stop their lending and that’s adding to the procyclicality of the adjustment in the economy. So, they’re very helpful for fleshing out those sorts of reactions.
On the framework for LVRs, when we first introduced them, banks were competing very aggressively to lend to people with low deposits. Almost a third of their lending was going to lending to people with deposits of less than 20 percent—almost a third. Now that’s down to about 7 or 8 percent at the moment. So, if you look at the quality, if you like, in terms of riskiness of a bank portfolio, then it’s got a significantly lower percentage of high LVR loans in its book at this point. So that’s been positive for financial stability.

Nash: You talked about 41 percent of the housing is investment. Is that just in the Auckland region or is that across the country?

Wheeler: That’s just Auckland data. It’s a bit lower elsewhere in the country.

Nash: Have you got a feel of what percentages are domestic investors versus international or overseas investors?

Wheeler: No I don’t.

Spencer: No, we don’t have those numbers. We’ve discussed that here on previous occasions. Now that the requirement to supply IRD numbers and foreign tax authority numbers—we’ll start to collect that information but that’s only starting as of October this year.

Nash: Do you have an indication of what sort of yield investors are getting on rental houses?

Wheeler: In Auckland, the rental yields are at historic low, they’re around 3 percent. So a lot of the investment that’s taking place is in the expectation of capital gains. Now, that’s borne out in a recent survey done just a few months ago by ANZ Bank that looked at investment behaviour in Auckland and basically asked Auckland investors: “What are your expectations for house price increases over the next 5 years?”. They indicated that they expect cumulatively Auckland house prices to go up by something like 48 percent over those 5 years. If you look at rental returns outside of Auckland, then they’re slightly below the 10-year average.

Nash: So basically people are investing for capital gains not for yield. Mr Spencer, you talked about the 2-year brightline test and there’s evidence, anecdotal maybe, that foreigners are exiting the market. Do you draw the conclusion that foreigners are actually buying and selling within a 2-year period, or do you think they’re buying and holding, or is it just a perception do you think?

Spencer: I just think foreign investors, when they’re comparing, from their home base, various markets, the ones that have least requirements in terms of potential tax liability and tax reporting, that will be a mark in favour for going for the least restrictive.

Nash: Basically, foreign investors are investing in New Zealand for tax advantage?

Spencer: That’s obviously a factor, obviously it varies between them. And I’m sure there are many foreign buyers who are genuinely buying for owner occupation, for the occupation of their children who are students, whatever this type of motivation, there’ll be a mix. But, yeah, we don’t know for sure.
Genter: The IMF mission statement mentioned that housing was also a risk to New Zealand's economy and made some specific statements about tax—I think they noted that the recent initiatives on the part of the Government with the brightline test were a positive step in the right direction, but that more comprehensive reform was needed to reduce the tax advantage. I'm just wondering, given the increase in the risk since the last time you reported to us and the length of time it takes to get these sort of legislative changes through, do you think there's some urgency to reduce risks going forward—that a more comprehensive reform of taxes around property is needed?

Wheeler: We're pleased that the Government has introduced the 2-year brightline test and we're also pleased about the moves in terms of IRD registration. If you look at most OECD countries, most of them have a capital gains tax. And you can look at, well, what does a capital gains tax do, what are the benefits of it? If you're a tax economist, you would say: “Well, you know, you broadened your income base, you reduce avoidance, and you can change rates for the same amount of revenue, potentially, and all of that.” But when you look at the impact of those capital gains taxes, you often find that they don't generate much revenue for the Governments in OECD countries. And that's partly because the systems are usually very complex, there's a lot of exemptions—the family home is usually exempted, not in all countries, but in many countries. So, there's a lot of issues around capital gains tax. Our perspective, at this point, is we're pleased at what the Government has done and we'll be very keen to see its impact.

Genter: Hasn't real house-price inflation been steeper here in New Zealand than in other countries, like Australia? Even though, obviously, they also have issues in markets like Sydney, there seems to be real house-price inflation has actually been higher here in New Zealand than in some of these other countries, that even though they still have issues, it hasn't been quite as great as ours?

Wheeler: I think the main problem with the housing market to date, has been, really, the Auckland market. And, as I say, it makes Auckland one of the most expensive cities in the world in terms of that ratio that I talked about. And some of that's due to the migration impact, that clearly is one significant factor.

If you look at house-price inflation outside Auckland, then you're seeing pockets of inflation from time to time. And you're certainly seeing it now with Tauranga and Hamilton, you see it with Otago Lakes, sometimes Nelson, and things like that. But house-price inflation outside Auckland is currently, I think, running at around 8 percent or so, from memory.

Genter: I note in your report there is a graph that shows rental yields have decreased quite significantly since 2012, particularly in Auckland—mainly driven in Auckland. What has been happening with rent price inflation in Auckland? Should we be expecting rents to be increasing in Auckland in the next little while, or has—
The rental inflation. Do you know what it is, Bernard? The rental inflation in Auckland?

Well, it’s varied depending on the source you look at, but it is running in mid-single digits, 5 to 6 percent, something of that order.

So it’s quite low, relative to house prices?

It’s certainly relative to house price inflation, and that’s of course why we’ve seen that reduction in yields over time.

Afternoon. Can I just go back to that point Stuart Nash raised in response to your comments, Grant, about foreign investors dropping off in October. Was that just anecdotal evidence, or—

That was anecdotal, yeah—that’s anecdotal.

In the report, you talk about the fact that the share of sales to multiple property owners has increased from 35 percent to 40 percent since mid-2013. However, that’s mostly due to the higher proportion of sales to investors owning fewer than five properties.

Given that, even though we’ve seen it increasing, there’s more people that own fewer properties, does that present much of a risk, or is that actually a positive change?

Well, it’s really just telling us that most of the additional activities come from the smaller investor segment rather than the large, professional investors who might own 10 properties. That’s clearly just the trend that we’re seeing. But I think it’s still of a concern, the fact that the numbers have picked up as much as they have.

What’s more of a concern though: those that own a large number of properties or those that own a relatively small number of properties? If you’re going to have people owning multiple properties, what’s the bigger risk from your perspective as the Reserve Bank?

Well, the focus is really on the trend rather than—and that’s clearly moving up in terms of the number of smaller investors that are holding properties or buying properties in Auckland and around the surrounding areas, and, as we said before, driving the market to a large extent.

In terms of the prudential perspective, we have this new investor class, and, basically, the capital requirements we are putting on that are an increase over and above owner-occupiers.

But we’re not differentiating; we don’t have a structure that differentiates between an investor with five properties versus an investor with 10 properties. The evidence is not evidence that one is more risky than the other.

You also make comments that, whilst recent developments around all the changes that the Reserve Bank’s putting in place, the Government’s putting in place are positive, it will take some time for increased construction to reduce supply shortages, especially while migration remains strong. Firstly,
do you have any modelling around when you expect to see significant changes and things improving?

And, secondly, with regards to migration and Australia, with the GDP growth in both countries relatively comparable, what do you see on the horizon in terms of migration from Australia to New Zealand? Do you see that continuing to increase, and what would you see driving that in the future?

Spencer: Well, the relative strength of labour markets is an important driver, as Graeme was saying before, and our expectation is, with some weakening in the labour market, that the net migration figure will start to come off—we think it’s near a peak.

At the same time, supply, which is now, again, as Graeme mentioned, the supply in Auckland is about meeting the net inflow—we may, as we go into next year, start to get to a point where the additional supply is actually reducing the outstanding deficit of housing in Auckland.

So we start to improve the situation in terms of the existing shortage. But that’s the direction. We don’t—in terms of qualification—

Ross: When you say it will take some time, is that based on modelling or is that just based on “in the future you’re likely to see it”? Do you have a—

Spencer: Well, our economics department do model these things, and we include them in our macroeconomic model, yes. But I don’t have the numbers in front of me.

Scott: Mr Nash implied that 3 percent was a poor yield in the housing market, and therefore that the only reason an investor would invest is for capital gain. But we know that bond rates around the world, in alternative estimates, are less than 1 percent.

Could you tell the committee how well a foreign investor has done if that person—that investor—had invested in a home 12 months ago, in terms of his P&L, if you like, given the currency? Given the Auckland investors made 20-odd percent, how has the investor fared if he is living in New York?

Spencer: Well, the currency has fallen by a similar amount over the past year. Against the US dollar at the peak of last year, we’re down 26 percent. Auckland housing, they’ve gone up a similar amount, so it’s probably close to break even if the foreign investor’s measuring is P&L in US dollars.

Scott: Right, so the foreign investor has a lot of risks associated with investing in New Zealand, and, in this instance, that investor has broken even at best. Thank you.

Spencer: But I still think it is worthwhile to say that the 3 percent yield is still low, because you can get 3.5 percent in the bank at present. So a bank is a safe investment; a house is always risk. So expectations around capital gain and price risk are, obviously, as Graeme said, an important driving factor for the investor.
Seymour: I just wanted to ask about the regulatory stocktake that you are undertaking of financial markets. There’s certainly a lot of anecdotal evidence that people are actually avoiding getting financial advice because of the regulatory requirements of being a financial adviser, and the policy may have backfired.

I just wondered if you had any feedback on that in your recent stocktake, and if it was something that you had a view on?

Wheeler: Well, I suspect that’s more an issue for the FMA, in terms of financial adviser and codes of conduct and what the requirements are. We’re currently reviewing all the feedback we’ve had during a consultative period on the regulatory stocktake.

One of the significant issues that’s emerging from that is the issue of quarterly disclosure: reporting, for example, from boards to the bank. But I think most of your question is probably more directed to the FMA, as I understood it, but—did you have any thoughts, Grant?

Spencer: That’s right, so we’re not covering that territory now.

Seymour: That’s fair enough, I was working on the basis that a financially literate and well-advised population is critical to stability. Can I just ask one other question? I noticed that, as far as I can tell, no reference in your report to any risks from fiscal policy. Is that because it’s not in the remit of the report, or that you didn’t think it was worth mentioning, or have I missed it?

Wheeler: We tend to leave that to our colleagues across the road, the Treasury, in terms of their financial reporting and the half-yearly fiscal projections that they put out.

We would comment on fiscal policy if we were concerned about the mix between fiscal policy and monetary policy, if we felt that there were real issues about whether it’s appropriately configured, whether it’s absorbing enough pressure, taking up the burden of adjustment, those sorts of things—we would report on it then.

Seymour: So the silence suggests you have no current concerns.

Wheeler: Well, the country is one of the few amongst the advanced economies that’s got a small—what looks to be a small—financial surplus at this point. There’s a lot of countries that would like to be in that fiscal position.

Robertson: Just because the Chair hasn’t taken up cause on behalf of the dairy sector, I feel they should get a question in. Obviously, you’re talking about an elevated risk from what’s happening in the dairy sector. We hear, occasionally, that given that dairy exports as a percentage of GDP, that they’re now less significant than they were, but you continue to highlight the risks from the dairy sector. What’s your response to people who say: “Well, other sectors are picking up in terms of exports; we shouldn’t be so worried about the dairy sector.”?

Wheeler: I think it’s a significant concern when you see something like a $7 billion hit to dairy farm incomes. If you take the price of whole-milk powder, say, in
February last year it was US$5,000 a tonne; it went down, I think in August, to around US$1,590 a tonne. That's a massive adjustment, and it's currently, what, around US$2,450, I think, at this point.

Robertson
With volumes much lower.

Wheeler
With volumes higher. So, that sort of adjustment to the terms of trade is something you're always going to take notice of, and particularly the way that it feeds through, one, the rural community, and, two, what impact does it have on the financial sector.

Now, if you look at other parts of the economy, I mean, tourism's doing tremendously well in terms of prospects also for the future there, I think, with different airline connections that are expected over the next 12 months. Beef has been doing very well until recently, but that's tied in with beef numbers in the States that have been declining. If you look at dairy in the medium term, I think you probably have to say the prospects look fine, given the urbanisation that's increasingly taking place in China and expected to take place over the next 20 years.

Robertson
I guess, my point being that the old adage that, you know, if the dairy sector gets a sniffle, then the country gets a cold is clearly still something you believe to be true.

Wheeler
Yeah, it's a significant part of the economy and we follow the auctions very closely, I think we all do.

Hodgetts
Of course, the level of debt in the sector is obviously something that makes it of particular significance for us.

Bayly
Last time we met, we talked about inflation and we talked about the importance of the tradable sector and how that was going to feed through to a much higher inflation rate for New Zealand. Since then, we've seen the inflation rate climb 10 basis points to 24. I was just interested, hence that context, in the IMF's opinion yesterday, where they were talking about use of monthly policy to manage price stability, and they were basically saying that unless prudential controls are not sufficient enough to manage that, then the use of monetary policy is basically [Inaudible]. Have you got a view on that comment from the IMF yesterday?

Wheeler
I think, I missed the last point, could you just repeat the last phrase you said?

Bayly
They're saying that only if financial stability risks are not catered for adequately by prudential policy, then, on that basis, monetary policy will be “leaning against the wind”—that was the exact clause they used—particularly in the context of you meeting your primary objective of price stability. Have you had a chance to have a look at that?

Wheeler
You're in a situation where we're in essence—to try and solve the Auckland housing problem, for example, is really a supply-side response. We can do things in terms of macro-prudential policy that can help out a bit, but in the end supply will fix that problem, or is needed to fix that problem.
The possibility of us raising interest rates at this point to lean against house-price pressures in Auckland are probably pretty negligible. You know, the last thing we would want to do is drive the exchange rate up, for example. With the economy going through dairy-price adjustment and growth probably slowing in the first half of this year, the prospect of raising interest rates in the short term is not something that we would consider feasible.

Bennett: Thanks very much, Governor, appreciate your time.

**conclusion of evidence**
Budget Policy Statement 2016
and Half Year Economic and
Fiscal Update, 15 December
2015

Report of the Finance and Expenditure
Committee

Fifty-first Parliament
(David Bennett, Chairperson)
March 2016

Presented to the House of Representatives
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Budget Policy Statement 2016 and Half Year Economic and Fiscal Update, 15 December 2015

Recommendation

The Finance and Expenditure Committee has considered the Budget Policy Statement 2016 and the accompanying Half Year Economic and Fiscal Update, and recommends that the House take note of its report.

Introduction

The Minister of Finance’s Budget Policy Statement 2016 sets out the Government’s broad plans for Budget 2016 and beyond. It draws on the Treasury’s forecasts about New Zealand’s economic and fiscal situation over the coming four years, which are contained in the Half Year Economic and Fiscal Update (HYEFU). Both documents were published on 15 December 2015.

This report summarises the main points from the two documents and our hearing with the Minister of Finance and the Treasury on 16 February 2016. It also notes the submissions that we received.

The House is required by Standing Order 332(4) to hold a debate on the Budget policy statement and this report.

Related material

We recently reported on the Government’s financial statements for the year ended 30 June 2015. The House may wish to refer to that report as background, as our discussion with the Minister of Finance covered similar issues.¹

Date for Budget 2016

The Minister announced at our meeting that the Budget will be delivered on 26 May 2016.

Summary of Budget Policy Statement 2016

Budget 2016 will continue to focus on the Government’s four broad priorities: managing public finances responsibly by returning to surplus and reducing debt, making the economy more productive and competitive, delivering better value for money from public services, and supporting the rebuilding of Christchurch.

Overall, the fiscal strategy remains unchanged: to keep a tight rein on spending, to focus on getting results from public services, to start paying down debt, and to look to return any excess revenue to taxpayers. However, with its accounts now broadly in balance, the Government now sees scope for the fiscal position to fluctuate in response to changing economic circumstances.

In particular, the Government intends to take a medium-term approach in its economic and fiscal management. Recognising the uncertainty in economic and fiscal forecasts, it will

not distinguish between small forecast deficits or surpluses, and will not sharply reduce operating allowances in response to a forecast weakening in the tax take.

With the current economic and fiscal outlook (which we discuss later), the priorities are to:

- maintain rising operating surpluses so that net government debt begins to reduce in dollar terms
- reduce net government debt to around 20 percent of GDP in 2020, and below that in the medium term
- implement a new funding policy for the Accident Compensation Corporation, following previous levy reductions
- begin to reduce income taxes from Budget 2017, if economic and fiscal conditions allow
- use any further fiscal headroom to reduce net debt faster.

**Operating and capital allowances for new spending**

The Government’s main fiscal tool is the limits it sets on new spending. For new operating spending, it intends to hold the allowance at $1 billion for Budget 2016, $2.5 billion for Budget 2017, and $1.5 billion for 2018 and 2019, as signalled in last year’s Budget. However, it is holding open the possibility of some “rephasing” of these allowances between Budgets.

For new capital spending, the Government will increase the capital allowance for Budget 2016 by $1 billion. This reflects the fact that the Future Investment Fund—which has funded $4.7 billion in new capital spending—has now been fully allocated. It intends to cover at least some of this increased investment by reprioritising existing capital.

**Other Budget priorities**

As well as focusing on improving the management of the Crown’s balance sheet and getting better performance from its assets, the Government has the following priorities for Budget 2016:

- Business Growth Agenda: the Budget will continue to focus on providing a supportive environment for businesses to invest, grow, and create jobs.
- Better Public Services: the Government will continue working to get better results from public services and to meet pressures on social spending, particularly in health, education, and income support transfers.
- Rebuilding Christchurch: Budget 2016 will commit the last major funding to support Christchurch as it moves from recovery to regeneration. The total Crown contribution to the rebuild, including payments by the Earthquake Commission, is forecast to total $17 billion.

**Economic and fiscal context**

The Government’s accounts returned to surplus in 2014/15, with the operating balance before gains and losses (OBEGAL) recording a small surplus of $414 million. In its half-year update, the Treasury says it expects the fiscal position to be “broadly balanced” over the next two years. It forecasts a small deficit in 2015/16, followed by rising surpluses.
The fiscal outlook in the half-year update is slightly weaker than in previous forecasts mainly because of international factors: weaker commodity prices, slower growth in China, and an increased risk of turbulence in financial markets. GDP growth in the first half of 2015 was lower than expected, and forecasts for growth in the next two years were revised downward. (However, as we note below, the latest picture is somewhat better.)

As a result of this weaker economic outlook for New Zealand, tax revenue is forecast to be lower. Nominal GDP, on which tax revenue is based, is forecast to be $17 billion lower over the five years to June 2019 than previously expected.

Net core Crown debt is expected to peak at 27.7 percent of GDP in 2016/17, and to fall below 20 percent of GDP in 2021/22, a year later than previously forecast.

**Summary of the Treasury’s forecasts**

The following table summarises the main economic and fiscal forecasts from the HYEFU.²

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<tbody>
<tr>
<td><strong>Economic (March years, %)</strong></td>
<td></td>
<td></td>
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<tr>
<td>Real GDP growth³</td>
<td>3.2</td>
<td>2.1</td>
<td>2.4</td>
<td>3.6</td>
<td>3.0</td>
<td>2.2</td>
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<tr>
<td>Unemployment rate⁴</td>
<td>5.8</td>
<td>6.5</td>
<td>6.1</td>
<td>5.3</td>
<td>4.7</td>
<td>4.5</td>
</tr>
<tr>
<td>CPI inflation⁵</td>
<td>0.3</td>
<td>1.4</td>
<td>2.1</td>
<td>1.9</td>
<td>2.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Current account balance⁶</td>
<td>-3.5</td>
<td>-4.8</td>
<td>-6.0</td>
<td>-4.5</td>
<td>-3.9</td>
<td>-4.3</td>
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<tr>
<td><strong>Fiscal (June years, % of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Total Crown OBEGL⁷</td>
<td>0.2</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.4</td>
<td>1.2</td>
<td>1.7</td>
</tr>
<tr>
<td>Net core Crown debt⁸</td>
<td>25.2</td>
<td>26.9</td>
<td>27.7</td>
<td>27.1</td>
<td>25.6</td>
<td>24.0</td>
</tr>
<tr>
<td>Net worth attributable to the Crown</td>
<td>35.9</td>
<td>35.5</td>
<td>35.2</td>
<td>34.3</td>
<td>34.9</td>
<td>36.2</td>
</tr>
</tbody>
</table>

**More recent fiscal and economic data**

Commenting on the fiscal position since the HYEFU was published in December, the Treasury said that the Crown’s accounts have generally been in line with forecasts. As normal, there have been some fluctuations from month to month, but nothing that would change the forecasts from a fiscal standpoint.

Regarding the small deficit forecast for the current year, the Minister said “We’ll just have to wait and see how that pans out”. He noted that the outlook can change markedly between half-yearly forecasts, and the process for the Budget 2016 forecasts was just getting under way.

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² Half Year Economic and Fiscal Update, 15 December 2015, p. 8.
³ Real production GDP, annual average percentage change.
⁴ Percent of labour force, March quarter, seasonally adjusted.
⁵ CPI, annual percentage change, March quarter.
⁶ Annual balances as percentage of GDP.
⁷ Total Crown operating balance before gains and losses (OBEGL).
⁸ Net core Crown debt excluding the New Zealand Superannuation Fund and advances.
In terms of the economy, both the Minister and the Treasury pointed out that recent data showed a more positive picture than the forecasts. GDP growth in the second half of 2015 was higher than forecast in the HYEFU. It is likely to be about 2.5 percent in 2016 and is now expected to average 2.7 percent through to 2020. Business confidence rebounded in the December quarter and the unemployment rate has improved.

Overall, the Minister said, New Zealand remains on track for reasonable economic growth, with jobs and incomes continuing to increase. The Secretary to the Treasury commented that “the economy isn’t sprinting ahead, but no one’s is; nor is ours crawling along either”.

**International risks and uncertainties**

While describing the domestic outlook as reasonably good, the Minister cited a number of factors in the international environment that create uncertainty and risks for New Zealand. Dairy prices have weakened in early 2016; China’s growth has slowed while growth in many developed countries remains muted; and low inflation, interest rates, and oil prices have increased the risk of disruption in financial markets.

The Treasury noted that, since the HYEFU forecasts were prepared, global financial markets have been more volatile than for quite some time. It is taking this into account in preparing its next forecasts for Budget 2016, balanced by other factors such as the generally positive picture for domestic growth. It considers it too soon to draw any conclusions.

The Minister said that such uncertainties underline the importance of New Zealand focusing on the things it can control, such as following through on the Trans-Pacific Partnership Agreement.

**Prospects for fiscal stimulus**

Some of us recalled that when assessing the global picture in late 2015, the Governor of the Reserve Bank and others had encouraged the Government to do more to stimulate the economy through infrastructure spending. The Minister said the Government focuses on the economy’s longer-term direction, and is careful not to react to month-by-month commentaries.

However, the Minister acknowledged that “there is a bit more concern about the mix that’s appearing than there was even 3 or 4 months ago”, and said that the Government has some fiscal flexibility. Within the fiscal policy direction it has set—which it sees no reason to change—it has some room to phase its spending between this year and next. Asked whether he would use that flexibility, the Minister said it was possible; the Budget process was all about watching the forecasts, and in the current environment many factors could influence what was desirable macroeconomic policy.

**The repayment of debt**

We note from the HYEFU forecasts that net core Crown debt is now expected to peak at 27.7 percent of GDP—higher than the 26 percent expected in last year’s Budget forecasts. Some of us also pointed out that net core Crown debt has increased fourfold since 2009—from 9 percent of GDP to 26 percent, and now totals $63.5 billion. We discussed when the Government might be able to start reducing debt.

The Minister said that the Government has not changed its target of reducing the Crown’s net debt to 20 percent of GDP by 2020. He acknowledged that the Treasury’s December forecasts now show the target being achieved a year later than previously expected. However, he pointed out that the main factor in the increase has been directly related to
the Canterbury earthquakes, for which the Crown had essentially borrowed $17 billion. He commented that the level of debt was reasonable by international standards, and said he believes New Zealand taxpayers are in good shape to handle the burden of rebuilding Christchurch.

The outlook for export-led growth

The Treasury and the Minister told us that worries about slower growth in China can be overstated. They noted that the slowdown is part of a deliberate strategy to rebalance China’s economy from investment to consumption. China’s consumption—the important aspect for New Zealand’s exports—is still growing by 9–10 percent a year. Moreover, China is made up of multiple economies at different stages of development, so the prospects for exporters depend on what they are selling, and where.

Rebalancing the economy

The Minister confirmed that it is still the Government’s goal to rebalance the economy from consumption to investment and export-led growth. He observed that circumstances such as the Canterbury earthquakes have prevented resources from moving to export-oriented investment. It would also take time to sort out the housing market, where poor regulation in the past had led to misallocation of resources. He acknowledged that not as much progress had been made on rebalancing as the Government would like, but believes that it is on the right track.

Some of us note that growth in the non-tradable sector is at an all-time high compared with that of the tradable sector, and consider that, after eight years, a different policy approach to rebalancing may be needed.

Prospects for dairy and other sectors

We discussed the potential effects of reduced dairy payouts, noting that the forecasts by many banks would mean a scenario of three consecutive years of below break-even payouts for dairy farmers. The Minister said that if a payout of below $5 per kilogram continued into 2017, it would clearly be challenging for many dairy farmers. While they had the advantage of strong balance sheets from the past 10 years, they could not continue indefinitely without positive cash flows.

The Minister acknowledged that such a scenario would clearly have an effect on the economy, and on the Government’s revenue, but added that the dairy sector does not set the direction for the whole economy. It represents 6 or 7 percent of GDP, and many other sectors are likely to continue performing well.

The Treasury noted that several other sectors have been doing very well. It cited the tourism, construction, and export education sectors, and exports of beef, wine, ICT, and horticulture products.

Trans Pacific Partnership Agreement

The Minister indicated that following through on the Trans-Pacific Partnership Agreement will be an important focus for the Government. He said the agreement would allow better access for New Zealand exporters to 800 million customers, representing 36 percent of the world’s GDP.

Some of us question the likely benefits of the agreement, and consider the Government’s analysis to be flawed. For example, the agreement does not take account of heavily
subsidised producers in large markets, and it allows preferential trade agreements between the USA and other countries such as Japan. Some of us consider that the agreement is more likely to benefit the USA, and that even the low level of benefit to New Zealand claimed by the Government is likely to be overstated.

The Minister disagreed; he said that the Government’s analysis has been conservative and is likely to have underestimated the benefits for New Zealand. He said the estimates do not include the growth in the volume of New Zealand’s exports that, based on past experience, generally follows reductions in tariffs. He noted also that New Zealand exporters would have done their own calculations of the likely benefits, and were not saying “Don’t do it”, but rather, “Why didn’t you get more, if you could have?”. The Minister said New Zealand got as much as possible in the negotiations. In his view, it was hard to argue that a small, open economy like New Zealand should not take every trading opportunity it can get.

**The distribution of growth**

**Per capita growth**

Some of us find it a matter for concern that, on a per capita basis, GDP has essentially not grown at all in the past year. The Minister indicated that he was not concerned, as the per-capita measure reflects the recent very high rates of net immigration. He said that this inflow is a good thing, as it shows people’s confidence in New Zealand. He also said that while it would take some time for infrastructure such as housing to match the growing population, even zero per capita growth showed that the economy was keeping up.

**Regional economic development**

We asked the Treasury about the extent to which it focuses on the health and well-being of regional New Zealand. Some of us are concerned that much of New Zealand’s growth has been stemming from Auckland and Christchurch, whereas in the regions the issues are very different and the economic risks higher.

The Treasury said it works for the health and well-being of all New Zealanders. Under the Business Growth Agenda, it works actively with the Ministry of Business, Innovation and Employment and others to understand local issues on the ground, so that it can support the best policy-making for each region’s economic development.

**Growth without carbon emissions**

We asked what specific policies the Government has to encourage growth in areas that would reduce rather than add to New Zealand’s carbon emissions. The Minister said that the main tool is the emissions trading scheme (ETS).

Some of us consider this an inadequate approach, given that the ETS does not put a price on carbon, and would prefer to see a carbon charge recycled back in the form of tax cuts. The Minister said that he considers the ETS a good policy, even though current oil prices mean it has not produced the results expected. In his view, the best next step is to complete the review of the scheme, which includes the possibility of effectively doubling the current price of carbon.

**Employment data**

Surveys gauging the rate of unemployment tend to “bounce around a bit”, the Minister said. After rising to 6 percent in the second half of 2015, the unemployment rate dropped to 5.3 percent in the fourth quarter—the lowest rate in almost 7 years.
The Treasury said it had been surprised by the latest data; it had been forecasting the rate to rise above 6 percent. It said that it pays close attention to two components underlying the unemployment data: employment growth, where the trend is quite pleasing, and the labour force participation rate. This rate had, surprisingly, fallen after being high for some time. It said that more work is needed to understand the reasons behind the movement, and advised against drawing any immediate conclusions.

**Growth in wages and incomes**

Recent data shows that the average annual wage grew by 3.1 percent in 2015, to $57,800.

Some of us consider that the change in median income would provide a more accurate measure of how New Zealanders are faring, as average wages can be skewed by those on very high incomes, and fail to reflect people not in employment.

The Minister said that a range of measures is needed to get a complete picture of income growth and distribution. One reason for focusing on the average wage is that it is used in the legislated formula for calculating national superannuation. He noted that the Government pays attention to income distribution through policies such as lifting the minimum wage, Working for Families, and free doctor visits for lower-income households.

**Social investment**

Budget 2016 will continue to support the Government’s programme of social investment, which seeks to achieve better long-term outcomes from social spending. The Minister said the approach essentially requires public service agencies to use the range of information available to ask harder questions about what is driving social spending—for example, about what is behind reoffending rates—and to apply a wider range of innovative and tested solutions.

The Minister said that the approach has been used for the past three years. So far, he said, it probably translates into a saving of $100 million a year in benefit expenditure over 20–30 years, and thousands of people having to spend less time on a benefit. Another advantage is that government agencies know that they have to apply more rigorous thinking to any new spending proposals.

**Managing public assets and investments**

The Crown, on behalf of the public, has about $250 billion in assets and spends about $6 billion a year on capital investment. The Government’s strategy will continue to focus on improving the management of the Crown’s balance sheet and getting better performance from its assets.

The Minister said that the Government has been introducing a new set of disciplines to the way it thinks about public investments. It has also published an Investment Statement—something he believes unique in the world—outlining the Crown’s assets and the change in their value over time. This has highlighted the fact that the Government’s balance sheet has become more “financialised” over time: physical assets are becoming less important than the funds under management, which amount to some $60–70 billion. He said this means that, while the Government continues to own roads, schools, and hospitals, its core business is becoming more about managing investment funds.

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9 We reported to the House on 26 June 2014 about the Treasury’s Investment Statement: Managing the Crown’s Balance Sheet, 26 March 2014.
One new discipline is to bring in an “investor confidence rating”: an independent assessment of the ability of asset-intensive agencies like the Ministry of Education and Housing New Zealand to manage their assets well. It has involved collecting for the first time a great deal of data about these assets.

Another discipline is to get the public sector understanding the concept of risk much better. Rather than thinking that capital is risk-free because it can be borrowed cheaply, organisations in both central and local government need to think about what risks they are exposed to, whether from earthquakes or something else. They then need to plan their reinsurance arrangements.

The Minister emphasised that fiscal control requires the Government to manage its capital better year by year. He noted that as the Government’s balance sheet becomes more financialised, it becomes more exposed to global share markets, so it needs to plan how it will assess and manage the risks. For example, he believes the New Zealand Superannuation Fund will make some negative returns, affecting the balance sheet. He commented that past governments have tended not to take a view about the risks they would take in investing across the world. He also believes that much of the present operating spending results from bad decisions in past decades, so this is an important area to focus on to avoid costs in the future.

**Land transport infrastructure projects**

We confirmed that transport infrastructure projects managed by the New Zealand Transport Agency (NZTA), and funded through the National Land Transport Fund, form part of the $6 billion of annual capital investment. We note the importance of such capital spending for economic development, and asked the Treasury whether it is satisfied with the oversight of decisions about these projects.

The Treasury told us it is satisfied with the framework in place, and the rules and processes followed by the NZTA. It said that a different system could work, but would not necessarily give better oversight. It assured us that if it had any concerns it would raise them with Ministers.

**Superannuation costs and long-range fiscal forecasts**

We discussed with the Minister whether it would be desirable for the Budget policy statement and the Treasury’s half-yearly forecasts to cover a longer period, say 20 years, rather than looking just 5 years ahead. This could give a clearer picture of the longer-term costs of demographic changes, particularly of the increasing cost of the New Zealand Superannuation scheme. At present the only long-term picture is in the statement the Treasury is required to prepare at least every four years on the long-term fiscal position, covering not less than 40 years.  

The Minister said he is generally in favour of longer-term documents, although he has some doubts about being able to forecast very long-term demographic changes accurately. He said the Government is increasingly moving toward a longer-term picture, especially in areas that have been less visible up to now, such as the long term costs associated with welfare, the prison system, and children in care.

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Regarding the costs of superannuation, the Minister said that the annual increase is currently about $700 million, which represents about half the Government’s new spending each year. He said that rather than restricting superannuation payments, the Government is focusing on trying to contain other long-term costs which may be more amenable to change, for example by avoiding long-term welfare dependency.

**Potential taxation changes**

The Budget policy statement reiterates the Government’s intention to begin to reduce income taxes from Budget 2017 “if economic and fiscal conditions allow”. We asked whether the conditions forecast in the half-year update would lead the Government to change this plan. The Minister said that the Government has always stated plainly that any tax cuts would be moderate, and subject to fiscal conditions. It would be part of the process leading up to Budget 2017 to assess the outlook; the Government would want to be reasonably sure that those conditions were met.

**Submissions about tobacco taxes**

We sought public submissions on the Budget policy statement. This year we received 33, an unusually large number. Almost all of the submissions related to measures that could be taken to reduce the prevalence of smoking in New Zealand.

Budget 2012 introduced four successive 10 percent increases in tobacco excise taxes between 2013 and 2016, as a step toward the Government’s goal for New Zealand to be Smokefree by 2025 (a smoking prevalence of less than 5 percent of the population). The last of those increases took effect on 1 January 2016.

Many submitters called for Budget 2016 to introduce further tax increases on tobacco, of at least 20 percent a year for at least the next four years. Some submitters urged higher increases in tobacco taxes, of 40–50 percent initially, followed by a 25 percent rise annually. We heard that there is strong evidence that increasing the price of tobacco products is an effective incentive for people to quit smoking. However, several submitters suggested that an increase of more than 10 percent is needed, to avoid having the effect of the tax undermined by price adjustments.

We discussed the potential financial hardship of further tax increases. Several submitters indicated that lower socio-economic groups are more price-sensitive, and therefore more likely to be responsive to price changes. Some pointed to international evidence suggesting that tobacco taxes are generally a pro-equity measure. The ACT Party member notes, however, that one submission cited the price elasticity of demand for cigarettes and concluded that a tax increase would have least effect on poorer groups, and would widen inequalities.

We also discussed the issue of electronic cigarettes (a smokeless nicotine delivery device which is inhaled like a cigarette); those containing nicotine are banned in New Zealand. We note that people who have studied this issue closely are open to the possibility that electronic cigarettes could help with quitting smoking, but there remain concerns about the potential for unintended consequences. Some submitters cautioned that electronic cigarettes can serve to normalise smoking. We see this as an area deserving of further research, and have drawn no conclusions at this stage.

We have passed on the information we received from submitters to the Minister of Finance and the Minister of Revenue.
Appendix A

Committee procedure
We met on 16 February and 2 March 2016 to consider the Budget Policy Statement 2016 and the Half Year Economic and Fiscal Update, published on 15 December 2015. We heard evidence from the Minister of Finance and the Treasury.

We received 33 submissions, and heard oral evidence from nine submitters.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour

Evidence received
Copies of the submissions we received, and additional information from the Minister of Finance, are available at www.parliament.nz.
Appendix B

Transcript of hearing 16 February 2016

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Fletcher Tabuteau

Witnesses
Hon Bill English, Minister of Finance

The Treasury
Gabriel Makhlouf, Secretary and Chief Executive
Girol Karacaoglu, Chief Economist and Deputy Secretary, Macroeconomics, International, and Research.

Bennett
Good morning, Minister and Secretary of Treasury. Welcome to the committee. So we’ve got till about 12.30 for your hearing of evidence, Minister, and then the Secretary after that. So if you’d like to please give us a brief introduction and then we can open up for questions that members may have.

English
Well, thank you, Mr Chairman. And can I acknowledge the committee changing the time to fit in with my arrangements last week; it was much appreciated. We’re referring here to the half-year update, issued in December, and I’ll just make a few comments on the relevance of that update for the outlook for the economy.

We’ve continued to be on track for reasonable economic growth. Job growth and income’s continuing to rise. A number of uncertain international factors: weak commodity prices, they’ve made it cheaper for families to fill up their car, but it’s lowered dairy farm incomes; slower growth in China, driven by lower investment, although the aspect of the Chinese economy that matters to us is the growth in consumption, and that is around the 9 to 10 percent rate of growth; ongoing uncertainty about the track for US interest rates and its impact on just about everybody; and also signs of growing risks around European banks, which would suggest, you
know, the possibility of some degree of the turbulence that we saw 5 to 6 years ago in the financial markets.

All of this underlines the importance of New Zealand focusing on the things it can control, for instance following through on the Trans-Pacific Partnership agreement, because that’s better access to 800 million customers—accounting for about 36 percent of global GDP. At home, New Zealand recorded a 2.3 percent economic growth over the year to September, following weaker growth in the first half of 2015—probably surprisingly weak, I’d say, for most people.

More recent data suggests that the economy’s picked up somewhat. GDP growth is expected to average around 2.7 percent through to 2020. Interest rates continue to confound expectations by staying lower for longer, with rates just above 50-year lows, and a lot of debate about whether they should be lower. The average annual wage grew 3.1 percent in 2015, to $57,800, over a period where the cost of living increase was 0.1 percent.

Recent job growth is expected to continue. There are 175,000 more people employed now than there were 3 years ago. The recent unemployment number probably surprised on the low side—it’s a survey that bounces around a bit, but it at least indicates that the rise in unemployment through the second half of last year probably hasn’t continued. And our employment rate, that is the proportion of the population over 15 in work, is the third highest in the OECD.

Just referring to the fiscal outlook in the half-year update. The Government’s books showed a $400 million surplus in 2014-15. There’s certainly some challenges ahead around maintaining and increasing surpluses and paying off debt. Continued low inflation, low dairy prices, low interest rates all add up to a low growth in the nominal economy, which is the tax base, and therefore a lower Government revenue. I mean, in the past, Government’s often solved its fiscal problems—when we have a positive part of the growth cycle, inflation’s tended to pick up and you get nominal economy growth, nominal GDP growth, you know, 5, 6, 7 percent per year. So, healthy growth in the revenue base, but that’s not happening. In a sense, Government’s having to learn how to deal with real dollars; that is, pay off the debt in a similar dollar value as when it raised the debt.

Treasury is forecasting a small deficit for the current year, before bouncing back to surplus. We’ll just have to wait and see how that pans out. As we saw last year, the outlook can change significantly between the half-year update and the final accounts; also between the half-year update and the Budget forecasts, which is a process just getting under way now.

As was set out in the Budget Policy Statement with the OBEGAL now broadly in balance, in the immediate future we will not distinguish between forecasts of small negative and small positive balances. In particular, we will not sharply reduce operating allowances in response to forecast weakening in the tax take, should that occur.
We remain strongly committed to prudent spending and continue to invest considerable time and effort, both in the improved management of the balance sheet and Government’s $6 billion a year of capital spending, and also in some better performance frameworks for managing our long-term core Government spending: health, education, justice, and welfare, in particular. The Budget Policy Statement made no change to spending allowances, which were set out in the previous Budget—that is, a billion in Budget 2016 and a one-off increase in Budget 2017 to $2.5 billion. We, of course, have the opportunity to phase the amounts between those two Budgets.

Finally, Mr Chairman, I’m announcing today that the Budget this year will be delivered on Thursday 26 May. It will focus firmly on building on the good progress we’ve made across the Government’s priorities, and advancing policy to continue to work at lifting economic growth prospects. I’ll leave it there, Mr Chairman.

Robertson: Thank you, Minister. Just one question before—I want to ask you some questions about the growth comments you made about the global economy. But just before, would you agree with Nick Tuffley that on a per capita basis, there has been essentially no growth over the past year?

English: I’ve seen a comment, but I haven’t looked at the numbers. I mean, with the very high—

Robertson: With respect, I mean, you probably have, haven’t you?

English: Well, no, not in detail. With very high rates of immigration, it’s quite likely, actually, that per capita growth’s flat. But then, you know, if you look at growth and take out all the things that are growing, you’re going to have no growth.

Robertson: Yeah, but when it comes to per capita growth, that’s a legitimate measure of the economy. If the economy’s not keeping up with the people who are living here in the country, then that, effectively, is no growth in the economy.

English: Well, it’s not that it’s not keeping up; actually, it is keeping up, even at zero per capita growth—is same per capita GDP. But there’s a lot of growth got to go on to build the houses, and—as the Government’s finding—build the classrooms, and make sure all the other infrastructure is up to the growing number of people. So, look, we welcome high rates, the inflows—that’s of people voting with their feet. It’ll take, you know, some time for that growing population to be absorbed, but growth is a good thing. I mean, because there’s migrants turning up wanting houses, there’s people getting employed and there’s incomes growing. So we don’t see it as a negative; it’s just a kind of artificial calculation.

Robertson: OK. But presumably your aspiration remains that, actually, the economy grows on a per capita basis.

English: Yes it does, and that of course—

Robertson: And it hasn’t happened in the last year.
English

Well, it can happen for the wrong reasons, can’t it. So you can have a net outflow of people and have per capita growth—per capita GDP growth. So, you know, it’s a bit of an accounting and calculation argument. But some people aren’t satisfied. When dairy was going up, people said that’s the wrong sort of growth. Except when it went down, it’s really bad. When migration goes up, that’s the wrong sort of growth. Except when it goes down, that’s really bad. When housing’s going up, that’s the wrong sort of growth. When it goes down, that’s really bad. I mean, it’s a pretty silly argument. Growth is growth. Income’s rising, jobs are being created—that’s a good thing.

Robertson

All of which are questionable. I want to take you back to your comments about the relative state of the global economy and, in particular, China. The latest numbers out of China for January show that imports are actually down by 14 percent. You yourself reflected on—some of the commentators were talking about conditions being similar, but perhaps not quite as extreme as 2008. Presented with that global scenario, you were encouraged by the Reserve Bank Governor and others, towards the end of last year, to do more to stimulate the economy. Are you intending to make any changes at all to, you know, your programme, as it has been outlined, in the face of the global situation and those calls?

English

Look, at any given time you can construct a pretty negative scenario out of those global factors. And, it would be fair to say, at the start of this year there’s a bit more concern about the mix that’s appearing than there was even 3 or 4 months ago. I mean, we’ve got a bit of flexibility—I suppose that’s the way I’d put it. Even within the fiscal tracks that we’ve set, we’ve got some room to phase between this year and next year.

But we’d be a bit careful about reacting to the commentary of the week or the commentary of the month. You know, we set a fair bit of store by a longer-term direction—a bit sceptical about the ability, month to month, or quarter to quarter for Government, to fill gaps in the economy. And in any case, the domestic outlook is reasonably good. So I’d say, right now we’ve got some flexibility but we don’t see any particular reason to change policy.

Robertson

So you’re not inclined to use that flexibility over this coming year?

English

Well, we may do. That’s what the Budget process is about, because you’ve always got to—in this kind of environment—you’ve got to pay attention to the forecasts. There’s any number of other drivers around desirable microeconomic policy. So we could use it.

Robertson

OK. So you’ve got Graeme with you—you’ve got the Governor of the Reserve Bank saying that monetary policy needs some friends, and that the people who are his friends, in this case, are you. And you’re telling him—a statement he made late last year—that you don’t believe that’s necessary at this time.

English

Well, we’re not his only friends. He’s got a lot of friends. We take account of, certainly listen to, what the Governor says, but in the end—

Robertson

But not in this case.
but in the end his job is interest rates, not fiscal policy. We will discuss those issues with him and make our decisions accordingly. I think an important point here is simply that we have the flexibility to move it around a bit without, essentially, changing policy direction.

Looking at the forecast—the period that we’re looking at here—we’ve now got, obviously, most banks talking about some sort of $3.85 to $4 payout for this year. But we’ve also now got other banks—we’ve got Westpac saying $4.60 for 2017. We’re then talking about the scenario that you’ve mentioned when you’ve been in this room before, of 3 years below break-even. What action would you be proposing to take in response to that? And what impact are you forecasting that that will have on your books?

Well, we take, you know, a somewhat similar attitude as when dairy was going very well, and that is: it has an impact on the economy but it’s 6 to 7 percent of GDP and whatever happens there doesn’t necessarily set the direction for the economy. For the sector itself it’ll be pretty challenging. I mean, if they have a sub-$5 payment in 2017, that’ll be 3 years of cash losses for a lot of dairy farmers. The advantage they have is a fairly big uplift in equity in the last 10 years, so they’ve generally got strong balance sheets. But, of course, you can’t run on your balance sheet forever if you just don’t have the positive cash flows.

So they’ll be, I’m sure, working pretty hard, as the joint owners of Fonterra and the other companies, to do what they can to try and beat the odds, if that’s where the odds are stacking up. So we wouldn’t expect to react to it—it’ll certainly have an impact, no doubt about it. It’s just less national income, smaller tax base. It’s part of that general environment I described before that’s fiscally pretty challenging, and that is even when you’ve got reasonable real growth—low inflation, lower tax base, and the Government has to deal in real dollars.

I’m interested that you’re, sort of, diminishing the impact around dairy, yet it was the only sector that the Prime Minister chose to highlight in his opening statement as having a particular impact on revenue. So it remains the case that what he said last year that if the dairy sector gets a sniffle, New Zealand gets a cold, doesn’t it?

Well, it has an impact, but I think we’ve learnt from—particularly as it slowed down. There’s other parts of the economy that are, say in the case of tourism—pretty much the same size—going very well. In the same way as when it was picking up, it wasn’t the only thing that the Government took account of in trying to—you know, we didn’t sit back and say “Well, dairy’s going fine so everything’s going to be great”. You know, I think we’ve got a pretty good perspective on it.

Minister, can I just ask about social investment, which you said last year would start to be embedded into the Budget processes—this notion that Government’s going to invest more up front for better long-term outcomes. And I just wonder if you could maybe give us an update on how that’s provided better fiscal results for the Crown in the last 6 months or last year or so, and what we might expect to see in Budget ‘16 about that.
Look, I think the way to see it is in the context of the Better Public Services result. So it’s a set of tools that allows you to get better outcomes. And it’s a set of tools that—the reason it helps achieve that is not because there’s some magic in it, it’s just that it gets people asking harder and harder questions. So, for instance, reoffending rates appear to have—a drop in reoffending rates appears to have flattened out, might have risen a bit. Prison forecasts are rising, when it’s been dropping for 3 or 4 years. So what I’m saying there is that sector digging much deeper than they ever have before. And when they are looking at solutions, then they can use the social investment tool kit. Because we’re developing further, different versions of liabilities—long-term costs of, for instance, rising imprisonment rates.

So that’s really the fundamental long-term impact of it—you just have the Public Service asking harder and harder questions, and looking for a much wider range of innovative and tested solutions. In terms of fiscal impact, probably where it’s had the most impact up to now has been the welfare liability, which has been running for 3 years. So there’s now a pretty well-understood way of looking at the next 20 or 30 years of benefit expenditure, and that shows that they’ve knocked a couple of billion off the long term. It might translate—in fact, I can’t tell you exactly what it would translate into in 1 year, but it could be maybe $100 million less, something like that. And it’d certainly translate into thousands of beneficiaries spending a lot less time on benefit.

I think the other feature of it is because any proposal has to answer three questions: which people where; how can you establish a relationship with them that means you can deliver the service; and how can you show you’ve made an impact? Those are questions—those are quite high hurdles for new proposals to get over. So, I know it sounds a bit simplistic, but one of the effects of it has been to stop a lot of silly, loose thinking turning up as bids for more money, because they have to be much more rigorous than they used to be.

Minister, you mentioned that average wages have increased by about 3 percent this year. I wonder if median household income would be a better—give us a better, more realistic picture of how New Zealanders are doing as a whole. Because, obviously, average wages are going to be skewed higher by people on very high salaries earning more money, and also that the unemployment rate being higher than it was when you came into power. You know, not everybody is working, so, obviously, average wages aren’t giving us the whole picture. Could you let us know how median household income is doing?

We’ll get those numbers for you. I mean, as you know, there’s any number of ways of measuring income distribution and income increase. And you need to look at a range of measures to get a general picture. And even then, it can be just a bit confusing. One of the reasons we use the average wage is because that’s the legislated formula for national super. So it’s been the, sort of, Parliament’s version of how you tie a retired population’s income to the working age population. So in that sense it’s just a standardised measure. But, yeah, there’ll be a bit of a different track for median income, there’s a
different track for gross wages, right? More people working, working more hours—gross wages can go up 4 or 5 percent in a year. And, you know, we can argue the meaning of them.

I mean the Government pays, as you know, a fair bit of attention to the distribution. That’s why, for instance, we follow the policy of lifting the minimum wage pretty much every year—well, we have lifted it every year. And why we pay attention to what families on benefit are getting and the impact of things like Working for Families and free doctors visits on lower income households.

**Genter** Sorry, on a different point, is it still a goal of your Government to rebalance the economy? And if so, how is that going?

**English** Yes, it is a goal of the Government. Remember the context in which that occurred, we’d had a sort of housing and consumption boom through the mid-2000s and so you want to see resources move away to things that we think are more likely to generate sustainable long-term income. It’s been pretty hard work. I think you’re starting to see some of the benefits of, you know, for instance a more vigorous, successful tourism industry—export of services.

My own view is that you’ve had—there’s any number of circumstantial reasons at any one time why resources don’t move. So in this case, that $40 billion of resource turned up for the Christchurch earthquake, so it can’t be invested in exporting. The whole housing—we’ve had endless debate about housing. And to the extent you think there’s a misallocation of resource there, it’s to a large extent driven by poor regulation of the housing market, which is going to take some time to sort out. But we’re on track there. So not as much progress as we’d like, but no less ambition to get there.

**Genter** Given that growth of the non-tradable sector is at an all-time high, compared to growth of the tradable sector, do you think, after 8 years maybe it’s time to rethink the policies to achieve rebalancing in the economy?

**English** I think we’re broadly along the right lines. I mean, if you think of what other policy settings that you might have a short-term impact on—that rebalancing—most of them are undesirable and been tried before in New Zealand. Remember, back in the ‘70s and ‘80s there was a big push on encouraging exports—policies that just about brought the economy to a stop, had damaging long-term environmental and economic effects. I mean, I saw some of that in the rural sector. So we’re certainly not going to go that far.

**Genter** And finally, I’m wondering what the plan is to grow the part of the economy that isn’t growing dangerous climate pollution. I haven’t heard anything in your presentation to us about that yet. After the Paris agreement, it seems pretty clear that we’re going to have to change our approach sometime in the next few decades—to phase out fossil fuels. So what, specifically, are you going to be doing to ensure that we are able to
grow the parts of the economy that don’t increase—in fact, decrease—dangerous climate pollution?

English: Well, the main tool there is the one invented by the Green Party—the emissions trading system.

Genter: I think you’re wrong about that. Our policy is a carbon charge recycled back in the form of tax cuts.

English: Oh well, they might have changed the policy, but it was a great—

Genter: No, it was always our policy.

English: —it was a great idea at the time.

Genter: Our policy was always an actual price on carbon, not a complex trading scheme that doesn’t put a price on carbon.

Unidentified: Oh yeah, that’s right.

English: I’m just handing out compliments here. It’s a good policy

Genter: I would like an answer that isn’t just—I mean, what specifically are you going to do, given that the ETS doesn’t actually put a price on carbon, which is what I’m sure all economists agree needs to happen—

English: Well it does.

Genter: —to send a signal to the economy that we need to move away from pollution?

English: It does put a price on carbon. It’s just the Greens would like it to be a much more painful process than it is. Sort of the “hair shirt theory” of change to fossil fuels. And, of course, a lot of the dynamics—

Genter: Economists agree with us on that, so if you think those economists are taking a hair-shirt approach—I think it’s just an effective approach.

English: Well, putting a price on carbon’s a very good idea—

Genter: Yeah.

English: —and supply and demand will determine that price. So we’re in the review right now, including the possibility of removing the two for one, which would, effectively, double the price of carbon from wherever it is. On the other hand, we’ve got the opposite of what everyone expected. We all thought we had peak oil, because we listened to some of the environmental analysis. It’s turned out, far from peak oil, we’ve got flood oil, or something, I don’t know what you’d call it—

Unidentified: Yeah, the Malthusians were wrong.

English: —which is, you know, a glut, or something. I don’t know what you call it. So that’s not going to help.

Genter: And to do anything to rectify the lack of a price on carbon pollution in this country?

English: Yes, complete the review. That’s the next thing we’re doing.
Ross

Minister, you mentioned the Trans-Pacific Partnership in your opening remarks. Can you give us a view, as the Minister of Finance, how significant you believe that agreement is for New Zealand and the economy?

English

It’s very significant. We’re a trading country! Yeah, it’s very significant, and it’s hard to understand how you could argue that in a small, open economy you would not want to take every trading opportunity you can get. And New Zealand’s role in procuring those is a bit challenging because we don’t have much to offer anybody. What can we offer to India that’s going to encourage them to open up their markets to us? Not much. So getting the TPP—from our point of view better access to 36 percent of global GDP—is pretty important, and particular groups are going to benefit, you know, quite considerably from those better opportunities in a way that will spread through the economy.

Just to give you a sense of how the benefits are calculated: the way they calculate the benefits is they take the existing volume of trade and multiply that tonnage by the change in tariff, and that gives you actually the minimum possible benefit you can get. And, of course, as we’ve learned from the Chinese FTA, once the trade barrier is lowered, the volumes can grow quite quickly—but the calculations we make about the benefits don’t include volume growth. So a good example is New Zealand sells apples into Mexico. We sell something like 300 tonne and they buy hundreds of thousands of tonnes from the US—our apples are a lot better than US apples, Mexicans will want more of ours if they can possibly get them, the reduction in the tariff means that New Zealand volumes in there will grow, could grow, quite fast. They certainly won’t stay at 300 tonne as they are now.

Ross

Many of the commentators that have indicated that if we were left out of that trade bloc it would be a detriment for us compared to other countries. How is our current economic growth looking compared to other developed economies?

English

Well, it’s a bit better than quite a few of them, but that’s totally dependent on us continuing to get better at what we do and take the global opportunities that are presented, such as the TPP. I think that part of the thinking about that is just to try and imagine us not being in it. So New Zealand politicians would be sitting here with our export community coming to us saying: “Why have you behaved in a way that’s enabled my other competitors—particularly Australia—to get a benefit I can’t get?” And it’ll be quite hard to answer that question.

Nash

One quick question, Minister. I note that from 2009 to 2015 gross sovereign issued debt increased—well doubled—to $86 billion, and net core Crown debt is increased by a factor of four to $63.5 billion. When, Minister, do you envisage that the Government will be in a position to start paying down some of this debt?

English

Well, the half-year update that’s the subject here actually pushed that back a little bit. So in Budget 2015 we had debt peaking at around—I just can’t
recall—something like 26 percent of GDP. It’s starting to drop over the
next couple of years, and we have a target of 20 percent by 2020.

We haven’t changed that. But the half-year update took the $17 billion out
of GDP over the next 4 years, which just means there’s less revenue. And
so, if you look at the graph, you’ll see it rather than peaking now, it pops up
a bit further, like about another percentage point of GDP. So we prefer to
be able to pull that back. We’ll work through that in the process of this
Budget and the next one.

Nash
It’s gone from 9 percent of GDP to 26 percent of GDP. Does that concern
you at all—the high debt levels we’ve got?

English
Oh, they’re not. By international standards it’s a reasonable level. I mean,
the single biggest sort of factor in there has been the earthquake. We’ve
basically borrowed $17 billion. So about 8 percentage points of that is
related—7 percentage points of that is related, directly, to the Christchurch
earthquake. So the numbers would be considerably better, but there’s been
no choice about that. Christchurch is going to be a bigger, better city for it.
I think the New Zealand taxpayer is in good
shape to be able to handle that
burden.

Tabuteau
Thank you, Minister, for this opportunity. I should have been asking supps.
For example, I want to come back to the TPP and this apparent exposure
to 800 million customers in 36 percent of the world economy. Even the
Government’s own flawed analysis suggests that the total benefit from that
is less than 1 percent. Actual analysis would suggest, with regard to tariffs,
for example—tariffs are at least half or, I would suggest, even a quarter of
the benefits published for New Zealand exporters. Have you relied on or
contributed to the analysis—your ministry or yourself—or are you just
taking the numbers as given?

English
Well, the Treasury has been part of the discussion or part of the
calculations, and they can tell you more about their role. There’s my views
about it. I think I’m conditioned by three things. One is those calculations,
some of which I regard as pretty conservative. Secondly, the feedback
directly from the export sector—so, people who’ve got their capital at risk,
whose jobs depend on this, are not saying to us: “Don’t do it.” They are
saying: “Why didn’t you get more, if you could have?” And the answer to
that is we couldn’t. We got as much as possible. And I think the third thing
is New Zealand’s past experience of these agreements.

In fact, pretty much every country who has ever taken the steps of getting
into a free-trade agreement has, in the long run, decided it’s not a bad thing.
There was a huge argument over NAFTA when it first came in. I don’t
think anyone is now suggesting that you would undo it, because the
calculations turned out to be wrong. The same with CER, 40 years ago.

Tabuteau
The reality is within the TPPA itself, for example, there’s preferential trade
agreements with beef and other agricultural products, between the US and,
say, Japan and also the prevalence in reality of trade in terms of competition
with US beef manufacturers and us accessing the Mexican market are highly
unlikely. It’s more likely to benefit the US. And on top of that your own
Government analysis hasn’t included the fact that all of those big markets
are hugely, heavily subsidised. So the numbers just don’t make any sense at
all. Would you care to comment?

English Well, I disagree. I disagree. The numbers indicate potential. And, you know,
as I said, some of them have got a pretty conservative basis of calculation—
some of them are bit more speculative. But if you’re trying to argue that
somehow we’re worse off for the pretty obvious gains that have been made,
then I just disagree with you. I mean we can’t be worse off. We certainly
would be worse off—

Tabuteau New Zealander business that I talk to are taking you and the Prime Minister
at your word as to the benefits of this trade deal. And the benefits,
according your own analysis and the limitations that your own report
admitted to, make those numbers almost farcical—and many New Zealand
businesses are relying on you and looking to you and the Prime Minister for
that guidance. So a lot of the support that you’re talking about is based on
what you’re telling New Zealand businesses.

English No, I don’t agree with that actually. New Zealand businesses are not dumb.
They don’t sit round waiting for politicians to tell them how to run their
business. Any of them that I’ve come across have looked hard—whether
it’s the cherry growers, the kiwifruit people, dairy, beef, meat, intellectual
property copyright—they’ve looked pretty hard at this thing, because the
provisions of it have been well known for quite a long time. There’s been
plenty of debate about it, and I don’t think they’re relying on Government
calculations by the bureaucrats to tell them—

Bayly Thank you, Minister. And moving on from the heady heights of TPPA—I
was just interested in the balance sheet. We’ve got assets of about $250
billion. You talked about a $6 billion additional spend, and I think that the
projection is about $50 billion over the next 10 years. You’re probably
aware that in the corporate sector people are increasingly—and bankers as
well as owners—moving away from just traditional balance sheet ownership
around physical assets, but also taking into account IP, or intellectual
property. I was just very interested to know what steps you’re taking to
improve the finance balance sheet over the next few years.

English It’s a long-run business, so we don’t pretend that you can have a huge
impact in a few years. What we’ve tried to do is bring in a set of disciplines—
some of which are very basic—like making sure we know which assets are
which and who owns them, and that we add them up and can see the whole
picture; because we have this thing called the “Investment Statement”—as
far as I know, no other Government has it—and it very simply outlines the
assets and the change in their value over time. And that shows some
interesting patterns: for instance the New Zealand Government bank
balance sheet is becoming much more financialised than it used to be. The
bit that people identify—the ownership of SOEs, or even the ownership of
physical assets—is shrinking in importance, and what’s growing is the $60
or $70 billion funds under management. So actually the core business of the
New Zealand Government’s balance sheet now is managing investment funds, not—it does own roads, hospitals, and schools, but their relevance on the balance sheet is shrinking a bit.

Then we try to bring in disciplines, the most recent one being investor confidence rating. So that’s an independent assessment of our intensive asset-owning agencies and their capacity to actually manage large chunks of assets. Because the Ministry of Education’s got $10 billion of assets—they’re tricky assets. You can’t buy and sell them. They’re quite specialised. They’ve got a whole lot of legacy problems—same with housing. We own 22—one in every sixteen houses in Auckland. We need to be confident that the entities that are managing these big chunks of specialised assets know what they’re doing, and that’s involved collecting a vast amount of data—which we didn’t use to have.

The other thing is bringing in a much better understanding of risk. So because the Public Service and most people think Crown capital is cheap—that is, you get it at the risk-free rate—they think there’s no risks with it. Well, that’s complete nonsense. The risk is not in the capital being at 3 percent; it’s in the asset you’re investing in. We need a better understanding of what exposure we have—not just to earthquakes, although that is a big one. We’ve got to redo, along with local government, the reinsurance arrangements, because we’re exposed to earthquakes and councils’ underinsurance or lack of insurance. That’s just one example.

But as we become more financialised, where the New Zealand Government is now much more exposed to global share markets than it used to be for instance—so the super fund is going to make some negative returns. That does impact on the value of our balance sheet. How likely is that? So they’ve got a whole set of ways of measuring that. Does the Government know what risks we take with investing across the world? Well, we haven’t actually. Governments haven’t taken a view about that. We need a tool kit that enables us to say “We’re willing to take this much risk,” as well as exposure to interest rates and exchange rates and so on.

So we’re trying to develop—well it’s a bit like, but not the same as—a corporate treasurer function to be able to assess the risks. Because my own view is that a lot of our operating spending is driven by badly managed capital. Today we are paying bills for bad decisions made 10, 15, 20 years ago about capital assets, and so at least one way we can get fiscal control is to manage our capital better year to year. Now we spend $6 billion of capital every year, and a lot of that’s depreciation and balance sheet finance, but it is $6 billion of capital spend per year, and that deserves a fair bit of attention.

Robertson I just want to take you back to a couple of questions about the global situation. What advice have you had about any banks in New Zealand, or perhaps their parent banks offshore, starting to become more concerned about the level of dairy debt?

English I haven’t had any particular advice on just that issue, but I’m fully aware that the Reserve Bank in particular in its supervisory function has been
keeping a very close watch on those sort of issues, and has done lots of
modelling with banks and with the sector about what could happen.

Robertson You haven’t had any advice then that there might be parent banks saying
that a third year of below break-even payments represents a level of risk
that they’re not prepared to sustain?

English No, I haven’t had that advice, but I would expect that both the New
Zealand banks and their parent banks are assessing these things. I mean,
you’ve just got to see—looking at what’s happened to bank share prices in
Australia—that the perception of risk around, say an Australian property
market, the mining sector coming off. The perception of that risk has
shifted in the last 3 or 4 months. And a longer, flatter profile for dairy prices
might shift that perception here somewhat too.

Robertson Just on another matter: what would be the conditions that would lead you
to back away from tax cuts in the 2017 Budget?

English Well, that’s what you work through a budget for. We’ve always said there
are some characteristics: one is moderate, and, secondly, subject to fiscal
conditions. So that’s what we said back in 2014 election and we’d stick to it.

Robertson So the levels of growth in the economy that are forecast in the documents
that we are looking at now and the state of the global economy as it is today
wouldn’t put you off, at the moment, from tax cuts in the 2017 Budget?

English Well, all I’d say is that given the conditions we laid down we would want to
be sure, to be reasonably sure over the next wee while, that those conditions
are met.

Seymour Thank you very much, Minister. I apologise for being late. [Interuption] I just
wish we had a few more comedians. I just wanted to ask you a couple of
questions. One was about the time frame for the Budget Policy Statement,
which is that it’s a 5-year look ahead, as far as I can see, and it also says that
there should be regard for fairness between generations in the policy. I just
wonder if you would support making the forecast in Budget documents
longer to take account of some of the demographic changes that we can
anticipate quite easily but don’t tend to state except for in the Treasury’s
long-term fiscal outlook?

English You could always do that. I’m—as the Treasury knows—slightly at the
sceptical end of being able to forecast demographics. So I think it’s a lot
harder than everyone says, but I don’t think that the Treasury takes much
notice of my view on that. You can be sure that they are paying a great deal
of attention to that. Yeah, you can put more of that in the documents. I’m
generally in favour of longer-term documents. We’ve gone out to 4-year
Budget plans because we’re dealing with long-lasting institutions which
don’t change rapidly. They have guaranteed incomes—pretty much. If
you’re running a Government department, much as they complain about
pressure, they’re the only businesses in the country that can guarantee that
in 2 years’ time they’ll have the income they’ve got now. And so they should
be able to plan, particularly if they’ve got long-run assets. If you’re running a
prison system then you don’t plan over 2 years; you should be planning
over 20 years. And it’s a bit the same with the fiscal stuff. So we’ve got this sort of concept of the comprehensive balance sheet, and there’s parts of it that we understand well—reasonably well—the ageing of the population, for instance, has been forecast to death.

Seymour: Literally.

English: Yeah—there is a comedian in your caucus. I’d like to meet the other ones. Now we’re adding to that the forecasts—we’re adding to that a longer-term view about the bits that have been much less visible, and that is the long-term costs around welfare, the prison system, your kids in care. So we’re generally moving in that direction now, if that could translate into Budget policy documents that expressed that over 5, 10, 20 years, if you want.

Seymour: I just wonder if the real motivation is not that seeing a billion-dollar, year-on-year increase in super costs every year throughout the 2020s would make this discussion quite a different one?

English: I think you can see that. I think it’s currently $700 million a year. It’s about half of the increase in Government spend—of actual spend. You can see that now. I don’t think it’s hidden from anyone. And there’s a whole set of policy issues around that that can be debated. The Government’s had a clear position on it, hasn’t changed that position, and one way of seeing it is we’re taking the opportunity where everyone isn’t totally focused on retirement income—to focus on the other long-term costs, many of which are more amenable to change. We can’t change much about 64-year-olds turning 65. We can change something about a 23-year-old on the verge of schizophrenia who’s on a benefit and if we nothing they’ll be there for 20 years. We can change that, with pretty much the same impact as restricting another person from getting national super.

Scott: Thanks, Minister. Worker participation rates—the third highest in the world, a pretty awesome result really. What’s driving that and what is the benefit of that?

English: You would be best to get a bit of advice from Treasury about what they think’s driving it. We can speculate about it. We have growing rates of participation for older groups of people, and some would argue that’s because we’ve got a universal pension that is not income-tested against their work income—so they are more likely to stay on for longer. With an additional pressure that if they had savings they lost some in the financial crisis, and interest rates are half what they were 7 or 8 years ago, so their incomes have dropped quite a lot. If you’re an older person you can’t, for a million dollars in the bank—and there won’t be that many of them—for a couple of hundred thousand in the bank, you’re not getting a lot of money off it. So there’s sort of a push and a pull factor about higher participation. The rapid expansion of early childhood education, which is our fastest growing single cost outside national super, and the pressure of housing costs—I think those two go together. So a lot more secondary earners in the workforce.

Bennett: Thank you very much Minister, I appreciate your time.
Thank you, Mr Chair. If I can just sort of kick off with some brief comments on development since we published our Half-Year Economic and Fiscal Update in December. Starting with fiscal matters, the Crown’s accounts are generally tracking along in line with HYEFU expectations. The latest financial statements that the Government released last month showed net debt at $63.5 billion, 26 percent of GDP, and core Crown expenses at $30.5 billion. Both are close to forecast. While revenue was a little behind where we thought it would be, we know fluctuations from month to month are par for the course, and they are expected to even out over time. In short, we’re not seeing any fiscal issues that would change our view from HYEFU right now. We’ll be putting out, as you know, our next official forecasts on 26 May in Budget 2016.

Now turning to the economy, the start of the year has had plenty to offer both pessimists and optimists alike. Dairy prices have weakened over January and February, with whole milk powder falling 10.4 percent at the latest global dairy trade auction, and Fonterra has dropped its farm gate milk price forecast to $4.15 per kilogram of milk solids. While January saw good rainfall across most of the country, drought remains a significant risk. We’ve also seen projections for global economic growth pegged back a bit. The IMF’s most recent World Economic Outlook Update picks growth in advanced economies to be 2.1 percent both this year and next. There are concerns about financial market volatility, falling oil and commodity prices, and simmering geopolitical tensions. Low inflation, as we’ve seen here in New Zealand, is also being experienced in many other advanced economies around the world.

Woes about the slowdown in China’s economic growth have been exacerbated because the European Union and Japan in particular have been flat, and US and UK economic recoveries are still relatively muted. I think the worry about China’s growth could be overstated. The slowdown is, of course, predictable. In fact, it’s in line with the Chinese Government’s strategy to rebalance its economy from investment to consumption. I’ve recently returned from Hong Kong and China, where the people I spoke to are not expecting a hard landing in China’s economy. I should add that it’s also unhelpful to think of China as a single economic entity. It’s more like the European Union, made up of multiple economies at different stages of development and growth, and the impact of China’s slowdown really depends on what you are selling and where in China you are selling it.

And let’s not forget, New Zealand’s economy is than one industry and one market. Tourism is doing well, with international visitors spending $11.8 billion in New Zealand in the year ending March 2015, which was up $1.7 billion from the year before. Construction is doing well, as new dwelling consents were up 21 percent in Auckland in 2015. Non-residential building consents grew 27 percent in Canterbury and the latest Occupation Outlook from MBIE shows strong prospects for those planning a career in construction and infrastructure. Horticulture export revenues are forecast to rise 16 percent to $4.8 billion by June this year. Beef export revenues rose 14 percent last quarter compared to the previous year. Wine export
revenues rose 14 percent last quarter compared to the previous year. Wine exports reached a record $1.54 billion in 2015 and ICT exports have grown at 14 percent per annum over the last 6 years. So all these sectors are doing well, and export education is also doing well.

There were 27,900 people who came to New Zealand on student visas last year—almost a quarter of all our migrant arrivals. So our diversified economy delivered high GDP growth in the second half of 2015 than we expected in HYEFU and may push growth in 2016 up to around 2.5 percent, which is again higher than we forecast in HYEFU. So the economy isn’t sprinting ahead but no one’s is, nor is ours crawling along either.

Business surveys pointed to sustained activity levels and a rebound in business confidence in the December quarter. And while business confidence is building, is holding up, the latest unemployment rate has come down. As you know, unemployment’s dropped to 5.3 percent, which is the lowest rate for almost 7 years. Labour market statistics show the proportion of 15 to 24-year-olds not in education, employment, or training has fallen to 10.9 percent, which is the best result since September 2008, and for 15 to 19-year-olds results were the lowest on record at 6.5 percent. So I’ll finish on that note.

Robertson Thanks very much for that. In the half-yearly update what figure did you use for projecting future dairy prices, because, obviously, yourself and the Prime Minister have both highlighted that. What price were you using?

Makhlouf We anchor our forecasts on the FAO’s, Food and Agriculture Organisation’s, medium to long term forecasts, so I can’t remember what the precise number is, but that’s what we follow in our forecasts.

Cosgrove Have you done any risk mitigation under the scenario that says “OK well, the dairy prices are down” but if there’s a contraction in international consumption, if there’s a meltdown, like in Europe, that obviously will impact on the tourism dollar as consumption, you know, moves. Have you done any scenario planning on this?

Makhlouf The scenarios that we’ve put in—maybe we’ll ask Girol in a minute to comment on that. We’ve done a couple of scenarios in the HYEFU, which address some of that. They don’t go completely all the way. I mean, part of the work that we do do is think of the most realistic scenarios as we arrive at our central forecast. And it’s fair to say that certainly, I think, since, you know—the events since HYEFU this year have seen a lot of volatility, turmoil, and uncertainty around global financial markets, probably the most that we’ve seen in quite some time. So these are things that we pay close attention to but, Girol, do you want to say something about our scenarios?

Karacaoglu Well, we do look at what’s happening in the international environment with regard to commodity prices. We also look at what would happen if the immigration numbers were to adjust in a different way, and so we try to pick one positive, one negative scenario and we outline that in our forecasts. Those are based on the key judgments we’re making. We have a list of judgments and then we pick one or two of them and say: “What if these
ones were different?”. Typically, in most of our thinking, there would be a major international base for those scenarios. The other would be a domestic one. In recent times we put a lot of emphasis on dairy prices and commodity prices as well as what would happen to immigration flows one way or another.

Scott

Yeah, following on from that, you know we’ve had 20 percent decrease in equity markets over the last couple of months offshore. We’re starting to see some softening in the asset class of housing in New Zealand. All these things start eroding people’s confidence. So my question relates to how much weighting do you give—how have you moved your weighting to these negative scenarios? You’ve talked about weighting, you know, particular scenarios, “what if” scenarios—how have you changed your weighting in the last 2 or 3 months to account for some of these equity decreases in confidence inevitably as confidence decreases?

Makhlouf

We are starting the process of putting together our Budget forecasts, which is when we’re really going to take count of the sorts of issues that you’ve just mentioned. As I said in my opening statement, at the moment we are seeing that the impact of growth around the various sectors that I talked about is actually having a positive effect, compared to our HYEFU forecast for 2016. But clearly those events around the world will play a factor in our thinking—I mean, they’ll play a factor in determining what global growth numbers are going to be and how they’re going to impact us. And they’ll also play a factor in us developing our scenarios, which we’ll publish in the Budget.

I mean, the one thing I would say is that it would be too early today to start to come to conclusions as to what’s been happening over the past 6 weeks. There’s a lot going on and there are a number of different factors in play, and, I think, I personally would give it time before we, in New Zealand, would start to make conclusions—would start to come to conclusions—which would influence both our forecasts and the advice we would give to the Government. But certainly, what’s happening in the world, we need to pay very, very close attention to.

Robertson

Just to go back to the forecast, you know, the changes in forecast for revenue, and you’re talking about a $17 billion gap in the forecast, and the increasing debt levels. What’s the Treasury’s advice to the Minister of Finance about both what should be done, in terms of those debt levels, and when the repayment of debt should start?

Makhlouf

Well, our advice, essentially, backed up the Government’s decision, which is reflected in this Budget Policy Statement on the fiscal target framework that it has adopted. We would not recommend a reaction in the short term to fluctuations in revenue or spending. We would definitely recommend the adoption of a very prudent fiscal strategy, and a pretty rigorous approach to evaluating new spending measures and maintaining the, sort of, broad-based tax system that we’ve got. We think that arriving at the, sort of, debt to GDP ratios that the Government has been focused on is the right direction—in other words, we’ll need to move downwards—but we would
be cautious about reacting in the short term to sudden changes in some of those macroeconomic numbers.

Nash I think your point about China was very well made, in terms of, you can’t just look at it as one big country, but rather a number of small economies. But would you say the same is the case for New Zealand? For example, you know, you talk about certain growth trajectories, which is all very well, but then you mention the possible drought; we look at falling dairy prices; we look at the low lamb price; tourism’s doing well, but it’s by and large a minimum wage industry. So are you a little concerned about the Auckland economy and perhaps the Christchurch economy? And then the other side of the coin, about what’s going on in regional New Zealand?

Makhlouf You know, we’re seeing growth all over the place of different kinds. I mean, when I think about it, the Auckland economy at one level is the biggest economy in New Zealand, and we need to pay attention to it. But, when I think of Auckland, I’m worried about making sure that the housing market works well, for example. When I think of other parts of the country, you know, we focus on different things. I’m not sure I’d use the China analogy to New Zealand in the way I tried to explain it. But certainly, the Government itself has got—part of its Business Growth Agenda involves looking at regional economic development.

From our perspective, you know, New Zealanders’ living standards are as much about addressing issues of rapid economic growth in Auckland as making sure social investment decisions are effective in other parts of the country. So we pay attention to the whole of the country. But it would be fair to say that we focus on different things. But I would be—I don’t think we would say that some parts of the country are more important than other parts of the country.

Genter The Minister mentioned a $6 billion capital spend. Does that include new transport infrastructure projects that are funded under the National Land Transport Fund?

Makhlouf No, I think those—

Genter Those are additional?

Makhlouf Someone can correct me, but I think that’s over and above, those numbers.

Genter Do you think that given the importance of infrastructure investments in economic development, does the Treasury have a good oversight of the decisions being made on new capital spending by the New Zealand Transport Agency through the National Land Transport Fund?

Makhlouf Well, we’re satisfied with the framework that’s in place and the processes and rules that the NZTA adopt. There’s no reason for us, at the moment, to be concerned from what we’ve seen. Could a different system work? Yep, it could. Would it give us better oversight? I’m not sure necessarily it would. I mean, if we had concerns, we would be raising them with the Government.

Bayly You’ve mentioned the unemployment rate down from 6 to 5.3 in the NEET rate, which is all fantastic stuff. Were you surprised how quickly that
dropped? I suppose the counterfactual is you’ve got the high employment rate, extremely high, as my colleague mentioned before. But do you have any concerns that statistically there are issues with that? Or do you think this is—

Makhlouf: Look, I know the Minister himself said that particular survey has a tendency—I can’t remember the words he used, but I think he may have said “jumped about”.

Unidentified: Bounced.

Makhlouf: Bounced. Yeah, so we do, as I said a few minutes ago, we don’t make decisions based on, you know, particular events; we look at the pattern. Considering what we forecast in HYEFU, you’d be surprised if I didn’t say, but I am surprised at the drop in the unemployment number. But, on the other hand, that may be telling a story—that we do need to understand it better. But it may be reflecting the fact that in the second half of 2015 we have seen a pick up. I mean, I think to really understand what’s happening in those labour market numbers, I would encourage everybody to just take a bit of time, so that we can really get underneath the data and we see what happens in the next release. Do you want to add anything to that?

Karacaoglu: Just to point out, yes, we were surprised relative to our forecast, as the Secretary said. We watch two inputs into that closely: one is employment growth, which is quite pleasing, the other is the participation rate, where the surprise came from, I think, mainly.

Nash: Just back to what I was talking about before. I mean, do you have any concern about the health and well-being of regional economies? And by that I mean the risks around regional health and well-being are obviously substantially different than they are in Auckland, especially—you know, we have had a good summer, in terms of tourism. But as we head into winter, dairy prices are forecast to be low, lamb prices are low, there may be a drought that’s forecast in the Bay, where I’m from. Are you concerned about the health and well-being of the regions?

Makhlouf: We’re concerned about the health and well-being of all New Zealanders.

Nash: What I’m trying to say is the variables that control the health and well-being and Auckland and Christchurch are different than they are, for example for Hawke’s Bay.

Makhlouf: Correct.

Nash: Do you have any particular concerns of the regions over the health and well-being of Auckland or Christchurch? Or do you view them differently—would you just say: “OK, we’re just going to take a good look at New Zealand and that’s that.”

Makhlouf: No, what I said earlier—and I’m sorry if I wasn’t that clear—is that, well firstly, we are concerned with the health and well-being of all New Zealanders. I mean, the Treasury is focused on improving the living standards of all New Zealanders. But the issues that affect the economies and populations in Auckland—in parts of Auckland—will be different to...
other parts of the country. And we just need to make sure that we understand what’s happening in other parts of the country so that we feed that into both our overall economic forecasts, but also in the development of micro-policies, which we do with other agencies.

So, you know, whether it’s in the Bay—I was there last weekend; it’s a fabulous place—whether it’s in the Bay, whether it’s on the West Coast, whether it’s in Northland, the Treasury plays an active role working with MBIE and others to make sure that we understand the issues on the ground, and we’re supporting the best policy-making on the ground.

**conclusion of evidence**
Reserve Bank of New Zealand’s Monetary Policy Statement, March 2016

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
March 2016

Presented to the House of Representatives
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Reserve Bank of New Zealand’s Monetary Policy Statement, March 2016

Recommendation
The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, March 2016, and recommends that the House take note of its report.

Introduction
This report summarises the contents of the Reserve Bank’s monetary policy statement released on 10 March 2016, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

Official cash rate reduced
The monetary policy statement announced the decision of the Governor of the Reserve Bank to reduce the official cash rate (OCR) by 25 basis points—a quarter of one percent—to 2.25 percent. The Reserve Bank said that further easing of the OCR may be required to ensure that future inflation settles near the middle of the 1–3 percent target range. It emphasised that any future cuts will depend on emerging economic data.

The decision to cut the OCR surprised most market participants and commentators, who had expected no change until later in the year.

Main reasons for the Reserve Bank’s decision
A weaker outlook for global growth and falling inflation expectations were two of the key reasons cited by the Reserve Bank for its decision. It noted that the dairy sector is facing difficult challenges, but it expects New Zealand’s economic growth to continue being supported by strong inward migration, tourism, construction activity, and low interest rates.

The monetary policy statement notes many risks in the economic and financial outlook. Internationally, the outlook for global growth has deteriorated since the last statement in December because of weaker growth in China, other emerging markets, and Europe. Risks within New Zealand include weakness in the dairy sector, a decline in inflation expectations, and pressures in the housing market.

Headline inflation, as measured by the Consumers Price Index, remains low (an annual rate of 0.1 percent), mainly because of continued falls in the prices of oil and other imports. Core inflation, which excludes transitory price changes, is higher at an annual rate of 1.6 percent. The Reserve Bank expects headline inflation to increase in 2016, but to take longer than previously expected to reach the 1–3 percent target range.

The Reserve Bank is concerned that recent measures show a material decline in what people expect future inflation to be over the next 1 to 2 years. It sees a risk that lower

1 Prices fell 2.1 percent in 2015 for the tradeables basket measured by the CPI.
inflation expectations could be self-fulfilling. However, it says that long-run inflation expectations are “well anchored” at 2 percent—that is, in the middle of the target range.

The Reserve Bank considered that a reduction of the OCR is warranted. Stimulating the economy through lower interest rates will help its task of keeping future average inflation near the 2 percent midpoint of its target range.

**Future interest rates**

We asked for the governor’s comments on the prospects for further interest rate reductions. We note that the Reserve Bank’s projections envisage the 90-day bank bill rate reducing by 40 basis points between June 2016 and June 2017. We note that some economic forecasters envisage more dramatic reductions, with the ANZ suggesting that the OCR might be cut to 1.75 percent this year.

The governor emphasised that the Reserve Bank’s interest rate projections are highly conditional, and future decisions on the OCR will very much depend on economic circumstances. He said that the projections entail judgements about such things as the exchange rate and commodity prices, potential developments in the housing market, and migration trends, all of which involve huge uncertainties.

The governor said the Reserve Bank’s judgement at present is that two interest rate cuts might be needed to move inflation toward the 2 percent midpoint, of which it had just made one. However, he added that “it could be that we don’t need another cut or we could need more”.

**Growth and the scope for economic stimulus**

New Zealand’s historical GDP data has been revised, with growth now estimated to have been 4 percent in 2014—higher than previously thought—but followed by a slowdown in early 2015, with annual growth of just over 2 percent in the September 2015 quarter. The Reserve Bank projects average GDP growth of around 3 percent a year over the next two years.

Growth in New Zealand’s trading partners in 2015 was weaker than expected, and their projected growth has again been revised downward, with growth now expected to average 3.4 percent a year over the next three years. The OECD has recently reduced its forecasts for global growth, and we heard that IMF forecasts due in April are also likely to be lower.

**Monetary and fiscal stimulus**

We discussed New Zealand’s situation compared with that of other countries, and the scope for economic stimulus, if needed. We note that, with an OCR of 2.25 percent, New Zealand still has much more room to use monetary policy to stimulate the economy compared with several European countries and Japan, where interest rates are now below zero. The governor agreed, and said that there is also plenty of scope for fiscal stimulus, if needed, with the Government’s finances in balance and low net debt as a share of GDP.

The governor said that at this stage he does not think fiscal stimulus is needed in New Zealand, but if it were—for example, as the result of a dramatic slowdown in the global economy stemming from Europe or China—the Government should not hesitate to use it. He emphasised that there are limits to what monetary policy can achieve, and that both fiscal and monetary policy need to work together.
We recalled that at our last meeting in December, the governor had commented that more infrastructure spending by the Government would be helpful. Since then, he had indicated that he was happy about recently announced government funding for capital projects like the Auckland central rail link. Asked whether he felt such spending was a sufficient response, the governor said it is up to the Government to make such spending decisions. He added that the Reserve Bank is still concerned about the Auckland housing market and what could be done to ease bottlenecks there, and about the slowing of the economy as the effect of lower dairy prices worked through.

**Inflation expectations**

Expectations about future inflation are a key consideration for the Reserve Bank when setting monetary policy to target inflation.\(^2\) It uses 20 or so measures to gauge expectations. Recent measures show that inflation expectations about the next 1 to 2 years have declined materially. The Reserve Bank says this is of concern because there is a risk that low expectations could become self-fulfilling if they dampen wage- and price-setting behaviour, making it difficult to revert to the mid-point of the inflation target band.

We note that at this stage the Reserve Bank believes longer-term expectations are well anchored at around 2 percent, and that the reduction in the OCR should help to guard against this changing. We will watch developments in this area closely.

**Inflation-targeting and the Reserve Bank’s forecasts**

**Accuracy of inflation forecasts**

In a special section of the monetary policy statement,\(^3\) the Reserve Bank points out that forecasting inflation has been particularly challenging world-wide since the global financial crisis. A review of its accuracy and that of 12 other forecasters shows that all have over-predicted what New Zealand’s inflation rate would be, although the Reserve Bank has been slightly less inaccurate than others.

The review indicates that people have been placing more weight on recent low inflation in their price decisions. The Reserve Bank says it has adjusted its forecasts and models accordingly. It told us that it works continually to improve its forecasting based on what it learns, but in reality there will always be surprises and a need for adjustments.

**The inflation-targeting approach**

We asked how the Reserve Bank can be confident in continuing to forecast inflation returning to the mid-point of the target band, since this has persistently failed to occur. It explained that the Policy Targets Agreement requires it to formulate a plan to bring inflation back to the mid-point. Generally its plan entails altering the interest rate profile. The aim is to close the output gap—that is, to align the economy’s output with its productive potential. However, the bank noted that the world is a dynamic place with inevitable surprises and technological changes, so adjustments are continually needed.

The governor added that various structural factors in the world—including globalisation, technology, and demography—have been causing low inflation. In addition, New Zealand has been experiencing supply-side shocks from falling oil prices and dairy prices, and

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\(^2\) Inflation expectations are discussed in the Monetary Policy Statement (Box D, p. 28), and in the Reserve Bank’s Bulletin, Vol. 79, No. 4, March 2016.

\(^3\) Box A, p. 8.
changes in migration flows and labour force participation rates. Most of these factors put downward pressure on inflation.

The governor said he continues to believe that the inflation-targeting framework is still a highly effective one. He noted that 25 or more central banks around the world use such an approach, and none have proposed moving away from it.

**Challenges facing the dairy sector**

We discussed the implications of the current very low global milk prices—the result of strong global supply, disruption from Russian sanctions on imports from Europe, and slower Chinese demand. The recently announced forecast pay-out of $3.90 per kilogram of milk solids is well below the average break-even price for dairy farmers of $5.30, as estimated by the Reserve Bank and Dairy New Zealand.

The Reserve Bank said the situation is concerning because some dairy farmers are highly indebted. Total debt in the dairy sector is now about $38 billion, after a rapid increase from the 2002 level of about $10 billion. The debt is also highly concentrated, with roughly half owed by 20 percent of farmers.

We heard that about 4–5 percent of dairy lending is currently on the watch-list as potentially non-performing; this compares with about 10 percent during the global financial crisis. We asked whether the Reserve Bank has modelled potential movements in farm values, and the implications for dairy farmers’ debt. The Reserve Bank said it believes land values are about 10 percent below their peaks, but it is hard to make projections, in part because few farms change hands during periods of weak returns.

We note that the forecast pay-out is about 10 percent below the “severe scenario” discussed by the Reserve Bank in its November 2015 Financial Stability Report. Under that scenario, if a pay-out of around $4 continued for three seasons, it was expected that about 40 percent of dairy debt would be impaired and 10–15 percent would default. While such a result would be severe for the dairy sector, it would represent 1–1.6 percent of total private sector credit, and could be absorbed by the banking sector, which was well capitalised.

Since our meeting, the Reserve Bank has published the results of more recent stress-tests it carried out on the five largest lenders to the dairy sector. It again concluded that losses, although significant, would be manageable for the banking system as a whole.

As to how long current prices might continue, the Reserve Bank said its main scenario envisages the current low price of about US$1,970 a tonne lasting until September, before increasing gradually to US$3,200 a tonne by 2018. However, it said that the current supply situation is complex, given the trade distortion between Europe and Russia, so it is hard to forecast.

**The housing market**

The Reserve Bank continues to monitor Auckland’s housing market closely. It says that house price inflation in Auckland has moderated from an annual rate of 27 percent in late 2015 to about 14 percent now, but prices remain high and more supply is still needed. It says it is too soon to say that the problem is over. It notes that house prices are also escalating in some other regions, including Hamilton, Tauranga, the Bay of Plenty, Central Otago, and more recently Wellington. It will be assessing data from the Real Estate Institute of New Zealand carefully.

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We discussed the extent to which house-price inflation has been fuelled by property investors. We note that it is still too early to gauge the effect of recently introduced tax changes, but it appears that the Reserve Bank’s move to increase loan-to-value-ratio (LVR) requirements in Auckland has led to investor-driven price rises elsewhere.

The Reserve Bank said that investor activity was clearly a significant factor in Auckland. Its research indicated that 2 years ago investors accounted for about 33 percent of transactions in Auckland. This had jumped to 41 percent but was now about 38 percent, perhaps because of the LVR and tax measures. The governor agreed that investors had been a factor in prices rises in areas such as Hamilton and Tauranga, where they see scope for capital gains and rental returns. The Reserve Bank is not considering new macro-prudential measures.

**Policy approaches to avoid asset bubbles**

We note that central banks around the world have tried looser monetary policy and approaches such as quantitative easing in an effort to stimulate demand and growth. While this has not occurred, asset bubbles have emerged as seen in the Auckland property market. We asked what scope the Reserve Bank sees for governments, in New Zealand and elsewhere, to consider other policy tools to limit asset bubbles and move investment into productive areas of the economy.

The governor said that bubbles in various markets—for property, bonds, and equities—have been a corollary of the monetary stimulus and other unorthodox approaches that have been tried around the world in recent years. He sees legitimate scope for discussion about what governments can do, whether about the scope for fiscal expansion in Europe, or about policies to encourage structural adjustments and reduce bottlenecks in property markets, such as those arising from regulation or the movement of factors of production.

As to whether tighter banking regulation might help, the governor observed that regulatory controls on banks have been increased substantially in recent years. This appears to have made banks more cautious, so there is now a curious situation where liquidity has been diminishing in markets that support transactions, despite the huge injection of liquidity by central banks. He said that this is concerning, and sees a tension between promoting financial stability while not constraining financial market efficiency.

**Policy Targets Agreement**

We raised the issue of whether the Reserve Bank’s mandate should be adjusted to include asset prices among the factors it must take into account in formulating monetary policy. The Reserve Bank said that asset prices are tremendously difficult to forecast, so it would be setting an impossible task. It said it does not know of any central bank that has asset prices built into its contractual agreement.

**Oil prices**

We note that the Reserve Bank forecasts a sharp rise in tradables inflation over the medium term, and questioned how likely this is given the continuing weakness in commodity prices.

The governor said the expectation is that commodity prices will pick up over time, causing inflationary pressures to start building, albeit slowly. He pointed out that oil prices have increased quite substantially in recent weeks, from about $25 a barrel to $41. As to whether this rise would continue, he outlined some of the current dynamics in the market, which he
described as “hugely challenging”. In his view, a lot would depend on the disciplines within OPEC. World demand for oil continues to increase, he noted.

The exchange rate

The Reserve Bank notes that the trade-weighted exchange rate is about 5 percent higher than it had projected in December. It continues to believe that a decline would be appropriate in view of the weakness in export prices.

Retail banks’ funding costs and interest rate margins

Increased volatility in international financial markets has led to some increase in the offshore funding costs faced by New Zealand banks. However, the Reserve Bank says that at this stage the effect has been mild, because banks have been able to meet most of their credit expansion from domestic deposits, which continue to grow strongly.

As to whether banks would pass on the full amount of the OCR reduction, the Reserve Bank said it expects to see floating rates fall by the full 25 basis points. Fixed interest rates depend on various factors, but it expects the bulk of the reduction to be passed on.

The Reserve Bank’s decision-making framework

Since inflation has persistently turned out to be lower than predicted, we asked whether, with hindsight, the Reserve Bank thinks it had been wrong in deciding to increase the OCR as it did in 2010 and 2014. The governor said the bank has to use the information it has at any point in time to make judgements about how the economy might evolve over the next 12 to 24 months. He was satisfied that it had made reasonable decisions on the basis of the information it had at the time.

We asked whether moving to a committee structure for decision-making, like that used by the Reserve Bank of Australia, might lead to more accuracy. The governor said he sees several advantages in New Zealand’s approach.

He pointed out that although New Zealand’s legislation specifies the governor as the single decision-maker, the process leading up to monetary policy decisions involves a group of 13, including the deputy and assistant governors and two outsiders. Every decision taken on the OCR had accorded with the majority view of that group. He also noted that the Reserve Bank engages frequently with businesses and private sector forecasters around the country. The Australian approach involved a wider group of outsiders, but they only met monthly for a short time to make the monetary policy decisions. He said he views monetary policy formulation as an intense full-time job, so such an approach did not appeal to him.

Reserve Bank’s resources

We asked whether the Reserve Bank believes it is adequately funded to undertake the important analysis required for its role. The governor said that more resources and capability would be helpful. He noted that the bank operates under a tight 5-year funding agreement which allows a 1.2 percent annual increase, and it had recently made 18 of its 250 staff redundant.
Appendix A

Committee procedure
We met on 10 and 30 March 2016 to consider the monetary policy statement. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Shamubeel Eaqub.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Transcript of hearing on 10 March 2016

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour

Witnesses
Reserve Bank of New Zealand:
Graeme Wheeler, Governor
Bernard Hodgetts, Head of Macro Financial Department
Dr John McDermott, Assistant Governor and Head of Economics

Bennett Welcome to the committee. Welcome to your team as well and if you want to give a brief introduction then we'll have questions.

Wheeler Thank you, Mr Chair. I will try and be brief. [Introductions] As you know, the Reserve Bank reduced the official cash rate to 2.25 percent. The outlook for global growth has deteriorated since the December Monetary Policy Statement, due to weaker growth in China, other emerging markets, and Europe. Domestically, the dairy sector faces difficult challenges, but economic growth is expected to be supported by strong inward migration, tourism, construction activity, and accommodative monetary policy.

The trade-weighted exchange rate is about 5 percent higher than projected in December, and a decline would be appropriate, given the weakness in export prices.

House price inflation in Auckland has moderated in recent months, but house prices remain at high levels and additional housing supply is needed. Housing market pressures have been building in some other regions.

While long-run inflation expectations are well anchored, at 2 percent, there has been a material decline in a range of inflation expectations measures. This is a concern because it increases the risk that the decline in expectations becomes self-fulfilling and subdues further inflation outcomes.

Headline inflation is expected to move higher over 2016, but take longer to reach the target range. Monetary policy will continue to be accommodative,
and further policy easing may be required to ensure that future average inflation settles near the middle of the target range, and we will continue to watch closely the emerging flow of economic data. So thanks very much, Mr Chairman.

Robertson Thank you, Governor. Just to pick up off the final point that you made there, about further accommodative monetary policy, ANZ are now forecasting that you’ll go down to 1.75 percent at some point this year. Would you like to comment on that, or, I guess to rephrase the question another way, how low do you go?

Wheeler I think it very much depends on economic circumstances. You know, we put out conditional projections. I mean, they are highly conditional. You can imagine the sorts of assumptions that go into them, assumptions about the exchange rate, about commodity prices, about what’s happening in the housing market, what’s happening to migration—so there’s huge uncertainties around a lot of these things. But we, basically, put together a set of interest rate projections that we think will help, basically, move or reduce the output gap, if you like, the extent to which there’s spare capacity in the economy, and therefore build up inflation pressures. So what is the monetary policy response, given all the uncertainties that are required to move inflation towards the 2 percent.

So the judgment we made was that we felt that two interest rate cuts might be needed. We made one of them today. Now, whether we need another cut, or whether we need more than another cut, will very much depend on the data, particularly around those sorts of things that are important that I mentioned in terms of the assumptions we make.

Robertson So that’s effectively not ruling out the potential for actually more than another cut?

Wheeler Well, it could be that we don’t need another cut or we could need more.

Robertson Because I think, you know, obviously if we look towards Europe and we can see that the trend has been to keep going and keep going and keep going, and in fact go below zero, I presume that’s not a scenario that you see in New Zealand. Obviously we’ve got a lot more headroom before we get to that point.

Wheeler If you look at Europe, you’ve now got the Central Bank of Switzerland, Sweden, Denmark, the European Central Bank, and now you’ve got the Bank of Japan with negative interest rates. In Europe their growth has been a lot slower than it has been in the US, and the US is not experiencing a strong recovery, by any means, but I think part of the difference between Europe and the US has been that in Europe you didn’t see the fiscal stimulus that you saw in the US. After the GFC, I think in about 2008, 2009, you saw a fiscal stimulus of about 7 percent of GDP. In Europe they actually tightened fiscal policy. Given the challenges of high unemployment in Europe, there’s been a reluctance of Governments, given electoral considerations, to make the structured adjustment policies that are needed.
Robertson: On that point, what happens to the forward track if there isn’t matching fiscal stimulus here in New Zealand?

Wheeler: Let me put it this way. If the economy got into real trouble here, if we talked about the possibility of a recession, you would sort of say: “Well, what would cause it?” It’s probably something that’s triggered offshore. You’ve seen the OECD reduce the growth forecasts for global growth recently. It’s quite likely the IMF will do that—in April, would be my guess. But if the global economy really started to slow dramatically, it’s probably something that’s coming out of either Europe or China, and that would have significant impact on us.

We’ve got scope, given that the official cash rate is at 2.25 percent, the Government has got fiscal balance, it’s got low net debt as a share of GDP, so it’s got plenty of fiscal space if it really needed to use it.

Robertson: Do you think it needs to use it?

Wheeler: At this point I’d say no, but if it did then it shouldn’t hesitate to use it, because there’s limits to what fiscal policy can do, and the last thing you want to do is exhaust all your degrees of freedom in the central bank and then sort of say: “Well, now we’ll turn to fiscal policy.” It can’t work like that.

Robertson: Indeed. I mean, the two have to work together. You said today that you were happy about the spending, subsequent to your last comment when you came here. Do you see that as a sufficient response?

Wheeler: It’s really for the Government to decide. We were concerned about, and are still concerned about, the Auckland housing market and are there things that could have been done to try and reduce some of the bottlenecks in the Auckland housing market. We’re also looking at an economy that, in the first half of 2015, was slowing quite a bit, as the dairy price effect was working through.

Robertson: On that point, and Mr Chair will wind me up shortly, around dairy, I listened to what you said in the press conference around non-performing loans and the consequences of what that can mean. Do you have a figure around what percentage of loans are on the watch-list?

Hodgetts: During the GFC, watch-list loans were considerably higher, as a share of the portfolio. I think they were up over 10 percent.

Robertson: What’s the comparison from that to, say, the GFC period?

Hodgetts: It’s around about 4 to 5 percent at present, so it’s been climbing. It’s certainly higher than the estimates of non-performing loans in dairy. But that’s a fairly familiar pattern—that the watch-lists lead the non-performing loans.

Robertson: And then the trend then carried through from there?

Hodgetts: The watch-list loans improved after the GFC, once dairy prices turned around, and it’s just been more recently that they’ve turned up again.

Robertson: Let me see if Bernard does, on that.

Hodgetts: It’s around about 4 to 5 percent at present, so it’s been climbing. It’s certainly higher than the estimates of non-performing loans in dairy. But that’s a fairly familiar pattern—that the watch-lists lead the non-performing loans.
Robertson Because obviously the concern is that—you’ve heard in recent days and your severe scenario is in fact 10c above where the payout is. There’s been a lot of commentary about that. What do you think that will mean in terms of—or have you forecast in what that means in terms of land values and then how that flows to the debt issues out of that?

Wheeler I think the worry is, you know you’ve got $38 billion of dairy debt and it has increased, I think from memory, from about $10 billion in about 2002, 2003. So it’s been a very rapid increase. Roughly half of that dairy debt, roughly half, is owned by 20 percent of the farmers. So there’s some highly indebted dairy farmers out there. If you sort of say well, look the break-even point, in terms of the work that Dairy New Zealand and we have done, is I think about $5.30 or thereabouts for the average dairy farmer, then that’s a concern.

The stress scenario basically said: what if the current prices, around $4, stay there for the next three seasons? We then assume that farm prices would fall by around 40 percent. So if you got into a situation where you’ve got negative cash flow for such a long period, the collateral or the farmer’s values are falling significantly, then that’s a worrying situation.

Robertson Have you done any specific work around the land value question and what that means?

Hodgetts We’ve certainly looked at the typical behaviour of land prices during a period of low dairy returns. Clearly this is a somewhat unique episode, compared to what we’ve seen in recent history, so it’s very difficult to sort of make predictions about how far prices might decline. I mean, at the moment we believe prices are around about 10 percent from their peaks, but of course it’s early days. I guess one of the points to make is that the dairy land market tends to become quite illiquid during a period of weak returns, and so there’s not actually a lot of property changing hands, so it’s actually very hard to establish where values are actually going to.

Robertson A lot of the forecasting relies on, for instance, production in Europe going back to the levels that it has, but actually recent indications are that that might not be the case. I think you would agree that it’s a realistic scenario, that we are looking at 3 years, around $4 or under.

Wheeler I’m not sure that we would see that as our main scenario. If you look at our forecasts, they basically assume that the current price for whole milk powder, which is about, what, US$1,970 a metric tonne, stay there until September and then they increase gradually to US$3,200 a tonne by 2018. If you look at what’s happening internationally, milk supplies increased by about 1 percent over the last year in the US, but by about 6 percent in Europe—a lot of it coming out of Ireland, a lot of it coming out of the Netherlands and Denmark. But that, combined with the trade distortion or the trade diversion, given that Europe, I think, provided about 20 percent of its dairy exports into Russia, has complicated the situation. So you then look at what’s happening to farm-gate prices, and they haven’t adjusted in
Europe like they have in Australia and New Zealand, so it’s a very tricky situation.

Robertson

Just one last one from me, which is on a different topic, on housing. Looking at the commentary here, it’s quite clear you’re not that certain about the assumptions that you’re making about what’s happening particularly in the Auckland housing market, in terms of both what’s going to happen and the impact of what you’re doing today.

Wheeler

When we look at house price pressures in the Auckland market we tend to look at what’s happened over the last 3 months, over the same period a year before, and we look at a stratified index produced by REINZ, which tries to quality-adjust, so that you’re making sort of reasonable comparisons. Something from one month to the next month, with different compositional effects, doesn’t tell you, I think, a lot. That was showing house price inflation at 27 percent in Auckland in September. It’s now down to 14 percent. We’ll get the REINZ’s data for February I think on Friday. It’s often out just before this meeting, I notice. We will be very interested to see what that says. So the data in the last 2 or 3 months is reasonably encouraging, but it’s too early to say that this problem is over.

Robertson

And the impact in terms of other cities and regions—I mean, there are, I guess, what would be concerning trends there. Are you concerned about this spreading to other regions?

Wheeler

If you look at the house price to income ratios for Auckland, that ratio at this point is about 8.5, which makes it one of the most expensive cities in the world on that ratio. For the rest of the country it’s about 5.1, so it’s 70 percent lower than—Auckland is 70 percent higher than the average for the rest of the country. So there’s more scope for adjustment outside of Auckland but, having said that, you are seeing a lot of pressures in Hamilton, Tauranga, the Bay of Plenty, Wellington is starting up a little bit at this point, Central Otago. So it’s things that—we’ve certainly got to watch it and see how that develops.

Bishop

Thank you very much, Governor. You’ve consistently forecast inflation returning to the mid-point target bands, and consistently that hasn’t happened. What gives you the confidence—what’s changed to give you the confidence to project that today?

McDermott

The Monetary Policy Statement is always about forming a plan to get inflation back to the mid-point. So we’re required to show that, and then reveal how we’re going to do it. So it will always be the case, under the current regime, that we forecast inflation to get back to 2 percent, otherwise we’d be failing in our task. So the issue is what moves around, to try to achieve that. Often it’s the interest rate. So we’re altering the interest rate profile, so as we consistently get back.

If nothing happens and the plan looks like it’s going to work out, you keep to it. But if you get surprised or the international developments come in, in a more adverse way, then you consistently have to alter that plan and revise it, and communicate that to the markets, so that you can, some time in the
future, get back to 2 percent inflation. So that’s the framework that we operate under.

Bishop Do you think we get to a point somewhere where cutting the OCR makes no difference to the inflationary outcomes?

McDermott No.

Bishop Is there any—[ Interruption] It’s a fair question in light of the world—

Wheeler I think it is certainly a reasonable question. If you look internationally, there’s certainly some structural factors that are causing low inflation, and they’re linked into globalisation, they’re linked into technology, and they’re linked into demography. And then you look at what are—they’re all supply side effects. So you also say, well what are the supply side shocks, in addition to those, that are affecting New Zealand? You see that oil prices have been falling, dairy prices have been falling, there’s the migration shock, there’s the labour force participation shocks. You’re seeing all those factors operating, and most of them would have downward pressure on inflation.

That then leads to a question: well, is your framework for dealing with monetary policy and price stability the right one? And then you see, well, OK, of the inflation targeters in the world, and there’s about 25 leading central banks who are inflation targeters, have any of them abandoned that framework? None, that I’m aware of, have moved away from that framework. None, that I’m aware of, have reduced its inflation target or its inflation goal in any way. They’ve all stuck to a framework which is the one that we have, in essence, that inflation targeters have, which is—and it’s really just what John has said—can monetary policy change the output gap in an economy?

The output gap is, basically, what is the level of output at any point in time—the actual level of output—and what is the level of output consistent with productive potential? In essence, monetary policy is trying to change that gap, because it’s an indicator of the degree of excess capacity or otherwise in the economy. So when you get to a situation when that output gap closes, you’re basically at a point where you don’t have excess capacity in the economy and that’s when inflation pressures start to build up, once you go to a positive output gap. That’s the heart of the framework of inflation targeting, and we believe that that’s still a highly effective framework, and no other central bank that we’re aware of has moved away from it.

Governor, I might be able to anticipate the answer to this question, but nevertheless, if you, in hindsight, look at the last two rounds of hiking, do you believe you got it wrong or, to put it another way, do you believe you executed the highest quality of decision making?

Wheeler I think, you know, inflation expectations have fallen in many countries. They’ve fallen in the USA, they’ve fallen in several European countries, and we’re in a situation where we’ve got low headline inflation, primarily because of what has been happening to commodity prices and what’s been happening with offshore inflation rates. So we have got low headline
inflation and we have core inflation—which is basically what is the trend rate of inflation once you take out one-off disturbances—running at about 1.6 percent, which is pretty well within the target range.

We make judgments on the basis of the information that we have at any point in time. We’re trying to make judgments about how the economy might evolve in the next 12 to 24 months. We can’t see into the future, and we have critical assumptions that we have to make about the exchange rate, about commodity prices, about migration, about the housing market and all of that. Am I satisfied that on the basis of the information that we had at the time that we’ve made reasonable decisions? I believe that’s the case.

Cosgrove Do you think, given that, that the forecasting, if you like, would have a higher quality or a higher degree of accuracy if you moved to a committee structure of decision making like the Reserve Bank of Australia?

Wheeler Let me just cover how our framework operates—how we do the forecasting. We do something like the best part of up to 200 visits around the country visiting firms, so there’s a lot of engagement outside; there’s a lot of engagement with private sector forecasters and all of that. When it comes to the actual decision, the decision that’s taken—even though under the legislation you have a single decision-maker—we actually operate through a governing committee, so we have the four governors involved. Now, there are 13 people, which includes the three other governors other than myself, who are giving advice to the governing committee. So there are 13 people giving monetary police advice. Every decision that’s been taken—and this one is no exception—has always been on the basis of the majority view of those 13 people. It includes two outsiders, by the way.

Cosgrove I suppose the last point you made is the point that I was trying to make. You have a high degree of internals, I understand, and the process works. But you’d understand the Australian model has a higher degree of—if you like—outsiders who have input into that decision making, rather than—

Wheeler Let me maybe correct that, if I could. The Australian model is, I think, a fairly unusual one in the sense that they make a monetary policy decision every month, on the first Tuesday of the month, which is fine—we make ours every 6 weeks; they make them every month. They take the forecasts that are produced by the staff of the RBA, and then they have a committee that comes together that comprises the governor and, I think, the deputy, and maybe some other people internally within the bank—but I think it’s pretty limited. And then you have a number of outside people coming together to make that policy decision. In essence they are coming together for a board meeting. They may be chief executives or chairs of boards of other companies, and they come together and make a monetary policy decision.

Now, the benefits of our framework are (1) we have a lot of contact with the outside; (2) we have some outsiders involved in the process; but (3) making monetary policy decisions is a full-time job. You have to live with these decisions—you have to sweat over them, you have to think very
deeply. I don’t think having a framework that has people coming together for a relatively short period of time is the model that would appeal to me.

Bayly
First of all, Governor, congratulations. I think it is a great thing that you have done today, and, personally, I think it was the right decision to make. Just in terms of headline inflation, rates have been persistently below your expectation over a number of years. Given the possibility of that new norm, I was wondering, first of all, are you now looking at adjusting your modelling of inflation to take in that new reality, and whether, in fact, you are going to make any findings around that public? And, secondly, you’ve always maintained to us at this committee that underlying core inflation is your peak driver and maintaining that over the long term is your key driver. Again, do you publish details around how you calculate that peak core inflation so we can get a better understanding of how you calculate that?

Wheeler
Let me hand you over to John. I think I covered a fair bit on the framework that we have involving output gaps and the modelling that lies behind it, but let me see if John wants to add anything and we can come back to the core inflation.

McDermott
There are a range of issues. You are certainly right, it has been a difficult period to forecast inflation—for everybody. If you look on page 8 of the document we actually show you a sort of performance list that shows that nobody has been able to grasp what’s been going on. Everybody’s basically over-forecast the outcomes. We always believed that we were very transparent and very clear about what we are trying to achieve—to the point that we were one of the first to actually highlight the errors that were being made, quite publicly. The reason for doing that is so we’d learn and adjust the frameworks we have internally. You can imagine that those models go under severe peer reviews before we make them public, because they are going to be shared quite widely. We are doing a lot of work on that front, and when we’re convinced we’ve learnt what we need to learn and if the new models are robust we will definitely publish them.

Bennett
Just on that, with the lower-inflation environment, and you’re saying you go for the mid-point—that’s where you’re targeting to—the settings that we have, because that was increased a few years ago, is that a problem now? Or should we have a lower range for you to, actually, go for a mid-point in?

McDermott
So the settings for the inflation target?

Bennett
Is 3 too high now?

McDermott
It’s not something, actually, that’s under our control. The target is set, you know, it’s agreed in the policy targets agreement, and then we have the independence to achieve that. And it is very clear and transparent and the public of New Zealand probably expect that. And that is generally a good framework. It has been true that New Zealand has moved its target from time to time—it’s generally been upwards—and every time that happens you get a pretty immediate response from your inflation expectations. So you get very little benefit in terms of extra output growth or anything in the
real economy. What you do is simply move inflation upwards permanently, and you just tend to lock that in. So that’s what tends to happen.

Bayly: Just going back to my first question—with the models you’ve now got—if you’d put in process the assumptions that we now know are reality and led to inflation of 0.1 of a percent, would your models have shown that same result?

McDermott: So had we known what we know now and gone back in history and used those improved models, would they have been better? Absolutely—but that’s kind of cheating.

Bayly: But the point is, going forward, you are relying on the model to calculate inflation. Every time you come in here we ask you about inflation—and I’ve asked this question every time you’ve been in here. And you’ve always given me a view that underlying inflation is higher, it’s going to improve, and all that sort of stuff. And, persistently, it’s been below your expectation over a long period of time. So my question is, using the models going forward, because next time you come in here you’ll be doing the same thing—my question is: taking into account what you now know and what the world knows, and you’ve made the point that everyone else has been getting it wrong, how do we make sure that the model going forward is a more accurate reflection not only of headline inflation but, my second point, around underlying inflation, or core inflation, I should say?

McDermott: It’s a reasonable and fair question. We will always try to use the model that we think will be unbiased and will deliver a true reflection of what the future will hold. We’ll try and incorporate learnings that we have. That’s what we always try to do.

But the world is an interesting and dynamic place, and inevitably there will be some irreducible uncertainty, there will be surprises in the future—there always is—and whether that’s coming from the international scene or changes in the structure of the domestic economy, even changes in technology about how people price, or pass on prices, and so you’re always having to revise your frameworks to take into account new technology or surprises from offshore. And that’s the reality.

Wheeler: An example of that would be embedded in this model is the Phillips curve relationship, which is a relationship between the rate of growth of inflation and the relationship with unemployment. If, for example, you find that some of the wage outcomes reflect adaptive expectations—in other words, to the extent that wage-bargaining outcomes reflect past low inflation as opposed to expectations of future inflation—then you would want to think about those wage equations, and that’s the sort of thing that we do.

On the second question, on core inflation, there’s several measures of underlying inflation. We publish a summary of them in Table 4.1 in the Monetary Policy Statement. We’ve done that for a long time. Core inflation is running, at this point, at 1.6 percent. It’s a bit like the situation in the US. You’ve got very low headline inflation but their core PCE, which is your
private consumption expenditure deflator, is 1.7 percent—low headline—but that's the underlying inflation.

We put some weight on the factor model—what we call a sectoral model. We've published papers on that and how it works. They're available on the website, and things like that.

It seems to me, and let me know if you think this is fair, that globally the central banks have tried to use loosening monetary policy and quantitative easing to stimulate demand and growth, and that hasn't happened as expected, but at the same time we have seen increasing asset bubbles, like the Auckland property market. What role do you think there is, specifically in New Zealand but maybe globally as well, for Governments to be looking at other policy tools, to limit these debt-fuelled asset bubbles and get investment in the productive areas of the economy?

I think it's a really good question. I mean, you've seen—as I said, you've got a number of central banks now with negative interest rates. Some of them are also applying quantitative easing—certainly the European Central Bank, the Bank of Japan, the Riksbank are doing quantitative easing. Some have done forward guidance, where they try and basically say to the market “Look, this is our expectation of interest rates.”, where it goes further and says: “Here's an actual commitment. This is how we're thinking about rates. That may be state contingent. If something happens, then we might change that view or it might be time contingent. This is how we see it, up to this point in time.” So there's been a lot of fairly unorthodox monetary approaches, if you like.

One corollary of all that monetary stimulus is that you have seen asset bubbles, not just in property. You've seen it in the bond market, you've seen it in equity markets, you've seen a huge contraction in credit spreads between emerging market debt and, say, advanced country sovereign bonds and also in respect of corporate debt. It’s widened out substantially now, but it did contract a great deal.

So is there scope for things that can support monetary policy? Certainly, fiscal policy in Europe, I think there was still an issue of: is there scope for more fiscal expansion in Europe? I think it's a legitimate debate. Is there scope for more structural adjustment policy that can help remove bottlenecks, or reduce them around the property market, that may be linked to regulation, or factor or product movements, and things like that? Certainly. I agree that's important.

Tougher banking regulations? Do you think that's something we could be looking at?

You've seen, through the Basel communities, quite a substantial increase in bank regulation, both in terms of capital requirements, both in terms of liquidity support that's required. One of the things that's happening—it's quite an issue—in essence is that liquidity in markets that supports transactions is diminishing quite substantially.
You sort of say: why is that, when there’s such huge monetary accommodation being injected by central banks? It’s partly because the regulatory approach has been—the banks would argue, at least—pretty substantial around proprietary trading, about the separation of activities within banking processes, that banks feel that they no longer want to be as actively involved in deal-making. They are less willing to inventory positions and to warehouse them, and so liquidity in markets is starting to diminish in quite a lot of asset classes, and that’s quite a concern. So there is an issue about financial market efficiency on the one hand, and financial stability on the other. It can end up diminishing liquidity in market-making activity.

Genter

Coming back to the housing market in Auckland, I am curious, after you increased the LVRs for investors in Auckland, we almost immediately saw prices jump up around the rest of the country. So while there’s a lot of talk of there being a shortage of supply, and I don’t contest that there may be, and particularly in the future in Auckland, if net migration keeps up, it seems like there’s still a big role of investors driving up house prices in New Zealand.

I know we don’t yet know what the impact of the Government’s brightline test is, but is it fair to say that reaction to the increased LVRs in Auckland for investors may have resulted in more property investment going elsewhere in the country, suggesting that maybe we do need to go further to ensure that our tax treatment is fair and not stimulating more property investment, as opposed to investment in other areas of the economy?

Wheeler

I think investor activity was certainly a significant factor in the Auckland market. I mean, 2 years ago—we’ve done quite a lot of research on the role of investors in the market. Two years ago investors accounted for, I think, 33 percent of transactions in the Auckland market. It jumped up to 41 percent, and now, at the moment, and it may be linked to these measures, it’s down to about 38 percent in the Auckland market.

But have investors basically said: “Look, property price appreciation may be going to slow in Auckland, and is there scope for further capital gains elsewhere, in higher rental returns?” Has that driven part of the Hamilton market and the Tauranga market? Yes, I think it has. I think that has been a factor.

Genter

One final question. You mention in the report that there’s a risk of our overseas creditors having higher cost of capital and passing that on to New Zealand. How likely do you think that risk is?

Hodgetts

Well, we have seen some increase in bank offshore funding costs this year, as a result of the volatility that we’ve been seeing in markets. But you’ve got to remember that banks are only raising a relatively small share of their funding from overseas, at this point in time. They’re continuing to see very strong deposit growth. So most of the credit expansion that’s going on is being funded through deposits. The need to go to offshore markets has been relatively—you know, there hasn’t been a great need to raise a lot of funding.
Clearly, if the upturn in international funding costs was to persist, then it would start to have more of an impact on banks’ funding costs, but I think at the moment the effects have been relatively mild.

Scott

My question relates to hockey stick-shaped curves and the weaker world that you described, and the expectation that the world will be weaker, since December. In fact, you say yourself that the financial markets are expecting a weaker world than your own projections. How do you reconcile that with the hockey stick-shaped curve of your tradables’ inflation, which is going to get you to 2 percent in the medium to long term?

Wheeler

I think—you know, are there a lot of risks around the global economy, in terms of output growth? Yes, in terms of the developing countries you’ve seen Brazil in recession, you’ve seen Russia in recession, you’ve seen growth slowing in China—question mark about how fast it’s slowing—you’ve seen concerns in Europe about slower growth and weaker inflation. So you put all that together and you say, well, that, combined with very slow growth in world trade, doesn’t look a particularly great prospect.

But there are views that underlying inflation—there are mixed views about this, but you’re starting to see stories that inflation in the US, underlying inflation, is starting to pick up. You’ve seen commodity prices in the last couple of weeks have picked up quite significantly. You’ve seen oil move from about $25 or $26 a barrel, to around $41 today, if you’re looking at Brent crude. You’ve seen a big movement in the iron ore price. So there is an expectation that commodity prices will pick up over time and inflationary pressures will start to build, albeit slowly.

Scott

So that was my next question. This rise in the commodity, particularly oil, price—a significant percentage increase from its lows—what’s your view? Is that sustainable or is it just a blip and we’re going to get back down to 30 bucks a barrel?

Wheeler

It’s very hard to say. I mean, if you look at the rig count in the US, it’s fallen by about 75 percent since—over the last 2 years or thereabouts. So it’s a very significant reduction. You’ve seen credit spreads for a lot of the fracking industry increase quite substantially.

A lot depends on OPEC and the disciplines in OPEC and what sorts of deals are put together with the non-OPEC countries. The Saudis indicated, basically in the middle of 2014, that they wanted to hold daily production at 30 million barrels a day, given that global production is about 95 million barrels a day, so OPEC is only about a third of the market, but they are an important producer and they’ve become, in the past, the swing producer, right? So that’s when the non-OPEC countries start increasing production and there’s an oversupply, the OPEC countries have always cut production. The Saudis, who dominate OPEC, basically said: “Look, we’re not going to be the swing producer because prices don’t go down because the non-OPEC producers don’t make any adjustment.” They said: “We’ll hold production at 30 million barrels a day.”, and that’s what caused the price to start moving down very rapidly, in around the middle and late 2014.
What’s happened is OPEC hasn’t been able to control the cartel, and so they’ve had several meetings where they haven’t agreed on 30 million barrels a day of production. Production has gone up to about 32 million barrels a day. I think 11 of the 13 countries are producing above their normal levels.

So the future of oil prices partly depends upon the disciplines in OPEC and what happens with the Saudi production, what happens with Iraq and Iran to some degree, because they’re big producers. Then the Saudis have reached an agreement with the Russians—the three biggest producers in the world are Saudi, Russia, and America. They’ve reached an agreement with the Russians to hold production, but they’re holding it at the January levels, which are very high.

So that’s the dynamics that are operating here. The Russians are in a bad situation, in terms of their fiscal position, in terms of recession, but they’ve agreed to hold production, as have the Saudis. So that’s all the dynamics that are at play around this market. They’re hugely challenging. Now, is demand for oil increasing? Yes, it is. It’s still increasing.

Nash Bearing in mind a couple of the large banks’ share price falls recently, do you expect that this cut will be fully passed on to businesses and households, or do you think that the banks will use this cut as an opportunity to increase their margins?

Hodgetts I would expect to see the bulk of it passed on, and I think there’s already, this morning, some examples of that happening.

Nash Has the bulk of it passed on?

Hodgetts Well, I don’t have a particular figure in mind.

Wheeler Certainly you’d expect the floating rates to come down 25 basis points, and the fixed will depend on a lot of factors but one would expect that most of that would be passed on.

Nash One last question. You talk about uncertainty quite a bit. But your role is to make sense of uncertainty, right?

Wheeler Try to.

Nash So you say you make judgments on information. So my question is, and it’s sort of a supplementary to Andrew Bayly’s question, do you believe that you have the resources and the capacity to undertake the level of analysis required to make sound decisions? After all, your decisions do have a significant impact on the New Zealand economy.

Wheeler That’s a very good question. The bank has very broad responsibilities, and it is essentially 250 colleagues. We do have a tight 5-year funding agreement that basically builds in inflation, builds in an increase of 1.2 percent a year for 5 years. We have had to make about 18 positions redundant. Would it be helpful to have more resources, more capability? Yes, I believe it would.

Seymour It seems that, at least informally, asset prices, for example in the housing market, are part of your calculation for setting the OCR. I just wonder,
given everything that we’ve discussed today, if it’s not time to formalise that arrangement and have those asset prices as part of your targeting, or a factor that you target?

Wheeler It’s very hard to—I don’t know of any central bank that has targets for asset prices built into any contractual arrangements. I will ask John to comment. But asset prices are just tremendously difficult to forecast at any point in time. There’s a whole lot of supply and demand factors and regulatory issues that affect them. They will be affected by overseas flows, capital movements. I think trying to have a policy targets agreement embedding asset prices would be too difficult. Let me see if John has a different view.

Cosgrove That would be dangerous.

Wheeler He’s allowed to have a different view, by the way.

McDermott I appreciate that. Some of the key points, when you’re thinking about asset prices, well, monetary policy will clearly have an influence on those asset prices. We’re actually thinking about monetary policy and interest rates impacting on real activity, the flows in activity in particular and its impact on the net balance between demand and supply within the economy, so it directly moves to inflation—and you can form the link. We’ve got some 25 years of experience, and it’s never perfect, and there’s lots of uncertainty, but 25 years of experience of linking monetary policy, ultimately through the economy, to inflation.

If you added asset prices into that, boy the change in the regulatory regime, the loan-to-value ratios, the different capital requirements, the international standards, rating agencies, banks’ profit margins, would all come into play, all of which we would have little direct control over. So you would be delivering the institution with a target it couldn’t achieve. So that would be the problem.

Seymour None the less, you continue doing it informally.

McDermott You have to manage the risk, but that’s a different proposition than trying to hit a numerical target for asset prices. We set that standard when we talk about inflation, which is actually a little bit more than in the past, where the central banks would try and manage inflation. Now we’re committed to hit a numerical target, and that makes it more challenging but we believe we can do it.

Bennett Thank you very much. Thank you, Governor and your team.

**conclusion of evidence**
Reserve Bank of New Zealand’s Financial Stability Report, May 2016

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
June 2016

Presented to the House of Representatives
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Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Financial Stability Report, May 2016, and recommends that the House take note of its report.

Introduction and summary of the Financial Stability Report

The Reserve Bank is required to report twice a year on the soundness and efficiency of New Zealand’s financial system. The following are the main points from its May 2016 financial stability report (FSR):

- New Zealand’s financial system continues to perform well, but risks in the outlook for financial stability have increased since the last report in November 2015.
- Internationally the economic outlook has deteriorated, with heightened volatility in global financial markets between December and February. As a result, the cost of wholesale funding for New Zealand banks has increased. While the volatility has abated recently the underlying causes have not been resolved.
- Concerns remain about the pace of growth in China, the health of the global financial sector, the outlook for the European economy, the uncertain pace of interest rate tightening in the United States, and sustained low commodity prices.
- Housing market pressures in Auckland moderated in late 2015 and early 2016 but prices remain elevated. Recent data suggests that price pressures are re-emerging. House prices have also begun to increase across the rest of the country.
- The Reserve Bank is monitoring developments in the housing market closely to assess whether further financial policy measures would be appropriate. It emphasises that increasing the supply of housing is key, and suggests that further efforts on a range of fronts should be considered.
- Dairy prices remain low and many farmers face a possible third season of weak cash flow, with heavy demand for working capital. Problem loans in the dairy sector are expected to increase significantly in the coming year, but to remain manageable for banks.
- Key regulatory initiatives are progressing. They include changes to the outsourcing policy for banks, bank disclosure requirements, and crisis management powers for financial market infrastructures. The IMF will undertake one of its regular assessments of New Zealand’s financial sector later this year.

The rest of this report discusses the main issues we considered during our examination of the FSR and in our discussion with the Governor of the Reserve Bank.
Risks in the housing market

The Reserve Bank is concerned that imbalances in the housing market continue to increase, despite some cooling in late 2015 and early 2016 as a result of its restrictions on loan-to-value ratios (LVRs) and the Government’s tax measures aimed at residential property investors. (We discuss the effectiveness of these measures, and other steps that could be taken, later in this report.)

The Reserve Bank says that the annual rate of house price inflation in Auckland has reduced to 12 percent, from 27 percent in September 2015, but that price pressures are re-emerging and spreading to other regions. It points out that the ratio of house prices to incomes exceeds 9 in Auckland. This is high by historical and international standards, and when compared with the average of 5.3 for the rest of the country. The Reserve Bank is concerned that, with nominal household incomes growing at 3–5 percent, continuing house price inflation could push this ratio higher.

Along with rising house prices, the Reserve Bank notes that credit growth has pushed the household sector’s debt-to-income ratio to new highs. It says that this leaves households vulnerable to deterioration in economic conditions or a rise in interest rates. In view of banks’ large exposure to the housing market, there is a risk that a future slowdown could threaten financial stability.

Regions outside Auckland

We asked how concerned the Reserve Bank is about the “halo effect”, as increasing house prices spill into other areas around the country, particularly nearby Hamilton and Tauranga, where recent house price inflation has been between 18 and 25 percent. The governor replied that such increases have taken the pressure off the Auckland housing market to some extent, but it is a concern how quickly widespread pressures are building around the country.

Role of investors

The Reserve Bank attributes the housing market pressures to a combination of factors: record increases in net immigration, low interest rates, a lack of supply, and investor activity. The governor noted that investor activity has been a big factor behind the house price movements, with investors accounting for 42 percent of transactions in Auckland and 40 percent in the rest of the country.

Potential further measures to curb house price inflation

Before the financial stability report was released there was speculation that the Reserve Bank might introduce new macro-prudential measures—such as a debt-to-income ratio for house buyers—to help cool the Auckland property market. We asked whether the bank is considering any such measures.

The governor told us that the Reserve Bank is watching developments in the housing market closely and is considering whether there is a need for further macro-prudential instruments. He said that at this stage the bank has not made a decision on whether further intervention is needed, and what the nature of any intervention might be. He said that the Reserve Bank is considering the issue in-house, and will be consulting with the
Government about whether there are strong grounds for further macro-prudential instruments. Any intervention would require prior consultation with the Government.¹

We explored the potential nature of any further measure. We note that the bank has previously expressed a preference for keeping any macro-prudential tool simple and broad-based; nevertheless, its most recent LVR policy distinguished between regions and types of buyer. We asked whether it is considering such differentiation to avoid penalising first home buyers, or regions where price pressures are less severe. The Reserve Bank pointed out that previously, price pressures had centred on Auckland, whereas the concern now is that they are becoming more widespread. For this reason, the case for a targeted rather than broad-based approach is less strong now. The governor emphasised, however, that the bank has yet to decide on whether further action is needed, or if it were, what form it might take.

Reason for macro-prudential policies

We asked why any measure might be needed to target debt-to-income ratios, since this would appear to be something that individual banks already focus on in determining a borrower’s ability to service a loan. The Reserve Bank agreed that banks look closely at both the loan-to-value and debt-to-income ratio; and most of the time a regulator can rely on their sound commercial practices. However, from time to time, particularly in the high point of a cycle, there can be a case for “additional conservatism”, as individual banks may not allow for risks in the system over and above their individual risks. The concept of macro-prudential policies is designed to address these additional risks.

Potential tax changes for property investment

Noting that investors account for more than 40 percent of activity in the housing market, we sought the Reserve Bank’s view on whether more could be done to reduce the tax advantages of property investment.

The governor said that the Reserve Bank welcomed the Government’s action in introducing a 2-year bright-line test for property investors from October 2015. He observed that a number of countries have capital gains taxes, but even so house price inflation can still be quite strong. He noted that major political parties in New Zealand appeared to have ruled out a capital gains tax.

As to other potential measures in the future, the governor said it would depend on the Government at the time and the advice it received from the IRD and the Treasury. In his view, the type of policies that political parties might consider would include interest deductibility—that is, whether investors should be able to deduct interest on their mortgages in the absence of a tax on their capital gains—and the ability to offset losses on investment properties against other income.

The ACT Party member noted that in most markets investor participation is generally beneficial, as it encourages increased supply and reduces price pressures. He questioned why the housing market should be different, and whether central bank policies have been effective internationally in reducing investor participation.

¹ At present, under a Memorandum of Understanding with the Minister of Finance, the Reserve Bank has scope to use four macro-prudential tools. They are: a counter-cyclical capital buffer; adjustments to the minimum core funding ratio; sectoral capital requirements; and temporary restrictions on high loan-to-value ratio (LVR) residential mortgage lending.
The Reserve Bank said that history has shown that lending to investors tends to be riskier than for owner-occupiers. Investors also tend to add to cyclical pressures as they can buy and sell more quickly, which can accentuate a downturn. It sees these as good reasons for designing policy to reduce the share of investor lending. It noted that APRA, the Australian Prudential Regulation Authority, recently set a limit of 10 percent annual growth in residential investment lending by major banks.

**Increasing the supply of housing**

In the Reserve Bank’s view, housing supply remains the key to resolving Auckland’s house price pressures. It notes that by the Auckland Council’s estimate, approximately 13,000 new houses per year are needed to keep up with demand. Currently around 9,700 building consents are issued annually. While noting that this is more than last year, the governor said the increase is still insufficient to meet the migration inflow—with about 50 percent of all migrants choosing to settle in Auckland—let alone to keep up with natural population increase or reduce the existing housing shortfall.

Asked about measures that could help to improve housing supply in the Auckland region, the Reserve Bank said that a number of things would help. Removing impediments to densification and greenfield development, including freeing up government land for housing; reducing the time and cost entailed in building consents; improving productivity in the building industry, which is well below that of Australia; and addressing infrastructure mismatches, would all help increase the supply of housing in Auckland. The governor noted that the Auckland Council’s decisions about densification will be of major interest and importance when it releases its unitary plan in August.

We agree with the Reserve Bank that it is important for increased housing supply to be matched by the necessary infrastructure. We asked whether banks consider transport costs in assessing housing affordability, and whether there might be a case for them to offer location-efficient mortgages. The Reserve Bank said that banks generally consider all of a borrower’s costs in assessing their ability to service a loan. As to whether any public policy intervention might be needed regarding location-efficient mortgages, the Reserve Bank said this would be more a matter for the Treasury to assess.

**Evaluating previous LVR measures**

A special section on pages 12–13 of the financial stability report discusses the initial impact of the Reserve Bank’s adjusted LVR restrictions. It notes that house sales in Auckland fell more sharply than expected in the period between November 2015 and February 2016: by 19 percent, compared with an expected 8 percent. Auckland’s rate of house price inflation also fell by more than expected.

The Reserve Bank believes other events may have contributed to this outcome, including the Government’s housing-related tax changes, a reduction in offshore demand because of financial market volatility during this period, and more rigorous enforcement of capital controls by Chinese authorities. It says the fact that sales outside Auckland also declined despite looser LVR restrictions reinforces this view.

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2 In November 2015 the Reserve Bank brought in changes to its policy regarding high-LVR mortgage lending by registered banks, imposing new and tighter restrictions on Auckland investor loans and easing restrictions on loans outside the Auckland region.
The Reserve Bank believes a major benefit of the LVR measures has been to reduce risk in banks’ loan books. The proportion of highly leveraged loans on their books (those with LVRs above 80 percent) has fallen from 21 percent in 2013 to about 13 percent now. New investor lending at LVRs above 70 percent is down by about one-third. The policy has therefore helped financial stability by making banks more resilient.

**Risks in the dairy sector**

With Fonterra’s forecast payout for the 2015-16 season well below the estimated break-even payout, it now appears more likely that farmers will face a third season of negative cash flows. Bank lending to the dairy sector has increased by more than 9 percent in the year to March, and is expected to increase further over the winter months. According to the Reserve Bank, highly indebted farms may have limited capacity to borrow further for working capital, which could result in an increase in non-performing and watchlist loans.

To date, the level of problem loans in the sector has increased only “modestly”, but banks are monitoring a number of dairy loans closely. The Reserve Bank expects the level of problem loans to increase significantly over the coming year, and it states that banks should be prepared to increase their provisioning. However, on the basis of stress tests it considers that banks are capable of absorbing losses from dairy lending, mainly through reduced earnings.

The Reserve Bank says the ability for anyone to forecast commodity prices is extremely limited at best. Its forecasts assume that the dairy price will recover, albeit slowly, to the end of 2016. It estimates the market clearing price for whole milk powder to be between US$3,200 and US$3,800 a metric tonne; the current price is about US$2,140.

In late 2015 the Reserve Bank conducted stress tests on the five largest dairy lenders. The tests included two hypothetical scenarios involving a low payout and a sharp fall in dairy land prices. It considers the current market outlook for the medium-term to be in line with the more moderate scenario, where banks’ average losses were estimated to be a manageable 3 percent. We note, however, that this scenario still entailed significant losses for many farmers.

**Dairy farm land valuations**

The Reserve Bank is concerned that with dairy incomes remaining depressed for several seasons, dairy land prices could decline sharply. A special section of the financial stability report discusses the cyclical nature of dairy farm land prices, and some potential scenarios involving declining land prices.³

Depending on the assumptions used, a peak-to-trough price decline of 19–49 percent is estimated under scenario 1. This would be comparable to the 27 percent price decline experienced in the wake of the global financial crisis. Under scenario 2, the estimated peak-to-trough price drop is more extreme, at 31–63 percent. The Reserve Bank notes that a 50 percent decline in per-hectare land prices occurred in the mid-1980s following the removal of farm subsidies.

We asked about reports that farm sales in Southland have entailed 15–20 percent losses in value, which appeared to be at the lower bound of scenario 1. The Reserve Bank said there have been few transactions to gauge by, but it believes farm prices have fallen by about 13 percent.

³ Box B, pp. 35–37.
percent in the past year. In an extreme situation with many foreclosures, it says, there is potential for prices to fall significantly more.

**The banking sector’s resilience and responses**

While the financial stability report discusses various risks, overall the Reserve Bank considers that there is good resilience in New Zealand’s financial system, and that banks are well placed to manage potential volatility. It notes that banks hold capital, liquid asset buffers, and funding positions in excess of current regulatory requirements. They also have strong profitability, although the report notes that this may come under pressure as a result of higher funding costs internationally or if losses on dairy lending increase materially.

As well as monitoring the banking sector’s preparedness for an expected increase in problem loans in the dairy sector, the Reserve Bank is also watching developments with households’ deposits. As noted in Box D of the financial stability report (pages 64–65), household deposits have exceeded credit growth since 2009, but recent data indicates a change in this trend. The Reserve Bank is uncertain how banks would respond to a decline in deposit growth. They might become more reliant on international markets for wholesale funding; alternatively, they might reduce their supply of credit. We will continue to follow developments with interest.

**Stress testing the banking sector**

In late 2015 the four largest banks in New Zealand participated in a common scenario Internal Capital Adequacy Assessment Process (ICAAP) test. These stress tests help the Reserve Bank to identify and assess risks to the financial system, and to individual institutions’ capital and liquidity buffers.

The stress test scenario was deliberately severe, but the Reserve Bank describes it as not beyond the realm of plausibility. It involved a major macroeconomic downturn, with a 6 percent fall in GDP and a 40 percent fall in residential property prices (55 percent in Auckland). The results suggested that individual banks would not fail, but that the financial system would not be fully functioning and able to aid an economic recovery.

We discussed the flow-on effects of such a scenario. While banks’ balance sheets appear robust enough to handle this type of extreme event, the Reserve Bank notes that they might well “close up shop” and stop lending, which would accentuate the downturn. One aim of the exercise was to ensure that banks think about such things, and consider their own capital adequacy. The Reserve Bank will carefully consider the results of the stress test in its forthcoming review of bank capital requirements.

**Australian banks’ lending to subsidiaries**

We note that a recent regulatory change in Australia will restrict the amount of lending from parent banks to their subsidiaries, which will affect the four largest New Zealand banks. The Reserve Bank confirmed that this policy by the Australian Prudential Regulation Authority will be phased in over the coming five years. It believes the transition will be quite manageable. The change does not mean that New Zealand banks will need to reduce their market share; rather, that they would borrow less from their parents and seek more financing direct from international markets.

**Financial sector regulation**

The Reserve Bank is working on a number of policy initiatives.
In 2015 it released a consultation paper proposing changes to the outsourcing policy for registered banks, which regulates their use of external service providers. In the event of a failure of a service provider or a bank itself, the policy will ensure that basic banking services continue to be offered. The proposed changes also seek to improve alignment with the Open Bank Resolution policy. The final version of the policy is expected to be released by the end of the year.

The Reserve Bank is also about to consult on a new “dashboard” approach to make banks’ quarterly disclosures more efficient. The proposed dashboard is an electronic form of reporting that would present summary information, with further details available for more advanced users. Final decisions on the dashboard will be made in late 2016, with implementation in 2017.

The Reserve Bank is also working on an enhanced oversight regime for systemically important financial market infrastructures (SIFMIs). In March 2016 it published a consultation document setting out the proposed crisis management regime to ensure the continuity of essential services. Next steps involve final policy decisions on the design of the regime and, if Cabinet agrees, starting work on an exposure draft of a bill to implement the framework.
Appendix A

Committee procedure
We met on 11 May and 1 June 2016 to consider the Reserve Bank of New Zealand’s Financial Stability Report, released on 11 May 2016. We heard evidence from the Governor of the Reserve Bank, and received advice from our independent specialist adviser, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Transcript of hearing of evidence 11 May 2016

Members
David Bennett (Chairperson)
Andrew Bayly
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Damien O'Connor
David Seymour
Stuart Smith
Phil Twyford
Dr Jian Yang

Witnesses
Reserve Bank of New Zealand
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Bernard Hodgetts, Head of Macro Financial Department
Mark Perry, Head of Financial Markets
Mike Hannah, Head of Communications and Board Secretary
Toby Fiennes, Head of Prudential Supervision

Bennett Welcome governor, and thank you for coming to the finance select committee. We have got the report in front of us, so members have had a chance to read that, so thank you. If you want to give us a brief introduction, and then we’ll open up for questions.

Wheeler Thank you, Chairman. It’s good to be here again. I will keep it brief. On my right I’ve got Grant Spencer, who’s the Deputy Governor and Head of Financial Stability, and on my left is Bernard Hodgetts, who’s the Director of the Macro Finance Department.

New Zealand’s financial system is resilient and continues to function effectively, but risks to the financial stability outlook have increased in the past 6 months. Although New Zealand’s economic growth remains solid, growth is slowing in a number of trading partner economies. Dairy prices remain low, with global dairy supply continuing to increase. Many farmers now face a third season of negative cash flow, with heavy demand for working capital. The level of problem loans in the dairy sector is expected
to increase significantly over the coming year, although we expect that dairy losses will be absorbed, mainly through reduced earnings.

On the housing side, imbalances in the housing market are increasing, with house price inflation lifting again in Auckland, after cooling late last year and early this year. House prices have also begun increasing strongly in a number of regions across New Zealand, although house prices outside Auckland are generally much lower relative to incomes.

The bank remains concerned that a future sharp slowdown could challenge financial stability, given the large exposure of the banking system to the Auckland housing market. Further efforts to reduce the imbalance between housing demand and supply in Auckland remain essential. This includes measures such as decreasing impediments to densification and greenfield development, and addressing infrastructure and other constraints to increasing housing supply. The Reserve Bank is closely monitoring developments to assess whether further financial policy measures would be appropriate. So thanks very much, Mr Chairman.

Twyford

Thank you, governor. My first question is really about the rate of housing inflation. In your report you commented that it’s now only 12 percent. What do you think a desirable level of housing inflation would be, and do you think that the reduction from nearly 25, down to 12, is sufficient?

Wheeler

Auckland was running at 27 percent in September and it now seems to be running at around 12, although the REINZ data will be out today. Some of it may have been released already.

If you look at house price to income ratios for Auckland, they are currently just over 9. Now, if you go back to just before the GFC, in 2007, they were 6.5. On that ratio, 9 makes them one of the most expensive cities in the world. If you look at that same ratio, house price to income, for the rest of the country, it’s 5.3. The concern I think is that that ratio could continue to increase. We’ve seen more momentum in the housing market in Auckland in February and March, both in terms of volume, and it looks as if prices are starting to pick up, accelerate.

In terms of what would be desirable, certainly house price inflation slowing significantly. If you look at incomes, in Auckland or for New Zealand as a whole, in nominal terms, they’re probably growing somewhere around 3 to 5 percent in general. So that’s our concern.

Twyford

There is some bit of commentary around at the moment about the so-called halo effect, with Auckland investors fanning out across the regions, and we’re seeing house price inflation pick up in places like Hamilton—more than 25 percent now, annualised. What’s your view of that, given that the feature of the current bubble or boom has been that it’s Auckland versus the rest of the country, and now we’re seeing a number of other regional centres with high rates of house price inflation? The way that you’ve responded to the conditions so far has been with differential LVRs, for example. How concerned are you about this trend and what, if anything, are you thinking of doing about it?
FINANCIAL STABILITY REPORT, MAY 2016

Wheeler

Well, if you look at the investor share of transactions in Auckland in recent months, the investors are accounting for 42 percent of the transactions. For the rest of the country, they account for about 40 percent of transactions. So they’re a big factor behind house price movements. There has been a spill-over into particularly Hamilton and Tauranga—you’re right. The house price inflation seems to be between 18 and 25 percent in those regions.

A significant factor has been the migration, the low interest rates, the lack of housing supply, but also the investor activity that’s come out of Auckland. To some extent that’s taken the pressures off the Auckland market, but it’s built up pressures in other parts of the country.

If you look at the rest of the country, you would say: “Well, look, on average the house price to income ratio is 5.3, so it’s not near 9.”, but it is a concern just how quickly house prices are rising in many, many places.

Twyford

Can I ask about your comment about housing supply and the need for more Government measures to increase supply. I think the general view seems to be that Auckland needs in the region of 14,000 a year to keep up with demand. The current consent rates, I think, are about 9,500. So the accumulated shortage of houses, which some people say is between 30,000 and 40,000 now, is increasing by 4,000 to 4,500 a year. Do you have a view about what the acceptable build rate would be to ease the pressures, so that you wouldn’t feel compelled to be considering new tools?

Wheeler

I think, based on some of the figures produced by the Auckland Council, they need something like—you’re right—something like about 13,000 houses a year. If you look at building consents for Auckland, they’re running at around 9,700. Now, that’s quite an increase over last year. It’s an increase of 22 percent. It’s the highest rate of building for 11 years, but it’s not enough.

If you say that migration is running at around 65,000, if you take total net migration rather than just working-age population, and if, say, half of that is going to Auckland, and the occupancy rate per house in Auckland is roughly around three, then the amount of building that’s taking place is not covering the net migration inflow, let alone natural increase, let alone deal with the shortage.

So clearly we need more supply than 9,600 or 9,700 at this point, and anything that can be done to accelerate supply, either through the unitary plan, the decisions that need to be taken, and will be taken, hopefully, in August, and issues around regulation and productivity and the consent process, and freeing-up land that the Government owns, dealing with infrastructure mismatches—all of those things can help.

Twyford

Given that the Government is doing some things of those that you mentioned at the moment, and yet the marginal increase in the build rate is way below what’s needed, do you have a view about what should be done now, in the short to the immediate term, to increase the supply?

Wheeler

I think it’s a complicated issue. I think the issue on densification in the unitary plan are important. So I think everyone will be very interested to see
what happens in August. A lot can be done on the regulatory issues. I mean, the time to get consent approval can often be longer than the time it takes to build a house. The costs can be very significant—tens of thousands of dollars. There are issues about joining up infrastructure. So, for example, there are special housing zones, and many of them, but there are still mismatches, I think, in terms of infrastructure availability.

Productivity of the building sector—this was work done by the Productivity Commission—is 25 percent, on their numbers, worse than the Australian building sector. If you look at the median price of a house in Auckland, the cost of land is roughly 60 percent. For the rest of the country, on average, it’s around 40 percent. So there’s a lot of issues tied up there with land availability and regulation.

Twyford

Thank you. Finally, I’d invite you to comment about the possible new macro-prudential tools that you’re considering, in particular loan-to-income or debt-to-income ratios. I note that you’ve, I think, expressed a preference for a simple and broad-based approach, and I remember that we had this discussion about LVRs, but you came to the view that a regional differential and an investor owner-occupier differential could be implemented. So a couple of questions.

What’s the time frame for you as you work through the preparation for new tools? Why do you prefer a simple and broad-based approach, instead of the differentials that might protect, for instance, first-home buyers from the distributional consequences of a tool like the debt-to-income ratio, or the regions, given that, notwithstanding the halo effect, there’s a lot of regions in New Zealand that still don’t have a lot of a house price inflation and would be really hurt by a tool like that?

Wheeler

We’re continuing to watch developments in the housing market pretty carefully. We’re currently discussing in-house are there strong grounds for further macro-prudential instruments? We will be having consultations with the Government about the housing market and whether there’s a need for macro-prudential instruments. We’re required to consult with the Government, as part of the arrangements, as you would expect. But at this point we haven’t made any decisions on (1) whether to do more on macro-prudential, and, if we do, what nature of policy intervention might be appropriate.

If you look at loan-to-value ratios, we said all along that this would have a temporary effect in terms of reducing housing demand and its effect on house price inflation. In essence, we’ve said consistently that it really is a supply side problem and there are a whole lot of issues that I just talked about that affect the supply side, plus migration and low interest rates are also factors.

But one of the benefits of loan-to-value ratios is that it has reduced the riskiness of loan books, the banks’ loan books. So if you take, for example, the proportion of their loan book that is highly leveraged with LVRs greater than 80 percent, if you went back to 2013 that comprised 21 percent of the banks’ loan books across the banking system. Now that ratio is down to 13
percent. So the banks are more resilient as a result of those loan-to-value ratios.

In terms of instruments, there’s a lot of benefit in trying to keep this as simple as we possibly can. We were concerned about the Auckland problems, and still are concerned about that. We’re concerned about house price inflation rising in other parts of the country. But we haven’t decided on two things: (1) whether to move; or (2) what the nature of that would be.

Spencer I would certainly agree with that. I mean, I think if you look back to last year, the strength in the market in Auckland was really standing out, in that it was also very clear that an increased share of investors was a major contribution to that. In the situation we have now, it’s a lot more even. There’s still much greater pressure and greater stretch in Auckland, but we’re seeing more widespread pressure across the economy.

So the argument for a more targeted approach versus a broader approach is probably less than it was late last year when we brought the Auckland investor LVRs in.

Genter Governor, you’ve mentioned today that in the long term you’re thinking of the supply side issue, but also a lot of your data indicates that there’s a high level of investor activity, and in fact that’s been increasing over the past few years. I believe it’s gone from about 30 percent to over 40 percent, and 42 is higher than previous data, which was 41. And there was that brief respite in house price inflation that seemed to follow on from the Government’s measures targeting investors. Do you think that indicates that more could be done in that space to reduce the tax advantages to property investment?

Wheeler That more could be done on the tax side, do you mean?

Genter Yes.

Wheeler It’s always tricky, in the following sense. The Government moved on a brightline test, the 2-year brightline test. We welcomed that. There are a number of countries that have capital gains taxes. They have it for investor properties. They have it for owner-occupied properties. You still find house price inflation is pretty strong in a number of those countries. From what I can tell, the main political parties are basically ruling out a capital gains tax.

Are there other things that could be considered over time? It very much depends on the Government at the time and the advice they get from IRD and Treasury, but there are things potentially, like interest deductibility. If there are no capital gains, should investors be able to fully deduct all the interest? If there are losses on investment properties, should they be able to offset those against other income? Those are the sorts of things that political parties may or may not choose to look at over time.

Genter You’ve mentioned that in jurisdictions with capital gains taxes that house price inflation in some of them has been high. Is it not the case that New Zealand’s house price inflation has been much higher over the past decade than countries that do have those?

Wheeler I’d have to check the numbers.
Genter  I’ve seen a graph from the OECD showing New Zealand house price inflation higher than Australia and a number of other countries.

Spencer  I would say clearly there has been high inflation in New Zealand, particularly in Auckland, but there also has been in Melbourne, Sydney, Vancouver, San Francisco. There’s been a broad effect and some very high rates of inflation, and in terms of the—the stretch in terms of the price to income multiple, some of those other cities do actually exceed Auckland. For example, Hong Kong is up as high as 15. So we’re not arguing that inflation’s been high, but it’s been very high in some other countries as well.

Genter  Can I ask a question about supply? Not all supply is equal. Obviously new houses that are in green fields where there isn’t sufficient transport infrastructure are going to maybe have cheaper houses but much higher transport costs, which will have the same impact on household income as high house prices. Do you think there’s a case for banks, and maybe even yourselves, to start looking at the relationship of housing and transport affordability rather than just housing affordability to really address the risks that are opposed? We’re trying to achieve cheaper houses, but if we’re getting cheaper with higher transport costs it’s basically undermining the cheaper houses.

Wheeler  I understand your point, and it’s a very interesting and important point. It’s probably more one for Treasury or other policy departments I suspect.

Genter  I believe there have been policies around location efficient mortgages. Would that be within your mandate to look at the impact of that, of maybe encouraging banks to look at location efficient mortgages?

Wheeler  Well, that would be up to the banks to see if there’s a demand for such mortgages. If there’s a need for public policy intervention to somehow skew those if—and this is a big if—it met a cost-benefit test, then the people who could advise on that would probably be the Treasury, I would imagine.

Spencer  One relevant point there probably is, you know, when a bank is considering eligibility for mortgage and the size of mortgage then it looks at debt service, and it looks at costs that the borrower is facing. So in the sense that the transport cost is adding to the cost of borrowing for a house that’s way out of town, that’s potentially going to affect the serviceability and will affect the size of the mortgage that they can take on.

Genter  Yes, and I suppose the question is: is that applying to where the new supply goes or is that once it’s already been built? Do you see what I’m saying?

Bennett  Julie Anne, we’ll have go to David Seymour for a question, OK?

Seymour  Thank you, governor. I’ll save my planning questions for someone else. I just wanted to ask about investor participation as well. In most markets when you get more investor participation you get more money into the sector, you get increased supply, and ultimately you reduce the pressure on the market. It seems that the presumption here is that housing is somehow different, and I wonder why that is. Also when you talk about reducing investor participation, as I understand it what you’re really saying is that you want to reduce the number of dwellings that a particular individual has a
beneficial interest in. But, given the plethora of investment vehicles that people can use to take a beneficial interest in a particular property, are there any examples of central banks elsewhere that have effectively managed to, I guess, reduce investor participation through the types of rules that have been spoken about here?

Wheeler If, in essence, you’re asking if macro-prudential instruments, such as loan-to-value ratios, and that reduced house price pressures and to the extent that may have been done through changing the incentives or expected returns for investors—these instruments have been around for a long time, particularly in Asia and increasingly now in Europe. Some of the work done by the IMF suggests that they have been effective in slowing down the rate of house price appreciation. Often that’s a temporary effect, because these effects wash through over time, but they have helped to make bank portfolios, if you like, more robust in essence—more resilient to the risks that would otherwise be there with high leverage.

Spencer I might add something. The history shows that investors are riskier propositions than owner-occupiers. Also, from a macro point of view investors are likely to just go in and out of their portfolio, so they’re more likely to add to the cyclical pressure and the cyclical downturn. If supply starts to exceed demand investors feel there’s nothing in it for them anymore. That will accentuate the downturn. So there are good reasons for designing policy to reduce the share of investor lending. One example is with APRA recently in the Australian banks, which has set a limit of 10 percent growth per annum in residential investment lending by the major banks. So it’s certainly happening in other countries.

Seymour Can I just ask a supplementary about the LVRs? We talked about the sort of aggregate effectiveness of LVRs, but what about the equity of it, particularly in times of shortage? Do you study who is most affected by loan-to-value ratio policies? And just one more, in your stress tests on page 51 you simulate a 55 percent drop in Auckland house prices. How does the bank choose such numbers, because that’s quite frightening for a lot of people?

Wheeler Perhaps Bernard might comment on the stress tests. I’m not aware of any distributional work that we’ve done in terms of the impact of LVRs.

Hodgetts On the stress test we deliberately choose movements that are scary. That’s the whole purpose of the stress test—to apply stress to the system to see how resilient it is to that stress. So, you know, a 55 percent movement in house prices in Auckland would be very significant, but, of course, relative to where they’ve come over the last decade it’s not beyond the realms of plausibility, but it is deliberately severe.

Scott The income-to-debt tool that’s being proposed sounds like it’s a nice simple way of restricting indebtedness, but aren’t you stepping into something that’s really the commercial banks’ business, in assessing the ability of someone to service a loan? Someone might have a high cash-poor, asset-rich situation, and this would restrict that person from investing.
Spencer  That’s right. Both LVRs—loan-to-value ratios—and debt-to-income ratios are things that banks definitely look at. Those are the main two areas that they look at. So most of the time we’re relying on good practices by the banks. We talk to the banks on their practices to make sure that they’re sensible, but from time to time, particularly in the high point in a cycle, there is a case for additional conservatism over and above what an individual bank would apply, because the risks in the system that the banks are not allowing for in their assessment are individual risks. That’s why we talk about macro-prudential, so that—

Scott  Thank you. So that leads on to my next question around the scenario analysis. You stress-test something, but do you consider where we would be or what we would look like if that were to occur? In other words, what are the consequences of, say, a 50 percent drop in asset value? How much thought do you do around the consequences of a scenario? I give you an example. A few years ago the hedge funds were stress tested. They thought they could survive a stress test. A stress test came, but it created another domino effect as a consequence of a credit crunch. There are a lot of consequences that flowed. How much thought have you given to the consequences of a stress test?

Spencer  We definitely do that, and that’s actually discussed in that box on page 51 to 53, where you apply a stress test and, as Bernard said, it’s a pretty extreme event, and the bank balance sheets appear to be robust enough to handle it. But what actually happens, of course, is that all sorts of second-round effects do happen and, in particular, if you start eating into banks’ capital the banks will tend to shrink and just sort of close up shop and stop lending, and that will accentuate a downturn.

So we have to think about that and how we analyse it, and banks have to think about that. The big part of this is getting it in front of the banks and making sure the banks are assessing it themselves, with their own assessment about their own capital adequacy. It helps to inform that dialogue, but there’s no easy answer in saying well “X—that’s the amount of capital you must have.”

O’Connor  Thank you. Can I just move on to the next area or sector that you’ve identified as, I guess, risky, and that is the one on dairy. I acknowledge the stress test that you’ve done of the industry, previously. Does this report today point to scenario 1 or scenario 2 in terms of a medium-term outcome?

Spencer  Well, it’s more in line with scenario 1, the sort of outlook we’ve had. We’ve had two poor seasons and the prospect now of a third. If you look in an approximate way against this, the two scenarios that we did, it’s more comparable to the first scenario, which is the softer version, which is more manageable than the second.

O’Connor  Still with significant potential losses.

Spencer  But still with significant potential losses. That’s right.
Well, we’ve, I guess, teased that out. We’ve already seen reports of 15 to 20 percent loss in farm value where there have been sales in Southland. That’s at the top end of your scenario 1 outcome. Do you think that land values may, indeed, go further downward than that which has already been established, I guess?

If you look at the data on dairy farm prices that have been sold, my understanding is, on average, the dairy farm prices are down 13 percent over the last year. Now, there haven’t been a lot of transactions, but if, for example, you did get into an extreme situation with a lot of foreclosures, then there is the potential for that price to fall significantly in a distress situation.

If you look at the dairy prices, whole-milk powder prices have been up 8 percent in the last two auctions. There are still issues around dairy supply, I think, which are hanging over the market significantly. Europe is still increasing production, particularly in the Netherlands and Ireland. It looks as if the US is still increasing production slowly, whereas we are cutting production by around 3 percent this season, for example.

The positive news, I think, is that it looks as if the inventory cycle in China is starting to change quite significantly—that China is now importing more dairy produce. A complication, of course, is Russia, and the trade diversion that is taking place out of Europe that would have gone into Russia is now going into other markets, including China. So what’s critical in this equation is what happens to local dairy supply and what happens, in particular, to European production and Chinese imports.

The signals going to the sector—and to farmers, in particular—have been somewhat confusing. I guess you’ve got Fonterra and ASB on one side saying that things are going to pick up at the end of the year, Rabobank and a number of others saying otherwise. Can you explain why that might be? Is it because Fonterra and ASB are more desperate, or is it that they perhaps have rose-tinted glasses? Because what you say and the messages going through are very important, I’d suggest.

I think anyone’s ability to forecast commodity prices is extremely limited at best. You’re dealing with massive flows here in terms of global supply and the change in global supply and the change in global demand. That’s also affected by what’s happening to monetary policy in the rest of the world as well. For our own forecasts we tend to assume that the dairy price will recover, basically only slowly to the end of 2016. If you said “What’s a market clearing price globally for, say, whole-milk powder?”, we think, based on a number of conversations with experts, that it’s somewhere between US$3,200 and US$3,800 per metric tonne. The price at the moment is about US$2,140 or so at this point.

I just want to ask you a few questions around the banking sector. Mr Spencer, you made a comment—I think it’s attributed to you—that the banking sector is facing increasing creditors’ threats. And you quote, I think, a figure of 0.5 increase in the volatility of those. There are specialists that think that the banking sector is consequently more at risk, at greater risk.
But given that the New Zealand economy is pretty strong by world standards—stable Government, and also the banking sector itself is extraordinarily profitable. I note that in December reported combined profits for the quarter were $1.1 billion. Are you overplaying that risk? It just seems to me that there’s an amazing amount of resilience in the banking sector.

Wheeler I would agree with you that there is a lot of resilience in the bank system. What happened earlier this year is that when the markets sold off in January/February, volatility went up, credit spreads went up, and the cost of funds to New Zealand banks went up. So it was like a precursor, like an example of what can happen. So the cost of funds went up by, say, 50 basis points—which is not a huge deal and certainly manageable.

The broader risk we talk about is if there was a worse outbreak of volatility, more of a meltdown, and then our banks are still vulnerable to that sort of global development because New Zealand is still a debtor country and the banks borrow on the country’s behalf. So it’s a risk that’s still there, but we totally agree that they’re well placed to manage such volatility.

Bayly And just the APRA requirements, I note that APRA announced in late 2015 that Australian banks are going to reduce their exposure, non-credit exposure, to the New Zealand sector to 5 percent. I just want to get further information on to what extent is the Australian banks portfolio in New Zealand greater than 5 percent, and, therefore, how significant is that? And if that was to occur over a 5-year period, which is what they’ve indicated, does that just provide an opportunity for Kiwibank and other non-financial institutions—non-banking institutions—to be able to step in and pick up that credit?

Spencer We think it’s quite a manageable situation, and the banks agree with that, provided the borrowing environment remains stable. So you’re right, APRA’s changed their policy to make it restrict the amount of lending from the parents to the subsidiaries. So they’ve given the banks 5 years, as you say, to transition to that. And that should be totally manageable to transition. So, in other words, our banks could borrow less directly from the parents and go straight to the markets to refinance that. It doesn’t mean to say that they’re necessarily going to reduce their market share or that there’s a great opportunity for other banks.

Nash As you know, governor, we already have a capital gains tax in this country and it’s based on an intent of whether you buy for yield or for the capital gain. When you say that 40 percent of house purchases are investors, the yield on these looks extremely low. Why do you think there is such a high level of investment in the housing sector?

Wheeler You’re right. If you look at the rental yield in Auckland it’s down now, I think, to about 2.8 percent.

Nash So it’s more money in the bank [inaudible]

Wheeler It’s very low, and you sort of say “Well, why would you invest for that sort of rental yield?” It’s linked in to expectations of capital gains and it’s one
reason why you’re seeing those investors move to Hamilton and Tauranga and other places—because the rental yield there is higher and they would think that the potential for capital gains is high in those towns.

Nash So what you are basically saying is that 42 percent of the Auckland housing market—a significant proportion of those people are actually buying for capital gain and not for rental yield?

Wheeler What I would say is that the rental yield is extremely low if that’s what driving it.

Nash Just one last question, if I may. I did note, with interest, that you mentioned Paymark and its strategic importance. Are there any circumstances under which you would put a submission into the Overseas Investment Office if an overseas purchaser sought to purchase this, or is this basically a shot across the bow of the Overseas Investment Office?

Spencer There is no shot across the bow. We mentioned some developments in the payments area but we don’t have a particular issue where we’re saying that this is a particularly strategic national asset. No.

Smith I just want to talk about the approaches to the farm valuation scenarios that you did and the peak-to-trough change. In Approach 1—the perfect foresight approach—are you confident that that’s a good model given the comment just before on volatility of commodities—how quickly things can get exponential change, either up or down, in commodity prices? And even though you’ve got a 5-year PE ratio, would that really buffer it to the extent that you assume in an Approach 1?

Hodgetts I mean these, at the end of the day, are models, and all of them have their limitations. I guess that what we’ve tried to do here is to take a number of different approaches to farm valuation and to see where they come out. But I think that we’d certainly acknowledge that there’s no easy way to model something, absolutely watertight. You’ve got to accept that, as you say, volatility can affect valuations. So there’s certainly no assertion here that these valuations are the real answer. It’s a case of trying to put some structure around the issue of valuation to see where some reasonably well-accepted approaches come out.

Smith So given that comment, do you think that a more fair assumption might be somewhere between Approach 1 and Approach 2, rather than Approach 1 as you’ve stated in the report?

Hodgetts Well, I guess opinions can differ, but they’re two separate approaches. Taking an average of them might well be the way to make sense of it.

Bennett Thank you very much. We appreciate your time, everyone.

conclusion of evidence
Reserve Bank of New Zealand, Monetary Policy Statement, June 2016

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
June 2016

Presented to the House of Representatives
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Reserve Bank of New Zealand, Monetary Policy Statement, June 2016

Recommendation
The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, June 2016, and recommends that the House take note of its report.

Introduction
This report summarises the contents of the Reserve Bank’s monetary policy statement released on 9 June 2016, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

Official cash rate unchanged
The monetary policy statement announced the Reserve Bank’s decision to leave the official cash rate (OCR) unchanged at 2.25 percent. The Reserve Bank said that global financial market volatility has decreased and the outlook for global growth has stabilised. However the global economy remains weak and significant risks remain.

While domestic activity remains strong, the dairy sector continues to face challenges and the exchange rate remains higher than it should be. House price inflation is also a concern for financial stability. Although inflation is low, mainly because of low prices for fuel and other imports, the Reserve Bank expects it to strengthen.

For now, the Reserve Bank judges that monetary policy should continue to be accommodative. It states that further easing may be required to ensure that future average inflation settles near the middle of its 1–3 percent target range. It will continue to watch the emerging flow of economic data closely.

Housing market pressures
The Reserve Bank remains concerned that house price inflation in Auckland and other regions is creating risks for financial stability. It projects that house price inflation will remain high over the next 18 months. Auckland house price inflation in particular is running high. While previous measures, such as the Reserve Bank’s restrictions on lending at high loan to value ratios (LVRs) and the Government’s tax policy changes, have brought down Auckland house price inflation from 27 percent in September 2015 to the current rate of about 13 percent, inflation has been accelerating again. Other regions are also experiencing an increase: inflation rates in Tauranga, Hamilton, and Central Otago are currently between 20 and 25 percent.

The Reserve Bank said the ratio of average house prices to incomes in Auckland is particularly worrying. The house price to income ratio is 9:1, making the Auckland market 70 percent higher than the rest of the country, which is about 5.2:1. Also of concern to the Reserve Bank is the household debt to disposable income ratio. It is currently running at about 162 percent for the whole country. The governor estimates that it would be much
higher for Auckland. At the very least he does not want to see these ratios increase any further.

**Potential policy measures to address housing market risks**

We asked what type of interventions might be needed to ease these concerns. The governor said low interest rates are contributing to housing credit growth, which is running at about 8 percent. Since higher interest rates, which would help to reduce credit growth, are not likely in the foreseeable future, further macro-prudential measures might help.

There are also supply-side issues, as high net migration is increasing the demand for housing, particularly in Auckland. While building consents in Auckland are 12 percent higher than last year, it is not enough to cover the net migration inflows and normal population increase. The governor observed that “in essence we just need a lot more housing”.

The governor also suggested other measures that may help. They include the tax treatment of housing, particularly around negative gearing and the deductibility of interest for investors; improving the productivity of the building sector; reducing the cost and time lags in developing new infrastructure; and the decisions to be made by the Auckland Council around densification in the next few months.

**Possible changes to loan to value restrictions**

We understand that the Reserve Bank is considering changes to its LVR policy to further target investors in the housing market. We asked whether this was the Reserve Bank’s intention, and what the changes might be. The governor told us that investors play a significant role in the housing market: they make up 46 percent of the Auckland market and around 40 percent for the rest of the country. The Reserve Bank is analysing potential changes to the LVR restrictions, and is in discussions with the Minister of Finance and the Treasury on the issue. The governor hopes to be in a position to make a decision by the end of the year.

The governor also talked about the effectiveness of previous LVR measures. When LVR restrictions were introduced, 21 percent of the loan portfolios in the banking system were highly leveraged, with LVRs greater than 80 percent. The aim of the LVR restrictions was to improve the quality of banks’ lending books. Since they were introduced, highly leveraged loans have decreased to 13 percent. In the Reserve Bank’s view this is an important structural change in the credit quality of banks’ loan books.

**Potential debt-to-income lending restrictions**

We also asked what the Reserve Bank’s intention was regarding possible debt-to-income (DTI) lending restrictions, and whether the Reserve Bank had analysed the impact of a DTI measure on first home buyers. We heard that the issues are quite complex; it is collecting data from the large banks and analysing this information. Part of the analysis the Reserve Bank is doing is looking at how a DTI measure would be implemented. There are issues around how it would be enforced, whether the banks would police it themselves, or whether the Reserve Bank would have a role in monitoring it.

We heard that overseas examples are not particularly relevant for New Zealand’s situation. For example in the United Kingdom 15 percent of bank lending can take place at DTI ratios over 4.5:1. However, when house price to income ratios are 9:1 in Auckland and 5.2:1 for the rest of the country, there are challenges about how such a restriction would
work. The calibration would need to be different for New Zealand as there is a higher proportion of investors and high DTI ratios for existing borrowers.

We asked about the feasibility of using a DTI measure to target investors rather than owner-occupiers. We heard that it would be difficult to target investors without restricting first-home buyers at the same time, as the more complex and targeted a DTI is, the greater the potential for distortion and spill-over effects. However, in considering alternatives to the LVR, the focus for the Reserve Bank is on investors, not first-home buyers. It noted that DTI restrictions would tend to affect investors proportionately more, as they tend to borrow at high DTI ratios.

We asked whether a DTI would replace LVRs, or if they would work together. The deputy governor responded that the Reserve Bank sees them as complementary, because they affect different aspects of risks.

**Evaluation of alternative measures**

We asked if the Reserve Bank is looking at alternative options to LVRs and DTI ratios, such as capital controls. We heard that a capital overlay—that is, a requirement for banks to hold additional capital against their lending—is one of the existing macro-prudential instruments listed in the memorandum of understanding with the Minister of Finance. Different tools have different effects: a capital overlay affects the pricing of credit for higher-risk activities, whereas LVRs and DTI ratios affect the amount of credit available.

The governor said that, at this stage, the Reserve Bank is considering various alternatives.

**The outlook for inflation**

Annual Consumers Price Index (CPI) inflation was 0.4 percent in the March 2016 quarter, mainly due to a decline in import prices and lower ACC vehicle levies. This is well below the 1 to 3 percent target band. However, the Reserve Bank expects inflation to strengthen, returning to within the target band by the end of 2016.

We asked what factors are expected to drive this projected increase within such a short period of time. The Reserve Bank pointed out that New Zealand’s inflation has been so low because tradables inflation has been negative for the past three and a half years. This is due to several reasons: low inflation overseas, a global oversupply of manufactured and capital goods, and a high New Zealand exchange rate.

The governor noted that the central bank is unable to influence any of these factors. However, the Reserve Bank expects the tradable component of inflation to pick up as oil prices and commodity prices increase. The Reserve Bank noted that the price of Brent crude oil has increased from US$27 a barrel to around US$52.

Inflation on non-tradables was 1.6 percent in the March 2016 quarter. The Reserve Bank expects it to increase as the economy grows. It considers that the economy is operating close to full capacity at present, which is defined as with an output gap near zero. It expects growth over the next 12 months to be around 3.25 percent, compared with “potential output” (the level of growth achievable without generating inflation) of about 2.5 to 2.7 percent. Therefore it considers that, as these capacity pressures start to increase, non-tradable inflation will rise.
Risks from the dairy sector

We noted that the monetary policy statement contained relatively little discussion of the risks from low dairy prices and high debt in the dairy sector. We asked whether concerns had abated, or whether they are less significant relative to the risks in the housing market.

The governor said it is quite worrying that dairy debt is currently around $40 billion, with half of it owed by 20 percent of farmers. Moreover, the Fonterra price guideline for milkfat solids is $4.25 per kilogram, about $1 below the estimated break-even price of $5.30, which means that most farmers are below break-even and have been for 18 months.

The Reserve Bank assumes that by 2019 the price of whole milk powder will rise to around US$3,300 per metric tonne. Some of us asked whether this assumption was too optimistic. The governor said that the assumed increase was over several years, but agreed that the price was a long way off from the current price of US$2,200. While whole milk prices have increased by 10 percent since March, there are still major uncertainties.

The high exchange rate

The Reserve Bank considers the exchange rate to be higher than appropriate, given New Zealand’s low export commodity prices. The trade-weighted exchange rate is currently about 6 percent above its 2015 low. Despite reductions in the OCR amounting to 125 basis points, the governor observed that the trade-weighted exchange rate has remained largely unchanged. It is strongly because of international conditions, over which the Reserve Bank has little control. However, its central projection assumes that the exchange rate will depreciate, in part because of strengthening in the US dollar as the United States gradually tightens its monetary policy. This would, in turn, influence the rate of inflation.

The Reserve Bank’s forecasting

We asked about the Reserve Bank’s track record in forecasting inflation, the exchange rate, and commodity prices. The Reserve Bank observed that forecasting is extremely complex, with many different assumptions involved. It is currently examining its performance, and will shortly put out a report showing how it is doing and possible areas of improvement. It is also examining its performance in comparison to an alternative set of tools it could employ. We also heard that the Bank of England has released a report comparing central banks, which ranked the Reserve Bank of New Zealand very high.

We suggested that, in future reports, the Reserve Bank could indicate what it had previously forecast against actual results for the previous two years. This would help to provide an indication of how accurate the forecasts are.

Bank funding costs and margins

A special section of the monetary policy statement discusses the recent OCR cuts, and notes that they have not been fully matched by falls in the mortgage rates charged by retail banks. There are two main reasons for this: banks have faced higher funding costs as a result of volatility in global financial markets; and banks have been trying to recover some of their profit margins, which had been squeezed by strong competition for lending last year. These two factors will influence whether mortgage rates will be matched by any future

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2 Box C, p21
OCR changes. The immediate pressure has decreased since March as financial market volatility has subsided.
Appendix A

Committee procedure
We met on 9 and 29 June 2016 to consider the monetary policy statement. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Transcript of hearing on 9 June 2016

Members
Chris Bishop (Chairperson)
Andrew Bayly
Todd Barclay
Hon Clayton Cosgrove
James Shaw
Stuart Nash
Simon O’Connor
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour

Witnesses
Reserve Bank of New Zealand:
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Dr John McDermott, Assistant Governor and Head of Economics

Bishop Good afternoon, governor. Welcome to the Finance and Expenditure Committee. David Bennett is away today so I’m the chair. We have a few other non-traditional members on the committee as well, but hopefully you know everybody. As usual we’re in your hands. [Introductions]

Wheeler Thanks very much, chair. You’ve all seen the statements, so I’ll try and be brief in my comments. First, on my left we’ve got Grant Spencer who is the Deputy Governor and Head of Financial Stability, and on my right is John McDermott, who’s the Assistant Governor and Chief Economist.

As you know, we left the OCR unchanged. Global financial market volatility has abated, and the outlook for global growth appears to have stabilised. There has been a modest recovery in commodity prices in recent months. However, the global economy remains weak, despite very stimulatory money policy, and significant downside risk remains.

Domestically, activity continues to be supported by strong net migration, construction, tourism, and accommodative monetary policy. The dairy sector remains a moderating influence, with export prices below break-even levels for most farmers.

The exchange rate is higher than appropriate, given New Zealand’s low export commodity prices. A lower New Zealand dollar would raise tradables inflation and assist the tradable sector. House price inflation in
Auckland and in other regions is adding to financial stability concerns. Auckland house prices in particular are at very high levels, and additional housing supply is needed.

Headline inflation is low, mainly due to low fuel and import prices. Long-term inflation expectations are well anchored at 2 percent. We expect inflation to strengthen, reflecting the accommodative stance of monetary policy, increases in fuel and other commodity prices, and an expected depreciation in the New Zealand dollar and in some increase in capacity pressures.

So monetary policy will continue to be accommodative. Further easing may be required to ensure that future average inflation settles near the middle of the target range, and we will continue to watch closely the emerging flow of economic data. So thanks very much.

Robertson

Thanks, governor. Just picking you up on your points around house price inflation being a further risk to financial stability and the prices being very high, and the desire you have for additional housing supply, can you give us an indication of the indicators or outcomes that would see your concerns reduce? What would they look like?

Wheeler

The situation we’ve got is house price inflation in Auckland was running at 27 percent in September, on an annual basis, and we got it down to around, or it decelerated, partly because of the LVR measures and partly because of what the Government did with the brightline test and IRD numbers. It came down to less than half that, but it’s now accelerating, and it’s been accelerating in the last 3 to 4 months. So Auckland house price inflation is running at around 13 percent at this point, and we see Tauranga, Hamilton, and Central Otago with inflation rates between 20 and 25 percent.

I think what’s particularly worrying is that if you look at Auckland the house price to income ratio is now 9. For the rest of the country it’s about 5.2, so the rest of the country is 70 percent lower, or Auckland is 70 percent higher, rather, than house price to income ratios for the rest of the country.

The other thing that’s a worry is if you look at household debt to disposable income, that ratio is about 162 percent. I don’t believe we have regional data, but if we did, given the fact that household incomes in Auckland are not that much different from the rest of the country, and given that you’ve got house price to income ratios of 9, my guess is that if you had the data, debt to income ratios for Auckland would be, on average, well above 160 percent.

At the very least, we would like to see that house price to income ratio not increase any further; I mean, at the very least. Given that incomes are probably—you know, one might forecast them to grow maybe 3 to 4 percent in nominal terms over the next year or so. If house price inflation continues to go at its current rate, or even accelerate, then those ratios will deteriorate further.

Robertson

Just to pick up on that. I will come to the things that you might do to address some of those issues, but I do just want to press you a little on what
are some of the immediate interventions you would like to see, to ensure
that that house price to income ratio stays flat or comes down.

Wheeler
There’s several things that are driving it. I mean, part of it, on the demand
side, is low interest rates. I don’t think that it’s conceivable to think that
they’re likely to rise in the foreseeable future, and part of it is housing credit,
which is growing at around 8 percent at this point. If you can’t ration that
through the price system, then that’s challenging, so macro-prudential
measures may be able to help on that.

Migration is—well, you know the numbers, how strong it’s running. If you
look at the supply side, in essence we just need a lot more housing. You’ve
got building consents in Auckland running at 9,300. It’s the strongest in 11
years. It’s about, I think, roughly 12 percent above last year. But it’s not
enough to cover just the net migration flows to Auckland. So there’s issues
around supply.

There’s potentially issues around the tax treatment of housing, around
negative gearing and the deductibility of interest for investors are the sorts
of issues. There’s a whole lot of issues around the productivity of the
building sector. There’s issues around the cost of infrastructure, in the lags
involved in getting there. There’s issues around densification. And so what
happens on 22 July and then on 19 August I think are tremendously
important.

Robertson
That’s a comprehensive and useful list. If we come to the things that you
might do, I just want to get a sense of both the priorities and the sequencing
that you’re looking at with macro-prudential tools. So some indication
coming out of this morning that you’re looking potentially at further
targeting and increasing the LVRs around investors—I just want to get an
understanding from you about whether that is your intention, and where
those speed-bump limits might go, and then what your intention is around
debt to income ratios.

Wheeler
At the moment we’re doing a lot of analysis. At this point we’ve had a
conversation with the Minister about it. We’ve had a chat with the Prime
Minister as well. So we’re doing analysis. We’re also discussing points with
Treasury.

If you look at the role of investor housing, in Auckland investors account
for about 46 percent per of the transactions. For the rest of the country it’s
around 40 percent or a bit more, so it’s very significant. That’s providing a
lot of impetus in the market. So that’s one area that we’re looking at, around
the LVRs around investor activity.

Robertson
Do you have a figure in mind?

Wheeler
No, we’re still doing analysis. We would hope to be in a position, I think by
the end of the year, to have made a decision, for example, on that. It could
be earlier, but by the end of the year it might be an appropriate benchmark.

On debt to income ratios, we’ve been collecting data from the large banks
for just over a year. We haven’t collected it from the smaller banks, but we
will start doing that.
The issues are quite complex around debt to income ratios, particularly when you have house price to income ratios in Auckland of around 9:1. So we’re just doing further analysis. But let me ask Grant if he’d like to comment.

Spencer That’s right. So the two areas are the LVRs, that we’re looking at, which Graeme just mentioned—debt to income. Debt to income—we haven’t ventured into that space as yet, but there are countries that do. Where they’ve done it, as in Ireland and the UK, for example, they’ve been along the lines of a bit of a speed-limit approach, where a certain amount, a proportion, of lending can be above a certain debt to income ratio. But that calibration would probably need to be different for New Zealand given that we do have a higher proportion of investors and relatively high debt to income ratios for borrowers compared with those countries.

Robertson In the speech you gave around some of this, you didn’t say that it would be possible to target DTIs ever towards investors or away from owner-occupiers. That’s a view you still hold?

Spencer It’s possible, but I think it would be relatively difficult and you’d run more risk of gaming, spill-over effects, etc. So there’s a greater potential for distortion, the more sort of complex and more targeted you try and make it.

Robertson Can I take it overall that the macro-prudential tools, the way you want to use them, is—you’re very aware of the concern around investor activity, the high level of investor activity, and that is a big part of the focus on how you would use these tools.

Wheeler That’s something that we’re looking at closely.

Bayly I note in the report you talk about inflation being 0.4 in the March quarter, but rising to 1.3 in December this year. Also you make comment about the increasing capacity and constraints, which is going to affect the non-tradable inflation rate. I was just interested in why you see such an increase in inflation over a relatively short period of time. What are the key drivers? Especially when we’ve had the World Bank come out yesterday with reducing its worldwide projections for growth. So I’m just trying to understand why you see it increasing so quickly.

Wheeler Yeah. If you look at why inflation’s been so low in New Zealand, as it has been in many other countries around the world, a lot of it is because of what’s happened to tradables inflation. Now if you look at the CPI regimen, roughly half of it is tradeable goods and services and the other half’s non-tradables.

We’ve had negative tradables inflation now for 3½ years, or thereabouts, and you sort of say: “Well, why is it negative now?” Partly it’s because inflation overseas is so low. Secondly, there’s a global oversupply of manufactured goods, particularly coming out of China. There’s a global oversupply of capital goods, and computer prices and other capital goods prices have been falling, and our exchange rate has been higher than what we want. So if you put all that together you get negative tradables inflation and you say, as a central bank: “What can you influence?”.
You can’t influence overseas inflation. You can’t influence global oversupply of manufactured goods. You can’t influence global oversupply of capital goods, and your ability to affect the exchange rate in a sustained way is very limited. It’s probably limited or totally non-existent—I mean we’ve cut the OCR 125 basis points and the TWI is roughly where it was at the start of that process, so the thing that we can influence is non-tradables inflation. That’s been running at around 1½ to 2½ percent. It’s down a bit at the moment, partly because of the ACC levies that took half a percent off non-tradables inflation.

So why will inflation pick up? On the tradables side, oil prices and commodity prices are increasing. So oil today is what—brent crude’s around $52. At the bottom it got down to about $27, so it’s quite a pick-up since that. So that will help raise tradables inflation as will other commodity prices. We think that the degree of excess capacity in the economy is pretty well zero at this point in terms of what we call the output gap. As the economy continues to grow, and we think it’ll probably grow around 3¼ percent around over the next 12 months, then those capacity pressures will start to pick up and they will affect non-tradables inflation. But let me see if John wants to add anything.

McDermott There are a range of factors. If you think about the Consumers Price Index half is going to be tradables, which we can’t really control, but what we already know is that oil prices are moving. Other input prices are moving and so that will simply filter through to the calculation and that will come through quite quickly. The other half is non-tradable inflation, which is influenced by policy, but the lags are quite long and, you know, so we move interest rates, that impacts on activity, activity starts to increase beyond potential. You shift the amount of supply within the economy and eventually you change inflation. So there are some things that will happen quickly and some things much more slowly.

Bayly But given that there’s been a lot of new capex and investment type businesses in the productive sector, that assumption around productive capacity being at the zero or close to it, how do you come to that theory?

McDermott Well, potential output, we think over the next few years, will run between 2½ and 2.7. So that’s the level of growth we can have without generating further inflation, and we think the economy, at least in the near term, will grow about 3 percent, maybe a little more. So the economy’s running faster than the growth with that potential, and that’s what, eventually, will drive up inflation towards the target and that’s the plan and the intention.

Cosgrove In terms of LVRs and income to debt, if you go down the income to debt road, do you see those two tools existing in unison? Or do you see debt to income replacing LVRs??

Spencer We wouldn’t see, necessarily, replacing—to some extent they could be seen as complementary, because they affect different aspects of risks. So, for example, when the commercial banks are doing their own assessments, they’ll be looking at both of those factors as relevant for overall risk. The LVRs mainly affect the, sort of, potential, what’s called, loss given default,
you know, the collateral value that would support a loan in the case of a default, but debt to income tends to affect the likelihood of the default happening.

Cosgrove Have you done any in-depth analysis as to the impact on first-home buyers? Because you could make an argument that it’s just [inaudible] Have you done any analysis to date?

Spencer It’s in process, looking at this.

Wheeler One of the complications with debt to income ratios is that when you’ve got house price to income ratios that are very high it starts to constrain or determine in a substandard way how you might think about debt to income ratios. So, for example, if you take the UK system, I think from memory, basically they have an arrangement that 15 percent of bank lending can take place at debt to income ratios over 4½. So if you’ve got house price to income ratios at 9:1 in Auckland and 5.2 in the rest of the—you can see the sorts of challenges that are there.

Spencer I would add that if you look at the lending that is high debt to income it’s a much bigger proportion of that lending that is investor lending than is owner-occupied lending. So debt to income, the appropriate threshold in terms of the hurdle, will tend to impact investors more than owner-occupiers.

Cosgrove Just a final question, because people want to move on. Have you done any analysis on alternative options in respect of capital controls—other options to look at rather than simply LVRs/debt to income? Have you done an analysis around that?

Wheeler In terms of capital controls?

Spencer The capital overlay is one of the other instruments in our tool kit, if you like. The things that are listed in the memorandum of understanding on macro-prudential with the Minister, and so capital overlay is certainly one of the macro-prudential instruments we have considered.

Cosgrove But you’ve done analysis as to the relative impact and stability and efficiency of capital use?

Spencer Yep.

Bishop Does that analysis include the equity considerations or efficiency considerations of the various tools relative to each other—their costs and benefits?

Spencer Well, it does. So, yeah, those different tools will have different types of impact. Some will affect credit more directly. Some will affect more the price of credit. So, for example, capital overlay will tend to maybe impact the pricing of credit for higher risk activities where you apply that overlay, whereas in LVRs debt to income will tend to have more of a quantitative impact on credit.

Bishop My question to that equity and efficiency—have you specifically considered those matters?
Spencer  Yep. We definitely do and that’s part of our mandate to look at soundness and efficiency. So any tool that we’re looking at in the prudential area, we certainly consider the efficiency implications of those tools.

Seymour  Could I put it more simply—will you promise to assess the impact of LVRs on younger, first-home buyers before you introduce a new restriction in the form of debt to income ratios?

Wheeler  Where we are at the moment with LVRs is just thinking of various alternatives, but the focus is on investors not first-home buyers—it’s on investors.

Seymour  So I think we’ll take it as a no.

Shaw  Again, on the debt to income ratios, one of the problems that the UK had, of course, was that the banks were allowing customers to self-certify that their incomes were high enough to justify the loan levels. So I guess I’ve got a question about—if you’re intending to introduce those kinds of measures, how would you police the banks so that they actually have the effect that they’re supposed to have?

Spencer  This is part of the analysis we’re doing. If you were going to implement such an instrument, how will it work? How would you enforce it, and the extent you would rely on the banks’ own policing, versus checks from the Reserve Bank, etc? Those are tricky issues—you’re right—and that’s why, in a sense, one of the reasons we’ve preferred LVRs in the past to debt to income, because the issues around defining income and proving income are tricky.

Nash  As you are well aware, we’re not the only ones interested in hearing from the Reserve Bank oracle. As you’re well aware there are people who make significant decisions based on your forecasts, including the Reserve Bank itself. So my question really is, are you happy with the performance of your forecasters? It just seems to me, the last 2 years on inflation, on the exchange rate, on commodity prices, you’ve got it quite wrong.

Wheeler  I’ll get John’s view on that as well, but look, the forecasting game is unbelievably tricky. We don’t have a crystal ball that we can predict the future. There’s no way. We wouldn’t even attempt to make any claims to that effect. So all forecasters face all sorts of problems about what do you assume about the global economy, what do you assume about commodity prices, what do you assume about the exchange rate, what sort of shocks might you experience—be it relative price effects, be it the oil price, for example, be it dairy prices—and what might happen to households’ willingness to save, in terms of their savings ratio.

You put all those together and you forecast with a great deal of humility. What we provide is a set of forecasts and a set of interest rate projections that are highly conditional, and we try and make that very clear as we do it. But let me hand over to John.

McDermott  It is a serious question, and we take the issue very seriously. There are no guarantees. The world is a very uncertain place. We will shortly be putting out some analysis and reports on our own performance, partly to inform us
about how we’re doing, partly to learn about how we can improve. But, just
a sneak preview, when we compare the Reserve Bank of New Zealand’s
forecasts against the market forecasts, we find that actually, on average,
we’re generally better, particularly, on what really matters for the Reserve
Bank, which is inflation. That’s been a longstanding finding.

We’ve also sought the results in a report out from the Bank of England—
that is public—that actually compares central banks; how are the central
banks doing? It was a peer group, relative to markets, and again the Reserve
Bank of New Zealand actually stands very high in that ranking. The third
thing we’re examining is how does our own forecasting performance
measure up against an alternative set of tools that we might employ. Again,
this is not perfect science, but the performance has not been that bad,
relative to the difficulties and what can happen and what can change.

Nash
Can I make one suggestion, just very quickly—that in the next report you
actually have what you forecast versus what you had for last year and the
previous year, just so we can get an indication of what happened. One very
last question to the governor: to what extent are you hanging your hat on
the Fed increasing rates?

Wheeler
It would certainly be helpful. Everyone looks at a lot of data out of the US,
but particularly the non-farm payrolls data, which came in at $38,000 for
May. The unemployment rate actually fell by 0.3, to 4.7, but that was
because participation fell significantly. If you look at wage pressures in the
States, it is running at around 2.5 percent wage inflation.

Nash
Are your forecasts predicated on the Fed increasing that rate?

Wheeler
We’ve built in a decline in the exchange rate. Part of that would come about
through an appreciation in the US dollar. I think everyone is going to look
very closely at the “Brexit” vote, and I think they’re also going to look very
closely at the June non-farm payrolls data to see whether a decision in July
becomes a live decision, or a more live decision.

They will also look very closely at what’s become known as the FOMC
dots, if you like, which is basically the members of the FOMC making a
projection about where they think, as individuals, the Fed funds rate will be
in 12 months’ time.

In December they were suggesting that there would be four tightenings. In
March they suggested that there would be two tightenings on average. The
market has said: “Well, at that point we don’t that there’ll be a tightening for
another year.”

That expectation changed with a number of speeches that were leading into
the recent non-farm payrolls data. But that’s now wound back again, in
terms of the expectations for June. So I think everyone is looking at those
sorts of things pretty carefully.

Scott
Governor, sorry to come back to the LVRs and the house price to income
discussion, but those narrow types of policies, as we’ve discussed, have
often unintended consequences, so they affect the first-home buyer and you
talk about it affecting investors—two groups that are really important to the
development of the housing market. Surely you’re better off pulling back from those narrow policies, and just leaving it to the banks to get on with their own business and manage them via the capital ratios that they’re required to keep—just put pressure on them in that way and let them do the business that they’re there to do.

Wheeler

Let me talk a little bit about the LVR ratios that we introduced. When we introduced LVRs we made it very clear that the supply and demand imbalances in the housing market was something that (1) we couldn’t fix, and (2) nor was it our responsibility to fix. But we are in a situation, on the demand side, where low interest rates have had some impact on house prices and also the demand for housing finance, along with migration and other things.

When we introduced the LVRs we were clear that any effect on house price inflation would be temporary. We were very clear about that, and it did slow down house price inflation in the Auckland market in particular, but elsewhere as well, for a period of time. But the big effect that we were hoping to get was to improve the quality of the banks’ lending books. That’s the big structural change that we wanted.

If you go back to when we introduced the LVRs—at that time the banks were competing like crazy to lend, in terms of a lot of highly leveraged lending. So about a third—in fact, it got up to 35 percent—35 percent at the peak of their lending was going to people with LVRs greater than 80 percent. We said that that’s driving the market and is creating a whole lot of upward pressure on house price inflation. So the deals were plasma TVs, $1,000 off the loans, the negotiation, and all that—the competition was intense. We said we wanted that highly leveraged lending down, from 30 percent to something below 10 percent, and that’s why we introduced the LVRs, knowing that 10 might become 7.

If you look right across the banking system as a whole, look at the loan portfolios of the banking system, and go back to when we introduced LVRs, at that point 21 percent of their loan books were highly leveraged in terms of LVRs greater than 80 percent. That 21 percent would have gone up if, at the margin, 33 percent or a third of the lending was going on high LVRs. That 21 percent average across the banking system would have gone up.

But let’s say, for comparison, it stayed at 21 percent. It’s now down to 13 percent. That’s meant that the banks basically have not delivered roughly $20 billion of highly leveraged loans that would have put upward pressure on the housing market. In other words, as a result of these LVRs you’ve seen a structural transformation in the credit quality of the loan books, of the quality of the loan books, in terms of leverage, and that’s been a sustained change and it’s been an important structural change. So that’s why we feel positive about the LVRs.

We’ve always said that we don’t want these to be permanent. We want them to be a temporary measure, but we’re in a pretty extraordinary situation at
the moment in terms of global interest rates and the like. Did you want to add anything, Grant?

Spencer  I would say that the banks have good risk management systems themselves. Indeed, I would say we’re encouraged by ANZ’s announcement last Friday that they were tightening up their standards around housing, recognising the risk that is inherent in the housing system at present.

But in general, over recent years, I would say the banks tend to underestimate the systemic costs of a housing cycle. They underestimate their own—they don’t allow for their contribution to the cycle, in terms of their lending decisions actually contributing to the housing boom, and I would say they underestimate the systemic cost of the downturn if and when it comes.

As long as they’re protected with their collateral, they say: “Right. We’re OK.” But actually if it generates an economic downturn, that causes much more widespread costs that are not allowed for.

Scott  My point is that you could discourage them from lending by other more basic, fundamental policies, rather than the specific, narrow policies of LVR and price to income. That’s my point.

Robertson  Some commentators are saying that the New Zealand dollar and the trade-weighted index is now 2 percent above the scenario that you’ve laid out that would see the OCR go below 1 percent. Do you agree with that analysis?

Spencer  I can’t give you the minute by minute dollar figure, but you’ll know what it was before you came in.

McDermott  As we walked through the door. What matters here is the path of the exchange rate over the forecast horizon, and so, as situations evolve, what would you anticipate—given New Zealand’s export prices and given New Zealand’s current account position, and New Zealand’s position relative to the world, and New Zealand’s very extensive net foreign liabilities—is that that exchange rate should depreciate, and that will influence the outcomes to inflation.

Robertson  Sure. I guess the concern is that in successive meetings, we’ve come in here, you’ve clearly expressed your view that the dollar is overvalued, and you want to see it come down. You’ve got a situation where it keeps going up. All of your assumptions actually include it coming down. We’ve got exporters who will be hugely concerned by it continuing to rise. At what point are we saying—you clearly want to do another cut, but you can’t. That’s really the scenario we’re moving into, isn’t it, if you can’t bring that down?

McDermott  But the exchange rate is going to move, for many, many reasons. As was highlighted in the press conference, we’ve moved the official cash rate down 125 basis points. The New Zealand dollar exchange rate is roughly where it was when we started those cuts.

The exchange rate will move, for many, many reasons—mostly reflecting what’s going on offshore with other monetary policy, which is very
extensive with changing global conditions, which have deteriorated, and with changing oil prices and other commodity prices. So we have to think about that and react to that, but there’s very little we can do about changing those global conditions.

Wheeler Just to give an example, when the Bank of Japan moved to negative interest rates and expanded their quantitative easing, in fact the yen appreciated.

Robertson But you’ve got a lot more room to move than that. You are well away from negative interest rates.

Wheeler We’ve got room to move if we need to move, and if we feel that we need to move we won’t hesitate to move.

Bishop What’s your view about what a neutral interest rate is? Is it still 4.5?

McDermott It would be lower than that today. We did some extensive research a couple of years ago, which is where the number 4.5 came from. Since then we’ve seen neutral interest rates probably on a very steady decline, but we calculate them as about three basis points per quarter. That hasn’t changed. It’s really a global phenomenon, so they’re probably closer to around 4-ish today.

Seymour I’m just curious. You said that you’ve met the Prime Minister and the Minister of Finance to discuss debt to income ratios. Did one of them first suggest debt to income ratios to you, or did you first suggest debt to income ratios to the Prime Minister and the Minister of Finance?

Wheeler Let me be clear, in fact, and I apologise if I have misled. We’ve certainly had a discussion with the finance Minister about some of the macro-prudential options that we’re looking at. There will be further meetings as we do more analysis, I’m sure. We’re required, as you would expect—and we’re very happy to, of course—to consult with the Minister and also with Treasury, as part of that process.

In terms of the Prime Minister, we’ve had discussions on the housing market. We go and brief him and the finance Minister a couple of days before the MPS comes out, and we often have a discussion for an hour or so about how the economy is going. We don’t tell him the decision that we’re taking. He doesn’t know that. But quite often we have a discussion on housing in general, and what’s happening on the supply and demand side. So it’s, in essence, that sort of dialogue we’ve had.

Seymour Just out of 100, these monetary policy decisions, what percentage are now based on the CPI and what percentage are based on controlling the housing market?

Wheeler They’re all—our primary focus is price stability, under the policy targets agreement. But, you know, there’s a lot of things that need to be considered around the policy targets agreement. There’s some specific language that talks about our need to avoid unnecessary instability and output interest rates in the exchange rate. There’s language there that requires us to monitor asset prices. That was put in specifically in the negotiations with the finance Minister, for the current PTA. There’s language that requires us
to take into account implications with financial stability. There’s issues that are identified there about how you could be outside the PTA range of 1 to 3 because of what’s happening with commodity prices, such as oil, for example.

Seymour So 60/40?

Shaw I just wanted to ask about commodity prices, particularly dairying. The MPS seems to sort of play down the risks from dairying debt. I was just wondering, first of all, is that a function of it coming down in absolute terms, or simply in relative terms compared with the housing crisis? And related to that, I just thought that the price of $3,300 a tonne seemed optimistic, given that a lot of commentators are talking about the new normal of the sub-$3,000—

Robertson Less optimistic than Treasury.

Wheeler The dairy debt is roughly, at this point, around $40 billion. I think what’s quite worrying is about half of it is owed by 20 percent of the farmers. So there’s some farmers that are badly stretched. In terms of the Fonterra price guideline of $4.25 excluding dividends, that means that most farmers are below break-even. They’ve been below break-even for 18 months now, on a cash-flow basis. We think break-even is around $5.30, so they’re down about $1 a kilogram of milkfat solids.

If you look at dairy prices for the future—I mean, whole milk powder prices have picked up 10 percent since March. But on the other hand, you’ve got European production still rising. It’s been rising by 4.5 percent the last year. You’ve got US production rising slightly, around 1 to 2 percent. Our production is falling, maybe by about 3 percent, and the Australians may be down a little. The Chinese increased their importation of whole milk powder in the March quarter. But there’s still a lot of expansion in milk products out there, particularly in Europe—countries like the Netherlands and Ireland. The Chinese are still working through their inventory cycles. So US$3,300 is still quite a way off given that the price is currently US$2,200. But I think our forecast basically suggests we don’t get there I think until 2018.

Shaw In 2019, but that still seems—given the conditions.

Wheeler It’s certainly one of the big uncertainties around it all, I agree.

Bishop We better wrap it up. Got to get to the House. Thank you very much, governor and your team.

Wheeler Thank you.

conclusion of evidence
Reserve Bank of New Zealand, Monetary Policy Statement, August 2016

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
August 2016

Presented to the House of Representatives
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Reserve Bank of New Zealand, Monetary Policy Statement, August 2016

Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, August 2016, and recommends that the House take note of its report.

Introduction

This report summarises the contents of the Reserve Bank’s Monetary Policy Statement released on 11 August 2016, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

Official cash rate reduced

The Monetary Policy Statement announced the decision of the Governor of the Reserve Bank to reduce the official cash rate (OCR) by 25 basis points—a quarter of one percent—to a record low of 2.0 percent.

This was the sixth reduction in the OCR in the past 14 months. The OCR was reduced by 100 basis points during 2015 (thus reversing the increases undertaken in 2014) and cut by a further 25 basis points in March 2016. The Monetary Policy Statement points out that the downward revision over that period has, in effect, been considerably larger—about 200 basis points—as the Reserve Bank has moved “from a tightening to an easing bias”. Wherein in 2015 it was signalling that the OCR might need to be increased, now it suggests that further reductions are likely.

The Reserve Bank now says that, based on its current projections and assumptions, further easing of the OCR “will be required” to ensure that future inflation settles near the middle of the 1–3 percent target range. Its forecasts imply 60 basis points of reductions, including this one, through to June 2017. As usual, the Reserve Bank emphasises that any future cuts will depend on emerging economic data.

Main reasons for the Reserve Bank’s decision

Although monetary policy has provided significant stimulus to New Zealand’s economy, the Reserve Bank judges that additional monetary stimulus is needed to help lower the exchange rate and to guard against further declines in inflation expectations.

New Zealand’s growth outlook remains comparatively strong, but weak global conditions continue to suppress inflationary pressures here. Global growth is below historical trends despite unprecedented monetary stimulus internationally. Surplus productive capacity in many economies, and low commodity prices, are suppressing global inflation. For New Zealand, the resulting high exchange rate and low import prices have caused inflation for

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tradables to be negative since 2012. Negative tradeables inflation, in turn, is keeping headline inflation low and “dragging” on people’s expectations about future inflation.\(^2\)

Annual Consumers Price Index (CPI) inflation was 0.4 percent in the June quarter. It is expected to weaken in the September quarter, reflecting lower fuel prices and reductions in ACC levies, before rising. The Reserve Bank projects that CPI inflation will return to about 2 percent, the middle of its target range, in mid-2018.

**The size of the OCR reduction**

We note that the Reserve Bank’s projections for 90-day interest rates suggest that the OCR will be eased further between now and June 2017, with an additional 35 basis points of reductions built into the forecasts. Based on this, we asked whether the Reserve Bank had considered cutting the rate by 50 basis points now, in order to send a stronger signal and encourage inflation to move up to its 2 percent target more quickly.

The governor said the bank had not given much thought to a 50 basis point cut. With the economy currently growing at about 2.5 percent, and projected to strengthen to 3.5 percent, he believes the economy does not need such extra stimulus at present, particularly with the housing situation as it is. He acknowledged that central banks in other countries have cut interest rates more aggressively, but pointed out that they have now run out of freedom to adjust any further to difficult situations.

The governor said the Reserve Bank will “do what we need to do” in trying to get inflation back within the target band, but noted that it is largely outside the band because of global factors out of its control. In the governor’s view, the economy would be “totally overheating” if interest rates were dropped rapidly to zero. He added that, with house prices already increasing by more than 20 percent in many regions, “just think what the housing market would be doing if we raced to the bottom and used up all our capacity on monetary policy”.

The Reserve Bank also said that if it had cut the OCR by 50 basis points, the financial markets would look for further cuts straightaway. It said that central banks need to be consistent in communicating their intentions, and they seek to be transparent in signalling changes in monetary policy stance.

Some of us question the Reserve Bank’s reasoning and consider that a larger reduction in the OCR is warranted at present.

**Response by retail banks to the official cash rate reduction**

We note that the Reserve Bank has said that it expects trading banks to pass on the OCR reduction to their customers, but initial reactions suggest that home loan rates will be dropped by less than the full 25 basis point cut. We asked whether this would undermine the effectiveness of what the Reserve Bank is trying to achieve through monetary policy.

The Reserve Bank said it does not want to direct banks in their pricing, preferring to leave such decisions to competitive pressures in the market. It noted that the ANZ’s initial reaction to the announcement was to reduce floating mortgage rates slightly, but to offer bigger cuts in business and agricultural lending rates, and to raise the rates offered on

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\(^2\) Headline inflation, as measured by the Consumers Price Index (CPI), measures the rate of price increases without adjusting for volatile or seasonal price movements (e.g. food and fuel costs). In contrast, measures of “core” inflation attempt to adjust for volatility in the headline rate, allowing the more general trend in prices to emerge.
deposits in order to attract savings. It said it is up to banks to decide for themselves how to allocate the reduction.

We also heard that it can take time for the new OCR rate to be reflected in lower fixed-term mortgages. However, as the Reserve Bank had signalled in previous OCR reviews that further easing was possible, banks may have already built the reduction into their current rates.

**Inflation expectations**

The Reserve Bank is watching carefully how people’s expectations evolve about future inflation. One of the key assumptions behind its projections is that inflation expectations will gradually increase. Although it says that long-term expectations are “well-anchored” at 2 percent at present, it sees a risk that the sustained weakness in headline inflation could cause inflation expectations to decline, as they did in March this year.

As we noted in our report on the March Monetary Policy Statement, this is of concern for the Reserve Bank because low expectations could become self-fulfilling if they dampened wage- and price-setting behaviour. This would make it more difficult for it to encourage inflation to return to the mid-point of the 1–3 percent target band. The governor added at our hearing: “Once you're in a situation of falling inflation expectations, it can perpetuate itself into further low inflation, and then you get into a pretty nasty cycle.”

We asked what plans the Reserve Bank has if low inflation persists. It said it is currently monitoring two issues to ensure that it is on track to achieve its mandate. The first is core inflation, which is currently within bounds. The second is whether inflation expectations are well-anchored to the 2 percent target in the medium- and long-term. At present the Reserve Bank believes they are, but policy settings need to guard against the risk of expectations becoming unanchored.

**The global outlook**

A key assumption behind the Reserve Bank’s forecasts is that global conditions will improve, causing a modest depreciation in the New Zealand dollar. We asked whether this assumption is too optimistic, and we suggested that the deflationary effect of negative tradables inflation might last longer. The Reserve Bank’s projections see average GDP for New Zealand’s trading partners growing by 3.2 percent in 2017, increasing to 3.4 percent in 2019. This compares with a historic average of about 3.8 percent.

The Reserve Bank acknowledged that the current global conditions are likely to persist for some time. Nevertheless, it sees conditions improving, albeit from quite a low base. Average global growth was about 3 percent in 2015 which is the lowest rate of growth since 2008. Global growth is low due to cyclical reasons but non-cyclical reasons are also playing a part. For example, Japan’s workforce is diminishing due to an ageing population and there is a global oversupply of manufactured goods. However, the International Monetary Fund, the OECD, and the Bank for International Settlements are all forecasting recovery and growth for the global economy.

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4 Inflation expectations are discussed on page 8 of the Monetary Policy Statement, August 2016.

5 Monetary Policy Statement, August 2016, p. 35.
The high exchange rate

The Monetary Policy Statement emphasises that a decline in the exchange rate is needed. The New Zealand dollar trade-weighted index (TWI) is currently around 6 percent higher than assumed in the June Monetary Policy Statement. This is adding further pressure to New Zealand’s export and import competing industries. However, the Reserve Bank assumes that the exchange rate will depreciate over the medium-term, reflecting a gradual improvement in global economic conditions and a narrowing in the interest rate differentials between New Zealand and other advanced economies.

We note that the New Zealand dollar appreciated after the OCR announcement, suggesting that currency markets had expected the bank to reduce the OCR by more than it did. The Reserve Bank stressed that it has little influence over the exchange rate. It has cut the OCR six times since June 2015 in order to increase non-tradables inflation and to reduce the risk of a decline in inflation expectations. However, the TWI is still 1.5 percent higher than it was in June last year. The governor said he believed that, without the reductions, the exchange rate would certainly be higher, possibly significantly so.

Reasons for the dollar’s strength

The Reserve Bank said that the interest rate differential between New Zealand and the rest of the world is one reason for the high exchange rate, but not the full story. The economy’s strength, and New Zealand’s strong reputation as a place to do business are also part of its attractiveness for overseas investors. The governor said that investors would look at such things as New Zealand’s ranking for transparency, its institutions, policy frameworks, and property rights enforcement.

The Reserve Bank’s mandate and the effectiveness of monetary policy

The Reserve Bank’s mandate, under its Policy Targets Agreement (PTA) with the Minister of Finance, is to keep CPI inflation between 1 and 3 percent on average over the medium-term, with a focus on keeping future average inflation near the 2 percent target midpoint.

The Reserve Bank is forecasting that inflation will not reach the midpoint until 2018—by which time it will have been below the target for 7 years. Given this, we asked whether its monetary policy tools are still working, or whether the PTA should be reassessed. The governor said he believes that the tools are working, and that monetary policy in New Zealand still has power. He pointed out that an accommodative monetary policy is a key factor behind the economy’s healthy growth rate. He noted, however, that the global factors causing negative tradables inflation are outside the Reserve Bank’s control, so its influence on inflation comes mainly through the non-tradables sector.

We were interested in the statement that “monetary policy may be approaching its limits of effectiveness in some economies”, and asked whether this applies in New Zealand. The governor said he does not think so. He said the comment applies in countries that have negative interest rates and high quantitative easing. In those situations, central banks are “running out of ammunition”. Up to now, extraordinarily accommodative monetary policy has taken pressure off governments in those countries to undertake structural adjustment reforms, but more appropriate fiscal positions are now needed.

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6 Monetary Policy Statement, August 2016, p. 15.
As for changing the PTA, the governor said he does not see a good case for moving away from inflation targeting. He noted that about 30 central banks still use it, including the Federal Reserve, the Bank of Japan, and the Bank of England. None are proposing to change from inflation targeting. He added that the PTA builds in some flexibility for relative price effects that move inflation out of the 1–3 percent range, such as the forthcoming cuts in ACC levies that will lower inflation by 0.3 percent in the September quarter.

** Tradable and non-tradable inflation**

As the Reserve Bank contends that it can primarily only influence inflation on non-tradable goods and services, we asked if inflation targets should distinguish between tradables and non-tradables in order to keep inflation in the target range. We were told that this would make sense in theory, but in practice would be too difficult to implement as you cannot readily separate the tradable and non-tradable components of goods. In contrast, the CPI measure is verifiable and the Reserve Bank can be accountable for it. We were also told that other central banks do not distinguish between tradables and non-tradables in their inflation targets.

** Continued pressure on the housing market**

While annual house price inflation in Auckland has stabilised at around 12 percent, house prices have increased by more than 6 percent in the June quarter. Outside Auckland and Canterbury, annual house price inflation was 18 percent in June.

We asked whether, if the proposal in the Auckland Unitary Plan to build 422,000 houses was passed, it would lead to lower mortgage rates in New Zealand. We heard that if the Auckland Council finalises the plan, then it could be expected to help in terms of house price inflation as there would be a greater supply of housing.

** Potential further measures to ease housing pressures**

We asked about future measures to restrict housing lending based on loan-to-value ratios (LVRs) and debt-to-income ratios (DTIs). The Reserve Bank said it will be introducing tighter LVR restrictions for investor lending on 1 September 2016. It is currently working with the retail banks to implement the new restrictions.

We heard that DTI restrictions are potentially a useful macroprudential tool to support financial stability, but the Reserve Bank is still looking at the data and investigating how such a measure would work. The bank told us it sees LVR and DTI measures as potentially complementary tools.

** Global dairy supply**

A special section of the monetary policy statement discusses developments in the global dairy market in recent years. While global dairy prices have fallen substantially since their peak in 2014, milk production around the world has increased. Since 2008 European production, in particular, has increased due to the relaxation and eventual removal of quotas. As a result, the Reserve Bank has reduced its assumption about medium-term prices for whole milk powder from US$3,300 a tonne to US$3,000 a tonne.
Appendix A

Committee procedure

We met on 11 and 24 August 2016 to consider the Monetary Policy Statement. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members

David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour

Fletcher Tabuteau replaced the Rt Hon Winston Peters for this item of business.
Appendix B

Transcript of hearing on 11 August 2016

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Fletcher Tabuteau

Witnesses
Reserve Bank of New Zealand
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Dr John McDermott, Assistant Governor and Head of Economics

Bennett Welcome everybody. Welcome to the governor. I’d like to welcome you and your team. Also, a very special welcome to, I think, Waikato Dio. Governor, if you want to make a brief introduction, then we can open up for questions from members.

Wheeler Thanks very much, Mr Chair, and it really is good to have the Waikato Diocesan School with us, I agree. As you know, the Reserve Bank today reduced the official cash rate by 25 basis points to 2 percent. Global growth is below trend despite unprecedented levels of monetary stimulus. Considerable surplus capacity remains across many economies and, along with low commodity prices, is suppressing global inflation. Some central banks have eased policy further since the June monetary policy statement, and long-term interest rates are at record lows. Weak global inflation and the upward pressure on our exchange rate is causing negative inflation in the tradeable sector and making it difficult for the bank to meet its inflation objective. A decline in the exchange rate is needed.

Domestic growth is expected to remain supported by strong inward migration, construction activity, tourism, and accommodative monetary policy. However, low dairy prices are depressing incomes in the dairy sector and reducing farm spending and investment. House price inflation remains excessive and has become more broad-based across the regions, adding to concerns about financial stability. Annual CPI inflation is expected to
weaken in the September quarter, reflecting lower fuel prices and cuts in ACC levies, but is expected to rise from the December quarter.

Although long-term inflation expectations are well anchored at 2 percent, the sustained weakness in headline inflation risks further declines in inflation expectations. Monetary policy will continue to remain accommodative. Our current projections and assumptions indicate that further policy easing will be required to ensure that future inflation settles near the middle of the target range.

Chairman, forgive me. I should have introduced Grant Spencer, Deputy Governor and Head of Financial Stability, on my left; and John McDermott, who is the Chief Economist and Assistant Governor, on my right. So thanks very much.

Robertson Thanks, governor. Earlier today, you said you’d like to see most of the cut passed on by trading banks. ANZ are looking at only passing on 0.05 percent in terms of floating home loan rates, and Westpac talking about perhaps, I think, 0.1 percent. Is that enough for you, in terms of what you’re suggesting?

Wheeler Well, we don’t want to get into a situation of directing banks in respect of their pricing. We’d rather leave that to competitive pressures in the market. But if you look at what I understand the ANZ to have done is they cut, I think, about five basis points on their floating mortgage rate in respect of housing, but they had deeper cuts in respect of business lending and farm income, agricultural lending, and they raised deposit rates. So banks will need to decide how they allocate those cuts in lending rates and to what extent they do try and induce more deposit growth through higher interest rates, but we’d leave that to the market competitive pressures.

Robertson But, presumably, one of the things you’re trying to do here is stimulate a bit more activity in the economy. You want to see—the purpose that you have is that you manage the money supply. You’re here saying: “We’re cutting the rates,” and the banks are coming back at you and saying: “Well, that’s all very well, but we’re not going to pass that on to a large chunk of our consumer base.” Surely that starts to undermine the effectiveness of what you’re trying to do.

Wheeler I think we’ll see what proportion gets passed on. I mean, it’s still early days in this process, but let me be very clear why we made the cut today. We’re concerned about the exchange rate pressures on the economy and we would like to see some of those pressures abated and, if possible, we would like to see the exchange rate down lower. We are also worried that tradables inflation, which has been negative for 4 years, and over which we have very little control, is causing actual inflation to be weak, and our worry is that inflation expectations, particularly at the short end, might start to decline as they did in March. Once you’re in a situation of falling inflation expectations, it can perpetuate itself into further low inflation, and then you get into a pretty nasty cycle. But let me hand over to Grant.
Spencer I just wanted to say that when you’re looking at the relationship between the wholesale rates, policy rates, and the actual mortgage rates, you have to look over a period of time as well. A lot, in fact the bulk, of new mortgages are fixed-rate mortgages, 1, 2-year or longer, and those are priced off the forward rates, which actually reduced when the expectation of our easing happened, actually before we actually ease. So some of that easing actually gets built into those fixed rates ahead of the time that we actually reduce the OCR.

Robertson I accept that, but when you look at what you’re trying to do here, you’ve got a job within the policy targets agreement to try and keep inflation between 1 and 3 percent, at a midpoint of 2. Got a situation now where, on your own figures, you’ll be 2 years under 1 percent, and you finally project to get there in the December quarter, and you’ll reach the midpoint in 2018, which will be 7 years under the 2 percent midpoint target. You’ve got an exchange rate that simply goes up every time you cut, and we’ve got the trading banks not passing on. Are any of the tools you’ve got working, or is this exercise— you know, what is the exercise you’re now engaged if it isn’t to actually meet your policy targets agreement?

Wheeler I think the tools are working. I mean, you’ve got an economy that’s growing at 2.5 percent—possibly going to accelerate to around 3.5 percent, based on our projections. A key factor behind that—it’s not the only factor, far from it, but a key factor—has been the accommodative monetary policy, the fact that we’ve lowered interest rates. You also, you know, are in a situation where—you’re quite right—we’ve had low inflation for a long period. We’ve had negative tradables inflation for 4 years. We have no influence whatsoever over offshore inflation. We have no influence over the global oversupply of manufactured goods, what happens in commodity markets, what’s happening with information technology costs, what’s happening with the global oversupply of capital goods, and we have very limited influence over the exchange rate.

Robertson I understand—sorry, with respect, I understand all of that, but at the front of the document that you give us every single time is the policy targets agreement, and that doesn’t distinguish between tradables and non-tradables. It sets a target for you, the midpoint of which you won’t reach for 7 years. Is it not time we took another look at both the policy targets and overall monetary policy? I mean, you yourself talk about monetary policy approaching the limits of its effectiveness in some economies. Is New Zealand one of those economies now?

Wheeler No, I don’t think it is. I think it’s approaching its limits of effectiveness in countries that have negative interest rates and that have high quantitative easing. I mean, you’ve now got negative interest rates in countries that represent a quarter of world output. We’ve now got more quantitative easing than we’ve had ever before. I mean, it’s now running at around $150 billion US dollars a month. So you’ve now got $12 trillion of Government securities out there now with negative yields. I mean, we’re in the most extraordinary of times. We still have power with our monetary policy, but we can mainly affect inflation through the non-tradables sector. Now, the
PTA does build in flexibility. It does build in allowances for relative price effects, such as commodities, taking you outside that 1 to 3 percent range. It does build in allowances for Government charges—like, coming up in the September quarter, we will have ACC cuts that will take 0.3 off the inflation.

Robertson  Look, I mean, why, in the environment you’re in, then, did you not do a 50 basis point cut and really push the market to respond, and for you to get back to the target?

Wheeler  Well, I think, you know, the economy doesn’t need it in terms of—in our view at this point in time. As I say, the economy’s growing around 2.5 percent. We’re projecting it to grow to 3.5 percent. We’ve built in 60 basis points of easing, and time will tell whether we need all of that or, indeed, whether we need more than that. But it didn’t strike us, at this point, with the housing situation as it is and the growth in the economy, that we really needed to use 50 basis points up at this stage.

Robertson  I accept that the housing market’s clearly been an issue—certainly an issue for the banks responding to you, clearly an issue for you. I guess the difficulty I have is that you have a job—I’m not quite going to use the phrase “you’ve got one job”, but you’ve got a job—and that is inflation targeting, and you will be outside of those targets for an extended period. You even yourself, in here, use the language about long term—not medium term anymore; long term. The PTA says medium term. That’s your job. The Government should be sorting out the housing crisis, but it seems to me that you’re not meeting the targets you’ve got because you’re now taking on the role of being public policy maker.

Wheeler  Let’s just explore it a bit, then. If you look around the world, there’s probably 30 central banks, mainly in advanced economies, that undertake inflation targeting. I don’t think there’s one central bank in the last few years that has moved away from inflation targeting. If you look at the targets that they’ve set, you see the Federal Reserve has a target of 2 percent, the Bank of Japan 2 percent, European Central Bank just below 2 percent, Bank of England 2 percent. So no one’s moved, to my knowledge, to change either away from inflation targeting or from the inflation targets that they’ve set. There isn’t a better framework out there. One can argue about where the targets should be, but I don’t think there’s a good case for moving away from inflation targeting.

Robertson  Just one last question, before I move on. You raise those other central banks. Equally, they have all been more aggressive in cutting rates than you have, haven’t they?

Wheeler  That’s correct, but they’ve also now run out of degrees of freedom—completely out of degrees of freedom—to a large extent. You just saw Mark Carney the other day say: “Look, you know, we’re cutting interest rates from half a percent to quarter of a percent. I do not want to go to negative interest rates.” So they’re running out of capacity to adjust to difficult situations.
Bennett: You mentioned these were unusual times. Has this ever been encountered before, and what have people done to get out of it in the past?

Wheeler: I think if you look internationally, and let’s say you were looking at a country with much lower growth than us. Say you were looking at the European area, for example. You’ve now got negative interest rates from the ECB and they’re undertaking the equivalent of US$90 billion of security purchases a month. That’s quite extraordinary—so much so that the Central Bank is not just buying Government securities, it’s also buying from the private sector, and some of these central banks around the world are now buying equities.

In those situations I think you’re reaching the limits of what monetary policy can do, and I think the worry is that central banks have accommodated so much that it’s taken a lot of pressure off Governments to do structural policy reform. So I think what I would think is important in a lot of those countries is that there be appropriate fiscal positions adopted in that more aggressive structural adjustment reform, because I think the central banks are running out of ammunition in those countries, and I don’t believe we are.

Bishop: On a slightly different note—so in the Monetary Policy Statement you note that rising capacity pressures can translate to price pressure. Are you doing any work as a bank on alternative economic models? That model seems to be breaking down. Are you looking at the role of technology and how that might be resulting in productivity improvements that aren’t captured by the official statistics? I know there’s work internationally going on. You’re picking up things that aren’t even discernible in the stats but that we know are having an impact on the economy, and potentially on capacity pressures, and therefore price as well. Is there some sort of deep thinking going on about that?

McDermott: As you can imagine, we’re spending an awful lot of time and resources thinking about inflation and low inflation. You asserted that the model is broken. Well, actually, according to our research that’s not the case at all. What’s taking place is there’s been a major financial crisis, one of the biggest in 80 years, in the world. It has left the world with a huge amount of spare resources. We’re seeing commodity prices being very weak, as a consequence, and we are seeing central banks around the world having to respond to that weakness, and that comes through New Zealand’s exchange rate, as a consequence.

The unusual thing for the Government is the impact of the rest of the world has left a picture of our tradables inflation that’s very unusual, that we haven’t seen before. That’s the very first picture in the Monetary Policy Statement, on page 5, where you see tradables inflation is often very volatile. In the past it got moved around by oil prices. The movements were very temporary, and a central bank could largely look through these developments and, as you can see, our tradables inflation has been negative for well over 4 years. That’s what’s unusual. When you put that into our
framework, into our model, you get the outputs that you expect. The forecasts aren’t broken.

Tabuteau You talk about good growth in the economy at the moment, but more than half of it is consumptive numbers brought about by high immigration inflows, and by definition those are short term. So I put it to you that the interest rate differential right now between us and the rest of the world is huge. You said yourself that’s putting so much pressure on our exchange rate. It’s putting the dollar up, out of kilter with expectations. Was it now the time, the opportunity, to go with that 50 basis points, at least, hit, to make that substantive difference, given that the conversation previously also said that what you’re doing now isn’t having much impact at all on the New Zealand housing market? Let’s help our exporters. Let’s grow sustainable growth in the economy.

Wheeler We didn’t give a lot of thought to the 50 basis point cut. As soon as you put in a 50 basis point cut, the markets would be looking for your next cut, straightaway. If you look at why we’re getting portfolio flows, why is capital coming to New Zealand, partly it’s interest differentials. That’s part of the story. But it’s also the growth story—the fact that you’ve got an economy growing 2.5, that may accelerate to around 3.5. But it’s also—you look at some of the international indicators. Look at our ranking on Transparency International. Look at our ranking in the cost of doing business report out of the World Bank. Look at the global competitiveness report that comes out of Switzerland and our rankings there for financial markets and other stuff.

When we’re in the top five countries of the world, so people look at the institutions, they look at policy frameworks, they look at property rights enforcement, and all of that. So that’s part of the attraction of investing here, compared to other countries around the world. You have a lot of funds out there, be they pension funds—let’s say you’re a defined benefit scheme. Your requirement is, as the manager of that fund, to try and generate something like a 7 percent return. So where are you going to get that? You look around for the most attractive environments—where to invest. That’s part of the story here.

Tabuteau You spoke again of the fantastic growth rate, and I did preface my question on the substantive nature of what is constituting growth in New Zealand at the moment. I have put it to you, and you’ve said it yourself, that a large part of that is consumptive, brought about by high immigration numbers. By definition, that’s not long term. They won’t flow through into the growth figures, medium or long term. So is that still your answer, basically?

McDermott Wherever the growth is coming from, it still will add aggregate demand in the economy and it will alter the balance and alter, ultimately, the prices for the economy so we have to think through that dynamic. The other point you were highlighting is: so why not 50? I can understand the question, but to some extent that trivialises monetary policy. What we’ve been trying to do, given the situation that we already face, is move the entire yield curve, so that we’re getting the right pricing—not just for housing but for business
lending, for agricultural lending, for commercial building lending, and most of those are priced off the wholesale markets that are influenced by where the yield curve is going to go, not off these very short-term interest rates. So we had a bigger picture to think through.

The other problem, and I think the governor has already mentioned this—if you just went 25, given that would be inconsistent to our previous communication, we’d actually just add noise to the financial market, and they would say: “Then what? Now what?”. So it would probably be less effective than always being consistent and telling the market our genuine intentions about how to achieve the mandate.

Bayly

I saw in your June statement that you said that the TWI was 6 percent over-valued. You make this announcement today and we see a rapid escalation in the dollar. What I’m trying to understand is, why are we getting this disconnect between what you are saying and doing and how the market is reacting? Everyone in this room would agree that having a higher dollar is not helping this economy. So these are really crucial communication issues that, for some reason, the market is interpreting differently. I’m just keen to hear your oversight.

Wheeler

The 6 percent I think you are referring to is the fact that the TWI, going into this decision, was 6 percent higher than what was contained in the June Monetary Policy Statement. So that’s the 6 percent. You talk about a 6 percent over-valuation. We weren’t talking about that.

We’ve cut interest rates six times now since June last year. We’ve done it and try and ease some of the pressure on the exchange rate, and we’ve done it to and try and get non-tradables inflation up and to try and reduce the risk of a decline in inflation expectations, like what we saw in March, for example.

Having cut six times, the TWI is still about 1.5 percent higher than it was in June, before we started cutting. So our ability to sort of have an interest rate decision and assume that portfolio flows are going to give us the outcome we want, it is not necessarily guaranteed—not at all. But you have to start thinking about the counterfactual. What say you didn’t start cutting in some way? What would be happening to the exchange rate in that situation? It would certainly, in my view, be stronger and possibly significantly stronger.

Genter

You’ve said that the tradables inflation is basically out of your hands—it’s not something that you can influence. Do you think that inflation targeting should distinguish between tradables and non-tradables in terms of the target we’re trying to reach? Or do you think that as long as tradables stay low or negative, that we’re going to have to aim for even higher non-tradables inflation?

Wheeler

That’s an interesting question. I’d be interested in John’s thoughts on that. If you look at the inflation targets that central banks adopt, they don’t distinguish between tradables and non-tradables, and it’s certainly true that our influence is primarily, without question, on non-tradables inflation, and
that’s been tracking roughly between 1.5 and 2.5 percent. We have quite a lot of influence over that.

It’s been a big weaker at times, because of the strong migration flows, and that’s created wage moderation in terms of expansion in the labour supply. It’s been low at times because of these ACC charges and things like that.

The PTA, as it’s specified at the moment, does basically have flexibility for the central bank in the following respects: it does recognise that commodity prices can throw you outside that target. It does recognise that Government pricing policies can throw you outside that target. But it is true that there’s an awful lot of the CPI that we can’t directly control. But let me get John’s thoughts.

McDermott Yeah, it is an interesting question, and actually quite complex. If I was a monetary theorist, I would say absolutely yes. But theory’s all very well; the practical realities are not when you work with a central bank, and when you’re thinking about tradable or non-tradable stocks, it becomes technical very quickly. It makes the job for the central bank much more difficult to communicate what—because when you go to the store, when you go to the supermarket, you’re not looking at the shelf and asking which is tradable and which is non-tradable, and you probably don’t know. Actually, even Stats New Zealand would have a tough time making a pure decomposition, because there are links between—something can come across the border, but there is a non-tradable component when there is a service element to it.

So the practical realities of drawing that distinction become very hard. I think how the framework accommodates that is to say: “Let’s have headline CPI as the target—it’s verifiable, we can be accountable for that measure, everybody can see it—but give this bank some flexibility to recognise there are some elements that we simply cannot control.” Then you get the flexibility over how long is it going to be before you return to target, and you have the discretion to do that so as not to make other problems in the economy even worse.

Genter So I guess what I’m interested in is, you know, what is the plan if we continue to have negative tradables inflation and persistently low inflation? Is that something that the Reserve Bank is dealing with, with the forecast for cuts?

McDermott Again, it’s a risk that we’re very concerned about. It’s the core of this statement, and how it would feed through to inflation expectations would undermine and make it more difficult to achieve our mandate. So it is a very important issue. So there are two things we are going to watch to see if we’re still on track. One is: where is core inflation? Once you take all the special features like ACC reductions and so on, is it sort of OK that inflation’s about 1.5? So it’s well within the bounds—maybe a little bit more than 2 but it’s well within the bounds. And the other thing is, our inflation expectation is well anchored to the target that we’ve been given, and for the moment—at least in the medium and long term—those expectations are, but we have to make sure we keep moving policy to eliminate the risk that that becomes unanchored.
Scott: Sort of a bit of a follow-up from Julie Anne’s question. So you’ve got the non-tradables just about right. As you say, you strip away ACC and you’re just about at 2 percent. But in your assumptions you talk about global conditions improving, and I would challenge that given the statement you’ve just made. This huge amount of liquidity, basically deflationary expectations with negative interest rates—I mean, Europeans are putting their money under the mattress rather than in a bank. Right? So a dollar tomorrow is worth more than a dollar today. Very unusual circumstances. I would challenge you and suggest that that deflationary effect is going to be around—that tradable deflation, or that negative inflation, will be a lot stronger and will be around for a lot longer. And so given that assumption, given my assumption, why don’t you get ahead of the game instead of waiting—I think you said waiting to see how the future unfolds.

McDermott: No, no, it’s a good point. Let’s be clear. We are very concerned about the global environment, and we do think the risks that are around at the moment will actually be persistent. The current global problems will not vanish tomorrow, and we have to manage against that risk. But what we also have to manage is: how is this flowing into the New Zealand economy? And it’s coming through through lower imported pricing—and so, for a central banker that’s not ideal. But I think if you were a general consumer, it’s probably not that bad—and it’s coming through through a higher exchange rate because of the response of the rest of the world, and that’s having very adverse consequences for our export sector, for our import competing sector. To the extent we can, we’re trying to take that into consideration. So I think the problems will be around—we’re actually agreeing with you. I think the problems are going to be around for a lot longer.

Scott: But your assumption says global conditions will improve.

McDermott: It doesn’t mean the problem’s gone. They’ve been improving from quite a low base. We’re going to be confronted with this, sort of, trend, below trend—lots of spare resources will be around for a long time.

Wheeler: If you look at the global economy, it’s growing, probably, around about 3 percent. That’s what it grew last year, and that was the slowest since 2008. If you look at what is the trend rate of the global economy over a number of years, it’s about 3.8, so it’s below trend. And it’s below trend despite this extraordinary monetary accommodation that I’ve talked about. And you’re seeing low inflation for a whole lot of reasons that are cyclical but also non-cyclical. You’re seeing structural elements to a low inflation that are linked to demography—for example, in Japan with a diminishing workforce and an ageing population. You’re seeing it linked into IT costs. You’re seeing it linked into the global oversupply of manufactured good.

So there’s a lot of structural elements to low inflation as well, but if you look at the forecasts that come out of the IMF, the OECD, and the Bank for International Settlements, they’re all forecasting recovery and growth. Now, the forecasts have consistently been marked down as the weakness of the recoveries continued, but they’re all forecasting a recovery and growth.
at some point. You know, it would be an unusual state of the world that if you look out for a long, long time and just had below trend rates of growth, and very low inflation, and these extraordinarily low interest rates continuing in perpetuity. I don’t believe they will.

Cosgrove

You made a couple of interesting statements, both you and your colleague. Governor, you said, in response to one of the questions that if you cut 50 basis points, then the markets will look to the next one. My first question is: do you think that’s a good argument? And your colleague then went on to say that a 50 basis point cut would somehow trivialise monetary policy. You could also make the argument, with respect, that it has been trivialised already given that you’re 2 years away, you say, from—in a low point of 1 percent; you’re 7 years away from hitting a midpoint of the PTA, which, actually, is the ultimate measurement of your performance. And then I’ve got one other question as well.

Wheeler

Well, the 2 percent got introduced as a concept when I became the governor, so it’s been around since that time, which is under 4 years, or so. Look, you have to think about what life is like in an economy that’s likely to grow at around 3.5 percent if you suddenly race to the bottom with interest rates. Now, we will do what we need to do in terms of trying to get inflation back within the band, which is largely outside of the band—as I’ve said—because of things we can’t control. The non-tradables is running well within band. The underlying inflation is well within band as well.

But, you know, if we drop interest rates rapidly to around zero, like much of the rest of the world, we’ll have an economy that’s totally overheating. We’ll have a housing market that is already growing faster in terms of house price inflation, than 20 percent in Central Otago, Tauranga, Hamilton, Wellington even. So just think what the housing market would be doing if we raced to the bottom and use up all our capacity on monetary policy. That doesn’t strike me as

Seymour

I just wanted to ask—there’s been a lot of criticism of not getting back up to 1 percent. Has anybody actually complained to you that prices are just so stable?

Wheeler

Well, a lot of people actually say: “Well, gee, we’ve got an economy that, for many people,”—not all people, obviously, because different people benefit from this economy in different ways, and some don’t benefit at all. But get a lot of people saying to us: “Gee, you’ve got pretty reasonable output growth, and the cost of living is pretty low.” We also get some people saying: “Look, we’re really worried about our interest rates we get on deposits given that we have to live off these term deposits.”

Seymour

Just on the Auckland Unitary Plan—422,000 houses if the plan, as proposed, passes. Will that make your job easier, and might it lead to lower mortgage rates for New Zealanders up and down the country?

Wheeler

It would certainly help in terms of house price inflation, if—let’s say that the council, on 18 August, or prior to that, finalises, or agrees on, the recommendations of the independent experts and that gets promulgated in
terms of greater supply, then that will certainly help in terms of house price inflation over time.

Nash
You talk about the fact that we do very well on Swiss indices and that how global pension fund managers are very happy with New Zealand’s performance. But shouldn’t we be more concerned about SMEs who have to borrow money at a higher rate than their global competitors, and exporters who are trying to make a buck with an over-inflated exchange rate?

Wheeler
I think we’ve talked about the exchange rate earlier in the conversation. I’d only be repeating myself, and I don’t want to trouble you with that. You know, interest rates have come down pretty substantially. If you look at our 10-year bond rates, for example, they’re at historic lows. The official cash rate is 2 percent. We’ve built in 60 basis points of cuts including the cut that we had today. I don’t hear a lot of business people saying—and I could be wrong; you may hear them—“The cost of borrowing is a major constraint on my ability to invest.”

Nash
Well, on that, then, you have got here: “Net migration also adds to labour force growth and moderates wage inflation”. Isn’t that just a way of saying that immigration keeps wages low and is replacing Kiwi jobs with foreigners?

Wheeler
Well, I think what you’ve seen is, you know, you’ve seen 160,000 people, in terms of net permanent long-term migration, working-age people, coming into the country. Now, in terms of the workforce that’s about a 4 percent increase since 2012. Now, that’s unprecedented, certainly in recent decades. It’s far stronger than what we saw in 2001-2002.

I think it has had the effect, in terms of the increase in the labour supply, of moderating wages in New Zealand, given that you’ve seen very strong employment growth in recent years. If you had not had this, I think it’s fair to say that, you know, you would’ve seen more wage pressure than what we’ve had.

Cosgrove
Could I just ask you—I think I put it to at the last meeting—about LVRs and debt to income ratios. Where are you at with work in terms of looking at either their complementary impact if they coalesce together or a duplication of impact? Where is the thinking?

Spencer
Well, we’ve been consulting on the LVRs—the tighter LVRs—for investor lending, and they’re due to come in from 1 September. So we’re working on the implementation of that for the banks. With the debt to income ratios, we still think that’s a, sort of, promising area of inquiry as a potentially useful macroprudential tool, but we’ve still got a bit of work to do in terms of examining what the behaviour has been, getting the appropriate data, and seeing how that instrument might work.

Cosgrove
You haven’t come to a conclusion about the duplication versus impact of having them as complementary tools?
Spencer: We don't see them as duplicating. We think they have overlap, but they also cover areas that are not overlapped. So we think they're potentially complementary.

Genter: I guess what I was interested about—and this was related to the LVRs—is there's persistently low demand globally and in New Zealand. Do you think that, maybe, banks have got too much of their balance sheets in property rather than lending to the productive side of the economy, and is there a way to influence that other than something like LVRs? Is that something the Reserve Bank's considering?

Spencer: Well, I mean, globally there's been a big push, particularly in the developed countries, to get more credit to business, and, frankly, there just hasn't been the demand for credit from business to the extent that there has been from the household sector.

Bennett: OK. We'll call it quits there. Thank you very much, governor. I appreciate your time. Thank you everybody.

**conclusion of evidence**
Reserve Bank of New Zealand, Monetary Policy Statement, November 2016

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
November 2016

Presented to the House of Representatives
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Reserve Bank of New Zealand, Monetary Policy Statement, November 2016

Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, November 2016, and recommends that the House take note of its report.

Introduction

This report summarises the contents of the Reserve Bank’s Monetary Policy Statement released on 10 November 2016, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

Official cash rate reduced

In the monetary policy statement the Governor of the Reserve Bank announced his decision to reduce the official cash rate (OCR) by 25 basis points—a quarter of one percent—to a record low of 1.75 percent.

This was the seventh reduction in the OCR in the past 17 months. Global conditions since 2015 have continued to suppress domestic inflationary pressure; and the Reserve Bank has forecast that it expects the OCR to be close to current levels until at least the end of 2018. This projected path for the OCR—low interest rates, likely to remain so for some time—is one of the key messages of this statement. Interest rates at this level are designed to support strong and steady growth in the economy, and to provide for a gradual increase of inflation towards the mid-point of the 1 to 3 percent target band.

Context in which the decision was made to reduce official cash rate

We were told that the context in which the Reserve Bank decided to reduce the official cash rate is one of weak global conditions including low global inflation. The comparatively positive outlook for growth in New Zealand, coupled with low global interest rates, has resulted in strong interest from investors in New Zealand dollar assets. This has supported an increase in the New Zealand dollar exchange rate. We note that it is the Bank’s view that the exchange rate is higher than is sustainable for balanced economic growth, and a decline in the exchange rate is desirable.

The high exchange rate, low commodity prices, and subdued global inflation have translated directly into low prices for New Zealand’s imports, suppressing tradables inflation. This weakness in tradables, which has persisted since 2012, is an ongoing challenge for monetary policy. The Reserve Bank considers that continued monetary policy stimulus is needed to support strong GDP growth, generating an increase in non-tradables inflation over the medium term, and guarding against further declines in inflation expectations.

GDP grew by 3.6 percent in the year to the June 2016 quarter, and we understand that this pace of growth is likely to continue. Migration flows have increased the supply of labour
and productive capacity in the economy, and this will contribute to higher non-tradables inflation.

**Impact of the election of Donald Trump to the United States presidency**

We met the morning after the United States election. We asked the Reserve Bank whether the election of Donald Trump had influenced its decision to reduce the OCR. The governor told us that the decision had been reconsidered earlier that morning, once the election result was known, and had been reaffirmed.

We heard that the United States election result had initially surprised the markets, resulting in the US dollar weakening and the price of gold increasing. The Japanese yen, the Swiss franc and the euro strengthened, while emerging market currencies weakened, and the Mexican peso dropped about 15 percent. Long-term bond rates fell about 13 or 14 basis points based on concerns about what Donald Trump’s election might mean for global growth.

However, during the night following the election, the market re-evaluated the situation, and long-term rates rose considerably, to end at 20 basis points compared to the day before the election. This probably followed consideration of the potential ease of putting through fiscal policy, possible growth in the US economy and an increase in inflation. The New Zealand dollar weakened against the US dollar. The Reserve Bank viewed this favourably, considering the New Zealand dollar to be higher than is sustainable for balanced economic growth.

**Inflation expectations**

We asked the governor to explain the Reserve Bank’s inflation expectations. Annual Consumers Price Index (CPI) inflation was 0.4 percent for the September 2016 quarter, which reflects the negative tradables inflation. Low annual inflation in September was also a result of falls in petrol prices, reductions in ACC vehicle levies, and lower domestic and international airfares.

Non-tradables inflation, which the Reserve Bank has some control over, is currently at around 2.7 percent, and is expected to increase to up to 3.5 percent. The construction cost inflation in Auckland is at around 8 percent. We heard that CPI inflation has now recovered slightly to 0.2 percent, and was expected to be within the 1 to 3 percent band by the December CPI.

Global demand for commodities is expected to increase, contributing to a gradual increase in the prices of New Zealand’s imports and exports, and causing a rise in tradables inflation. In particular, oil prices are expected to increase to around US$60 per barrel. The price of whole milk powder is expected to reach US$3,000 per tonne in the medium term. We heard that signs of higher inflation are now apparent in the United States, China, and one or two European countries.

**Balance between monetary and fiscal policy**

The focus of monetary policy is to maintain price stability. The Policy Targets Agreement between the Governor of the Reserve Bank and the Minister of Finance sets out specific targets to achieve this. Fiscal policy encompasses Government expenditure and taxation decisions. We asked how the governor saw the optimal balance between these two tools.

We heard that monetary policy has been used quite a lot to adjust pressure in the economy—through the seven cuts to interest rates, for example, since the middle of
2015—and it has been an important factor in achieving growth. However, the governor considers that it is possible to place too much pressure on monetary policy, as demonstrated in countries where interest rates were lowered to zero or even negative figures, and governments have been reluctant to make changes to their fiscal policy.

He described the situation in New Zealand as keeping fiscal policy “on more of a neutral stance” in recent times. In his view, the economy does not need fiscal stimulus while it is growing at between 3.5 and 4 percent. If it were to slow down dramatically, the Reserve Bank would look at its scope for making further monetary policy adjustments, but he told us that fiscal policy adjustments would also be needed at that point.

**Bank funding costs**

We wanted to know whether the funding rules of the Australian Prudential Regulation Authority (APRA) are impacting on the funding of the Australian subsidiary banks in New Zealand. We heard that this is not the case—APRA restrictions mean that the New Zealand subsidiaries are now pretty much on their own in terms of funding.

We were told that the funding of banks in New Zealand has been getting tighter because growth in deposits has slowed down, while growth in credit has continued. With the resulting bigger gap between deposits and lending, banks have had to turn to more expensive offshore wholesale markets. Their lending standards have been tightened over the past six months across the household, business, and agriculture sectors.

**Factors behind projections**

The Reserve Bank’s projections around unemployment show it dropping to 4.5 percent, net immigration reducing sharply by almost two-thirds, and house-price inflation lowering to 2.5 percent. We asked about the validity of the factors behind these projections.

We were told that there is always uncertainty around such projections, because economic conditions can change suddenly, and economic relationships can evolve differently from in the past. The Reserve Bank’s assessments, therefore, depend on a range of judgements relating to how global conditions might evolve, and how those global factors and domestic policy stimulus affect the domestic economy.

**The unemployment rate**

The Reserve Bank has forecast the unemployment rate to drop from the current 5.2 percent to 4.7 percent in 2017, and 4.5 percent in 2018. The governor explained that, as the economy grows beyond its ability to supply, labour market participation increases and the unemployment rate drops. He expects growth to continue faster than supply, and this factor is behind its projected unemployment figures.

**Net immigration**

We heard that high net immigration is supporting growth in labour supply, and limiting wage pressure. However the impact per migrant might have been smaller than in previous migration cycles.

On an annual basis, the net inflow of working-age migrants rose to a new peak of around 60,000 per annum in September, reflecting relatively favourable labour market conditions in New Zealand. The Reserve Bank has projected a steep drop by almost two-thirds in net immigration in 2019. The governor told us that more people would still arrive, but the unprecedented number of migrants is expected to drop to a more normal level as foreign
labour markets improve. He said that analysing these trends has not been easy; it was a matter of “trying to get a sense about how people feel about New Zealand, [and] how people feel about the rest of the world.” Immigration numbers may be affected by such things as New Zealanders not leaving because things look better here, New Zealanders living overseas choosing to come home, and potential new Kiwis arriving.

We heard it is important when making projections to go beyond pure numbers, to look at the composition and source of the migrants, and how they impact on the economy. While very large swings in net migration have had an inflationary effect in the past, that has not been the case in more recent times.

Migrants today are likely to be younger than in previous years, of working age, and single, rather than arriving as a family unit. They are probably buying fewer houses than migrants in previous cycles did. They may live in higher density housing, and buy different goods and services. By entering the workforce these migrants have added to the supply of labour in the economy, moderating some of the inflationary pressure associated with the boost to demand. We were pleased to hear that the Reserve Bank will continue to analyse immigration issues.

**House-price inflation**

We note that the media release which accompanied the monetary policy statement put the current situation as being that house price inflation remains excessive and is posing concern for financial stability. Although house price inflation has moderated in Auckland, it is uncertain whether this will be sustained given the continuing imbalance between supply and demand.

We asked the governor to explain whether the use of macro-prudential tools had impacted on the Reserve Bank’s projection of house-price inflation dropping to 2.5 percent in 2019. We were told that the recent moderation in house-price inflation, particularly in the Auckland market, is probably due to restrictions on the share of high loan-to-value ratio (LVR) loans in the residential property sector, particularly regarding investors and investor-related lending. Another factor is the tightening by banks in New Zealand of their credit criteria for offshore buyers seeking a loan here who are relying on offshore income; this is because of doubts about the accuracy of statements about that income. There have also been signs of mortgage rates increasing as banks face higher funding costs because the growth in their lending is increasing more rapidly than the growth in their deposits.

These factors, along with the supply of housing growing but not quickly enough, and the expected drop in migration to more normal levels, are the reasons for the Reserve Bank projecting a decrease in house-price inflation. We discussed the impact this will have on people’s expectations of capital gain, and heard that it will probably result in some people switching to other asset classes.

We were told that, while demand for housing is very high, supply is increasing. Building consents across the country are up about 11 percent on last year, while in Auckland that figure is 14 percent. This is the strongest activity seen in the sector for about 11 years.

We asked about the possibility of the introduction of another macro-prudential policy tool, a Debt to Income Multiple. This is yet to be approved by the Minister of Finance. The governor said he would not use such a tool at the moment because of the moderation in house-price inflation.
Review of assumptions behind Kiwi Inflation Targeting Technology model

The Kiwi Inflation Targeting Technology model (KITT) is the core macroeconomic model at the heart of the monetary policy process. It builds a picture of the macroeconomic economy from specific assumptions about the microeconomic behaviour of households and firms. We asked the governor how often the assumptions behind KITT are reviewed.

We heard that every time Reserve Bank staff examine the related set of deliberations they check whether they still make sense. Where systematic errors occur, a more detailed evaluation of the frameworks is undertaken. Research findings are made available to the public in a number of publications.

Assumptions about the prices of oil and dairy products, net migration, house-price inflation, wealth effects, the exchange rate, and overseas inflation rates, are looked at very closely because of their impact on inflation forecasting. The process of forming expectations can also be backward looking, and we were told that the Reserve Bank considers and publishes a range of scenarios.
Appendix A

Committee procedure
We met on 10 and 30 November 2016 to consider the Monetary Policy Statement. We heard evidence from the Reserve Bank of New Zealand, and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Transcript of hearing on 10 November 2016

Members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour

Witnesses
Reserve Bank of New Zealand
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Dr John McDermott, Assistant Governor and Head of Economics

Bennett Welcome Governor. Thank you very much for coming in. We’ve got the monetary policy statement and your decision here. If you want to give us a brief introduction then we’ll open up for questions.

Wheeler Thanks very much Chair. I will be brief. [Introductions]. As you will have seen, we cut the OCR 25 basis points to 1.75. Significant surplus capacity exists across the global economy, and global inflation remains weak, even though commodity prices are off their lows. Political uncertainty remains heightened and market volatility is elevated. The exchange rate remains higher than is sustainable for balanced economic growth.

Domestic growth is being supported by strong population growth, construction activity, tourism, and accommodative monetary policy. We’ve seen some positive dairy auctions recently, but uncertainty remains around future outcomes.

House-price inflation remains excessive and is posing concerns for financial stability. We’ve seen some house-price moderation in Auckland, but it’s probably still too early to say whether it will be sustained.

Headline inflation remains low, but is being held below its target by persistent negative tradables inflation. We expect annual inflation to be within the target range in the December quarter.
The monetary policy, we’ve said, will continue to be accommodative. Our current projections and assumptions indicate that policy settings, including the easing that we’ve announced today, will see growth strong enough to have inflation settle near the middle of the target range. And, of course, numerous uncertainties remain, particularly in respect of the international outlook, and policy may need to respond to that. Thanks very much Chair.

Robertson

Thanks very much Governor. Just as I start, my apologies, I have to leave to go to a funeral. I guess we need to address the almost literal elephant in the room, in terms of what happened yesterday in the US. Could you give us your thoughts on the impact of that, and whether it’s influenced your decision in any way. Overall, what do you think that might entail in terms of exchange rate and—

Wheeler

There are probably two scenarios that would have surprised the market. We saw one last night. The other one, I think, that would have been a major surprise, if there had been a very large landslide win to *Hillary Clinton. But the market was positioned, probably, for Hillary Clinton winning and the GOP retaining control of the House and Senate. You saw pretty well what you expected with that scenario being a surprise to the market. You saw risk-off behaviour, you saw the US dollar weaken, you saw a flight to more safe haven assets—so you saw gold pick up, you saw the Japanese yen, the Swiss franc, the euro, strengthened. You saw emerging market currencies weaken, and, you know, the Mexican peso got heavily hit, that was down about 15 percent.

Robertson

The wall is going to be expensive.

Wheeler

There was no mention of the wall during the acceptance speech I saw. And then you saw—and this was interesting—you saw long-term bond rates, 10-year bond rates, fall about 13 basis points, 13 or 14 basis points, based on, you know, concerns about Trump and what that might mean for global growth and things like that, and just the surprise element as people shifted their portfolios.

But, then, during the night, it was very interesting, you saw the market re-evaluate as it became clearer that Trump was going to win the election—start to evaluate what impact he might have, and particularly on the fiscal side. He had made a lot of comment about tax cuts, he talked about a 15 percent corporate tax rate. He’d talked extensively about large infrastructure projects, and he repeated that last night in his speech.

So, the markets started saying look, here’s the GOP in control of the House and the Senate, and also had a win in terms of the presidency, so it is going to be relatively easy to put fiscal policy through. And then saying OK, fiscal policy could be really quite expansionary, we could see the US economy grow quicker, inflation pick up, the Federal Reserve having to lean against those sorts of growth and inflation pressures, and long-term interest rates started rising. And then you saw quite a phenomenal rise in long-term rates. They went up, having fallen 13 basis points, they then went up 33 basis points, which is huge for a long-term instrument like that.
So, we ended up yesterday with long-term interest rates up 20 basis points compared to the day before the election. Now, we went down 13 basis points as well during the evening, and we came back, I think, up about 20 basis points, as opposed to the 33 of the US rates.

So, I think, where things are—people are trying to work out: what does it mean for fiscal policy, in terms of infrastructure spending and tax cuts? They’ll look very closely at what sort of *advisers he has around him, what sort of *Cabinet position selections might be made. And they’ll spend a lot of time thinking about “What are the trade issues?”, because he has made such striking comments about trade protectionism.

Now, if you look at global trade it’s a tremendously important catalyst to global growth, and in the last 5 years you’ve seen the weakest growth in the volume of trade since the early 1980s, and you’ve seen protectionism measures rise in G20 countries to the greatest extent since 2009. So, at the moment, you’re seeing very weak global trade and rising protectionism. And if you put that against Trump’s previous comments about “I’m going to renegotiate NAFTA. I’m going to oppose the TPP. I’m going to put a 45 percent tariff on China, and a significant tariff on Mexico”, then what people need to focus on for the medium term is: what is the US position on trade reform? That potentially has significant implications for us. I think the US will need to, you know, think very seriously about its leadership in the Asia-Pacific region, and what role trade and investment flows have in that. Because TPP was a vehicle for delivering a lot of that leadership.

Robertson  Just a [Inaudible] of the dollar—New Zealand dollar specifically—what is your thinking? I know you’re crystal-ball gazing but what is your—

Wheeler  Of the dollar? Well, what we saw was the dollar weaken. You saw the US dollar weaken and then that reversed itself. But we’ve weakened against the US dollar, which is good. The issue is: what are we seeing in terms of—or what’s the probability, in the more immediate future, of a cut in policy rates in December. Now, prior to the election, a couple of days ago, the market was anticipating, put about, and so—let me put it this way—it put on about a 83 percent probability that rates would rise in December. That fell to 50 percent during the night, and is now back up at 80 percent. So the market’s thinking that Fed will tighten policy and—

Robertson  Going to your report itself, I just want to tease out some your inflation expectations. In figure 2.1, you’ve got inflation at the bottom of the range by December [Inaudible]. That seems to be built off a big bounce in terms of tradables inflation, going from about -2.2 to -0.6 this year. That seems like a big bounce and I just wonder if you can talk us through how you’ve come to that.

Wheeler  Maybe I’ll make some comments and then John can as well. I mean, the situation we’ve got at the moment is that headline inflation’s low, it’s running at around 0.4. It’s primarily because of negative tradables inflation. We’ve had negative tradables inflation for 5 years, and at the moment it’s running at -2 percent. So, we think we will be back in the band, the 1 to 3 band, by the December CPI.
We’re anticipating a pick-up in tradables inflation because the low oil prices that pulled down inflation in the December 2015 quarter falls out of the calculation, if you like. We’ve got oil prices—over time, we think, will pick up. They’re currently around, what, $46, $47, heading over time towards $60. We’ve got the dairy price index, in terms of whole-milk powder, picking up to US$3,000 a tonne. And you’re starting to see some signs of higher inflation now in some of the other countries. You’re seeing it in the US, you’re seeing it in China, that inflation is off the bottom, or it appears to be, and you’re seeing a slight pick-up in one or two of the European countries.

Robertson  The inflation expectations are [Inaudible] very low [Inaudible]

Wheeler  Well, we just had some inflation expectations dated just recently for 1 and 2 year inflation expectations, and they’d picked up a bit. If you look at long-term inflation expectation, they’re still very well anchored at around 2 percent, which is where we want them.

Robertson  Yes, I guess, I mean, it just seems like a big lift up. I accept the point about the oil prices. Yourself, you saying here that you think the dairy price rises may reverse, so, you know, is there an ongoing expectation that this can [Inaudible].

Wheeler  Yeah, no, we are confident that we can stay within the band and head towards 2 percent. If you look at non-tradables inflation, which is basically what we have control over, to a certain degree—unless the Government cuts ACC levies or something like that—that’s running at around 2.7 at this point, and we think that will pick up around 3, 3.5. If you look at construction cost inflation in Auckland, it’s running at around 8. There’s inflation pressures on the domestic economy side.

Robertson  Just one last area of questioning. I’m sure you’ve read and, hopefully, perhaps even discussed with the *Secretary to the Treasury at his speech last week that he gave around sustainable improvement and well-being, and in it he talked at some length about the coordination of [Inaudible] and the reliance that they have on one another. He talked about “relying on monetary policy alone to do [the job of managing the economy’s performance] risks the longer term growth potential of the economy… by leading to the misallocation of resources towards investments such as residential investment”. I’m interested to know whether you discussed the speech with the Secretary to the Treasury. I’m also interested in your view about the balance of who’s doing the heavy lifting in the economy in terms of monetary and fiscal policy.

Wheeler  I didn’t discuss the speech with the Secretary to the Treasury, although John has been discussing those sorts of issues with the Treasury, in terms of balance of monetary and fiscal mix. You’ve seen quite a lot of the adjustment pressure in this economy take place through monetary policy. I mean, we’ve cut interest rates seven times since the middle of last year. Partly as a result of that—in fact, significantly as a result of that—we’re getting the sorts of growth outcomes that we’re seeing. Not solely, of course, there’s a number of other factors, but it is an important factor.
So you’ve seen our fiscal policy on a more neutral stance, if you like, and most of the adjustments at this point in time is being taken by monetary policy. But let me see if John wants to add anything.

Robertson
Let me just, in one last line of questioning, Mr Chair: the same question is being raised again by the—I mean, you can say: “Yes, we’ve cut seven times.” You’ve only got so much that you can do. You’ve only got so [Inaudible], you told us before. Treasury is saying here that [Inaudible] experience over the past 10 years has [Inaudible] the effectiveness and efficiency of monetary policy. I take it that you’ve said [Inaudible] there’s more work to be done to get the balance of the [Inaudible] stimulating and managing the [Inaudible].

Wheeler
Well, I think what’s happened, and particularly in other countries that have pushed interest rates down to zero, or even negative, or you’ve seen substantial quantitative easing, is that you’ve seen too much pressure placed on monetary policy, and Governments have been reluctant to move on the fiscal policy side, and the fact that central banks have stimulated the economies through such monetary accommodation has taken pressure of Governments to do structural adjustment reform. So, we’re in a situation now where I don’t think the economy needs fiscal stimulus at this stage. It’s growing at 3.5 to 4 percent. If we did slow down dramatically—if that were to be the case—then, clearly, we would look at what scope we have got to adjust in terms of monetary policy, but you would also want fiscal policy coming in at that point.

Bayly
I just wanted to turn to the Australian banks. Obviously, the APRA rules seem to be driving the Australian banks particularly towards higher funding ratios. And the consequential impact—there appears to be almost a shifting away from lending in New Zealand, perhaps back to Australia. I was just interested in your view, in terms of: do you think that what they’re doing is actually undermining some of the controls that you are trying to put into the Reserve Bank; and what impact that ultimately might have on lending in New Zealand?

Spencer
APRA have their own funding rules, and we have funding rules. So, the Australian banks in Australia will be funding in Aussie dollars, and, basically, that’s a separable issue to the funding of the New Zealand banks. New Zealand banks—the Aussie subsidiaries used to depend more on lending from their parent; in recent years, that’s been pulled back substantially, as a result of APRA restrictions. So, in recent times, the New Zealand subsidiaries are pretty much on their own, in terms of funding. They’re either getting it from deposits locally or they’re going offshore to raise the funds offshore. I wouldn’t say that any additional restriction from APRA on the Australian banks is affecting the funding of New Zealand banks.

But, having said that, the New Zealand banks funding situation has been getting tighter, because the growth in deposits has slowed down. In the meantime growth in credit has continued, so the gap between deposits and lending has increased. So they’re having to go more to the offshore markets,
which, sort of makes them uncomfortable. It’s more expensive, they don’t
want to put too much pressure on that market. That’s been one of the
reasons that the banks have been tightening up on that lending. It’s a result
of what’s been happening in New Zealand, as well as the costs of funds in
the global markets, not something that’s just come from APRA.

Ross
Good afternoon. Can I ask about some of your projections, please,
particularly around unemployment—you’ve got that cracking down to 4.5
percent over the next few years; net migration looks like it drops quite
sharply by almost two-thirds; house-price inflation you’ve also got dropping
down to about 2.5 percent, by the looks of it, over the next few years as
well, dropping down to about 2.5 percent. Can you talk to us, please, about
the factors sitting behind those projections: what you’re seeing influencing
those numbers, how you got to those figures, and how confident you are
around them?

McDermott
OK, there’s a number of things there, let me—the first one was, I think you
mentioned, unemployment slacking down to about 4.5. Essentially, what
we’ve been doing is keeping monetary policy very accommodative to help
stimulate this economy, to absorb surplus resources faster than the
economy can supply those resources, so we move inflation back towards
the mid-point of the target. A very important resource sits in the labour
market, and, the [inaudible] economy grows beyond its ability to supply that
means you start increasing labour market participation, you start taking
people out off the unemployment queue and they move into jobs. So that
would be consistent with a whole range of indicators, of seeing where the
economy is growing—it’s growing faster than supply, and we expect that to
continue, and we would need it to do so, so we could meet the mandate in
terms of the policy targets agreement. The other issue you mentioned was
migration—

Ross
Yeah. You’ve got it dropping sharply.

McDermott
Yes, that’s been a tricky one. It’s the balance between two very large
numbers. So, you know, you can get both of them really close and still make
quite large errors. You’re trying to get a sense about how people feel about
New Zealand, how people feel about the rest of the world. And one of the
big things that was very hard to anticipate was New Zealand’s not leaving
because things look better here. That was the big element of the net
migration story being so positive in New Zealand. Now, at some point, you
think you, sort of, run through that stock of people and then, you know,
not add more people not leaving, so to speak. But there’s also the question
of New Zealanders overseas who might look at the world and say “Well,
New Zealand’s looking rosy, and the rest of the world looks very
uncertain.”, and they might choose to come home—very hard to predict.
There’s no controls around that. Finally, you’ve got new Kiwis potentially
arriving, and you can have some regulatory rules around that, but it ends up
being a relatively small proportion. So I’d have to say that on that one, we’re
probably far less confident about the, kind of, numbers. We can watch it
very carefully.
I also have to say that it’s not the pure number that matters for our job; it’s actually how it impacts on the economy. And that’s the big change. In the past very large swings in net migration has been very inflationary. That’s not been the story of this business cycle. It’s one where we’ve seen very different age cohorts come, people entering the labour market, probably buying less houses relative to previous cycles, and so we’ve had a closer balance between supply and demand from that source, and that’s been much more important to analyse and keep a track of.

Ross
Just before you go into house-price inflation, forgive me if this seems a little dumb, but I just find it a little hard to put together the argument that the economy’s doing well, unemployment’s coming down, people are happy about New Zealand, they’re coming home, and then, all of a sudden, net migration drops off and you see departures jump up again, but the economy’s still going well in your projections, and unemployment is still relatively low. How do you put the two together?

McDermott
I see where you’re going—it’s still more people arriving; it’s just that it comes down off unprecedented historical levels. So we don’t think we can hold on to these levels forever. We come from a very unusual time to a more normal time.

Ross
But—but—

McDermott
Yes, despite the fact that New Zealand’s still doing relatively well.

Ross
You’ve got net migration dropping by almost two-thirds.

McDermott
Off levels we’ve never seen previously. So it’s a sort of reversion to normal.

Ross
OK. So, sorry, house-price inflation, too. I’m interested in your view that you see house-price inflation dropping to about 2.5 percent. Just, when you answer that question around what you see leading towards that projection, how much of that do you believe has been impacted by macro-prudential tools that you’ve used, and, secondly, does that projection include the use of macro-prudential tools that you do not yet have available to you?

Wheeler
On the latter, no, it doesn’t include that, but what you’re seeing with the housing market is that you’re seeing some moderation in house-price inflation, certainly in the Auckland market, and we really don’t know to what extent that is going to be sustained. We’ll need to see another two or three months of data, I think. That will give us a better insight. So if you say “Well, why are house prices moderating there?” some of it is probably the impact of LVRs, particularly on investors and investor-related lending.

Some if it’s the banks tightening their credit criteria. We’ve seen them tighten it in terms of offshore buyers relying on offshore income but still wanting a loan from the banking system here. So the banks have tightened up on all of that significantly because of doubts about the quality or the accuracy of the offshore income that supports the loans. So we’ve seen that. We’ve seen the banks tighten credit policy around some developments, particularly apartment developments—be more conservative there. And we have also seen the banks, as Grant talked about, facing higher funding costs because their lending growth is more rapid than their deposit growth, so
they have to go to offshore wholesale markets to get that extra financing, and those rates have been rising. So you’ve actually started to see mortgage rates—you’ve seen some signs of mortgage rates starting to pick up.

So, if you put all those factors together, and the fact that supply is growing but not growing quickly enough, and migration falling off, if that indeed happens, from unprecedented levels by and large to something like more normal levels, then you could see house-price inflation start to moderate further. That’s the reasoning.

Ross House-price inflation that’s moderated quite considerably would make it harder to argue additional macro-prudential tools, wouldn’t it?

Wheeler Well, what we’ve said—this came up in a press conference this morning, and we indicated that we would be keen to have debt-to-income ratios as an instrument within the memorandum of understanding around macro policy, macro-prudential policy. But we also indicated that given the moderation in house-price inflation that is taking place, we wouldn’t be introducing—if we had them in the portfolio, we wouldn’t be introducing them at this point.

Bishop Can I just pick up on something you hinted at before, which is about the migration cycle, where migration flows in the business cycle—so you mentioned it before, but you say on page 5 of the full statement: “… the impact per migrant may have been smaller than in previous migration cycles.” In terms of—that’s in the context of demand for housing and other goods and services, which I think you hinted at before. Can you just unpick that a bit? Why is that? What’s the rationale for making that statement? And I noticed it’s caveated in the statement but you were bit more definitive just before.

McDermott So, the comment refers to how inflationary the net migration cycle has been here. And, so, most of our analysis and research on this has pointed to, actually, probably a different age profile of the net people. So that they probably sit in a younger age profile, but working age. And they’re probably coming more as singles rather than as an already family unit. So there’s less pressure, maybe, on the schooling system.

They’re entering—you know, there’s more of a proportion of those arriving that are entering the workforce. You know, some of them may be in the rebuild in Christchurch, for example, although they go to other parts of the country. And so immediately they add to that supply of the economy, and they may suppress various non-tradable prices.

Also, that age group may have higher density housing, so they may live in flats rather than wanting to buy their own individual house, and those kind of things. And the types of goods and services they may be willing to purchase may well be different.

So it’s not that they’re not adding to demand in the system. That’s not true; they clearly are, but it’s also they’re adding as much supply as they’re adding demand, which was very different to the types of person either leaving last time or arriving, and they tended to be a bit older.
Bishop Are you doing some more substantive work on that? I mean, that seems to me—that’s very interesting, and it has a range of impacts for lots of different things beyond the monetary policy. So are you doing a bit more on analysing—

McDermott You’ll find there’s an extensive amount of analysis in a various range of publications, some of it extremely technical, ranging from the discussion papers, analytic notes—we’re trying to communicate that to a broader audience through our bulletin articles, and to the extent it continues to be a major feature of this business cycle, we’ll continue to work and analysis on it.

Nash I just have two questions. The first one is your house-price inflation figures. With a forecast flatting in the house price do you see a change in domestic patterns? I.e. are Kiwis going to give up their love of bigger houses and chase greater return on the capital markets [Inaudible]?

Spencer I think once it moderates—I mean, we’re contributing to reduced investor activity now as a result of the LVRs; also the banks have sort of reduced their risk appetite for lending to investors. But you’re right, I think. I mean, if the market does soften, turn down, there’ll be less motivation out there to go and sort of, you know, reap the capital gains in housing, and there’d be more concerns that, in fact, there could be capital losses, and so there’ll be a more balanced, objective approach to investment. I mean, it’ll continue. I mean, the Kiwis, you know, do have that business significant part of their savings, but I think it would certainly moderate.

Wheeler You see, if you look at, just to build on Grant’s point—if you take investors in the Auckland market, we think they’ve accounted for somewhere between 40 and 45 percent of transactions. And we’ve also seen rental returns fall to really very low levels of around 3 percent, so a lot of the investor activity’s taking place on the expectation of capital gain. And if our projections are right, then those—the expectations of capital gains—won’t be there and you’ll see some switching in terms of asset classes.

Nash Do you think that’s sophisticated investing, or do you think that’s Kiwis, do you say—my next door neighbour’s buying a house, that is a fair bit of money [Inaudible] new house, or do you think that it’s actually a conscious effort to do this as opposed to investing in the capital markets, and you may see a conscious shift? It’s hard to know. I’ve got one more questions.

Bennett Yeah, go for the next one.

Nash What or how often you review the current assumptions? Because we don’t seem to be there in terms of a high level of accuracy.

McDermott There’s a number of elements to that comment. I mean, every time we go through them, our set of deliberations, we’re always asking: “Does it still make sense?” To the extent we learn whether the forecasts, you know, are close or not close—look, and they’re never going to be perfect; that’s an impossible world. But to the extent you seem to be making systematic errors on one side, you do a more detailed evaluation of the frameworks. And we’d been looking very extensively at what’s gone on with our
performance in terms of inflation forecasting—in fact, which has, by the way, not been perfect. It’s been better than most; I think, actually, better than all.

But there’s lots of big things that have been changed, that we have learnt, and it was about—that the supply potential to this economy has been much better than I think anybody’s anticipated. So we’ve been able to grow a lot faster without generating any inflation, which, in the long run, you would think is actually quite a good thing. It becomes a bit of a problem for the central bank, but there’s been other elements about: where’s, you know, non-tradable information coming from, and are the lags a little bit longer?

Most of our findings from that—we’re always trying to make that available to the public. So a few weeks ago I gave a speech that summarised all the details of that research, but, actually, all the research is on our website, in our vast array of publications. So it should be all available, but that won’t stop us continuing to find out surprises and things we’re going to be operating differently. And the essential reason is: people will behave differently in, often, similar circumstances because of what they’re seeing. And it’s—human behaviour can change and shift on you and you have to try and be aware of that as you’re making your forecasts.

Nash So you were actually making assumptions for [Inaudible] modelling [Inaudible].

Wheeler Some of the things that we look at very closely and which can move the inflation forecast around a lot would be assumptions about the oil price, what are we assuming will happen to the dairy price, how strong will the net migration be, how quickly will it fall off, will the supply or *demand side, that John just recently—just momentarily—talked about, which will dominate? What about house-price inflation? How strong will it be, and to what extent will wealth effects flow into spending, into capital gains, and things like that. What might happen to the exchange rate? What might happen to inflation expectations, and what happens to overseas inflation rates. We’re looking at all those sorts of things.

We’ve found that the supply-demand split in terms of migration has been different from previous cycles, particularly the cycle in 2002-03. We’ve also found that inflation expectations have been more adaptive than what we thought. In other words, the cycle that can become very tricky is where you have negative tradables inflation, which we’ve had for 5 years, so it’s currently running at -2, that leads to low headline or actual inflation, and then people base their expectations of future inflation off what’s happened in the past. And then you can get into the tricky problems of low inflation aspect. And we’ve found that that process of forming expectations has been more *backward-looking, particularly around wage setting, than we thought.

Clark [Inaudible] I’m interested to kind of know how sensitive what happens to inflationary expectations if that [Inaudible], you know, that drop off that you projected there. [Inaudible] the migrational pressures stay as they are now [Inaudible]. But if that were to carry on, how would that affect things overall? How sensitive is the model in that respect?
McDermott: So you’re asking how sensitive is our inflation forecast to the change in this net migration. Look, and I’d have to caution, it depends who—who’s arriving, who’s leaving. It’s not just the sheer number that matters. And that was the big lesson from the last cycle. It was a different type of person. It was a much younger person, on net, staying in New Zealand or arriving in New Zealand. And so that had a bigger surprise potential. And, again, I think that’s a lesson learnt, and we’d be watching that very carefully.

So not only would we be watching the numbers, but we’d be looking very, very carefully at the composition, and also the source of that net migration. So where we’re seeing lots of either Kiwis coming back from Australia or Australians coming across. And there again we saw perhaps they were coming back from Australia into New Zealand with a lower paying job than they maybe have had across the Tasman, and so their spending profile was a lot less. So there’s lots of elements to that story. So it would be the size of the net migration cycle that would matter, who it is, where they’re coming from, is what our analysis would focus on.

Clark: Did you do a scenario where that level remained high [Inaudible]?

McDermott: There’s a whole range of scenarios that we’ve actually highlighted and published, and we’ve considered a whole vast array that we haven’t even published, so I’m sure in that list we’ve probably got it, but I—

Wheeler: We have shown scenarios of high migration not falling off, yes.

Spencer: I think it’s fair to say, to just emphasise the point that we don’t think that that assumption is a key determinant of the inflation outcome. It’s an important determinant of the house-price result, with that graph on the same page, but for CPI inflation it’s not a huge driver.

Bennett: Well, that’s interesting, yeah, because you’re seeing house-price inflation in Auckland at a lower point, even though you’ve got the highest migration to Auckland though, haven’t you?

Spencer: That’s right, so what we’re seeing at present is there’s still an underlying excess demand. There’s more people coming in than houses being built. But the credit overlay, the investor overlay, is moderated, and that’s brought the inflation in Auckland—Auckland house prices—down to, you know, just under 10 percent now.

Clark: With the big increase in figure 5.7 [Inaudible]. How is that impacting on investment and the rest of the economy? Is it [Inaudible] investment from the [Inaudible]?

McDermott: At this stage, we don’t think there’s any particular crowding out from that profile. What you might have seen in a previous business cycle is a very high residential investment that was putting pressure on resources, which was forcing the central bank to raise interest rates very high, and that would have the crowding out element because it would increase the cost of capital for business investment. Right now we’ve got very low interest rates and we’re not seeing that business investment being constrained by the interest rate environment.
But I think it’s an interesting question you raise because, you know, we’ve got—if you look at building consents for the country as a whole, they’re just under 30,000. They’re up about 11 per cent over last year, and Auckland’s just under 10,000 at this point, and up about 14 percent. So, you know, you’re seeing the strongest activity, I think, for about 11 years in the sector.

But we’ve just been talking to a number of construction firms around the country—we talked to about 20 of them recently—and a number of them were, particularly in the Auckland market, were talking about the inflation pressures that are there, the bottlenecks. Inflation, construction inflation, was running at around 8 percent. Some of them were worried about scaling-up activity because they’ve seen stop-start cycles in the past. They’re worried about how much land might be available if they were going to make large development investments. So there’s a number of issues around the construction sector and the pressures that are building up there. Whether we can get—how much more supply can we get in terms of annual increments.

OK—thank you very much; appreciate your time. Thank you everyone.
Reserve Bank of New Zealand’s Financial Stability Report, November 2016

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(David Bennett, Chairperson)
December 2016

Presented to the House of Representatives
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Reserve Bank of New Zealand’s Financial Stability Report, November 2016

Recommendation
The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Financial Stability Report, November 2016, and recommends that the House take note of its report.

Introduction
The Reserve Bank is required to report twice a year on the soundness and efficiency of New Zealand’s financial system. The following are the main points from its November 2016 assessment:

- New Zealand’s financial system remains sound and continues to operate effectively. The banking system has strong capital and funding buffers that are above regulatory requirements, and it remains profitable by international standards.

- Globally, GDP has been subdued, despite extremely accommodative monetary policy in a number of countries. Financial markets have remained volatile due to heightened political uncertainty.

- The Reserve Bank Governor has asked the Minister of Finance to agree to add a Debt to Income (DTI) tool to the Memorandum of Understanding on macro-prudential policy. However, the bank is not proposing to use such a tool at this time.

- The report also notes that the recent 7.8 Kaikoura earthquake is not likely to present a risk to financial stability, with the main impact likely to be on the insurance sector. The insurance sector as a whole appears well positioned to meet related claims.

Three key risks to New Zealand’s financial stability
The Reserve Bank has identified three key risks to New Zealand’s financial stability: housing market vulnerabilities, bank funding pressures, and dairy sector indebtedness.

- Auckland’s house price-to-income ratio, at 9.6, is among the highest in the world, and house prices are continuing to rise rapidly in the rest of the country. Although house price inflation has moderated in Auckland in recent months, it is uncertain whether this will be sustained given the continuing imbalance in demand and supply. Credit to the household sector is growing rapidly, and the household debt-to-disposable-income ratio is at a record high of 165 percent.

- Banks are relying more on offshore funding as household deposit growth has slowed and credit growth has increased. Banks could become more susceptible to the risk that global market volatility could increase funding costs and reduce access to offshore funding.
Auction prices for whole milk powder have increased by 69 percent since July this year, resulting in Fonterra raising its forecast farm gate milk price for the 2016–17 season to $6 per kilogram of milk solids. However, some farms may still struggle to achieve profitability because of low dairy prices over the past two seasons.

The rest of this report discusses the main issues we considered during our examination of the financial stability report and in our discussion with the Governor of the Reserve Bank.

The housing market

A large part of our discussion focussed on factors affecting the housing market. This included the effects of higher interest rates, house price inflation, debt-to-income ratios, loan-to-value ratios, building consents, and offshore speculation.

Impact of higher interest rates on households with high mortgages

We asked the governor what level of interest rates might cause significant problems for highly leveraged borrowers. The governor said the Reserve Bank has taken a close look at the level of debt that the household sector has now, compared with the last time interest rates were in the upper part of the cycle. While there is no magic figure, the concern is that some households will be put under pressure as interest rates rise. This is because households are carrying significantly higher average mortgages than they were 10 years ago. Those coming under most pressure are likely to be households with lower incomes or high debt-to-income ratios.

With a 165 percent household debt-to-income ratio, households are vulnerable to increases in interest rates. We asked the governor about the likelihood of such a rise, and were told that in his view, “We’ve seen probably the bottom now…of longer-term global interest rates.”

The governor described the situation of housing demand and supply in New Zealand. On the demand side, net permanent migration flows are at historic highs, there is a low interest rate environment with increases anticipated, bank credit conditions are tightening, and investor commitments are starting to reduce. On the supply side, while building consents are at an 11-year high at around 30,000 consents for the year ended September 2016, there are limits to the rate of construction. We were told that the Reserve Bank is watching carefully to see the effect of these factors on house prices.

We note that the financial stability report concluded that the rate of house building in Auckland is still less than required to accommodate the strong population growth; and that there remains a real risk that pressure will once again start to build.

High house price inflation in urban areas outside Auckland

Since the May Financial Stability Report, house price inflation has remained broadly flat, although elevated, at 11.9 percent in the year to October. While annual price growth has fallen to 9.3 percent in Auckland, price growth has generally broadened across New Zealand.

We raised the issue of the extremely high rates of house price inflation that Queenstown and some areas in the North Island are experiencing, as shown in figure 3.1 of the report. The governor said that, if this trend continued, it would be a concern. The financial stability report says that price-to-income ratios are rising throughout much of New Zealand, and further house price inflation would see prices continue to stretch relative to incomes. The Reserve Bank tightened its loan-to-value ratio policy in October 2016, partly due to this situation.
Debt-to-income and loan-to-value ratio policies

We note the significance of the Reserve Bank’s request to the Minister of Finance, seeking agreement to add a DTI tool to its Memorandum of Understanding with the Minister about macro-prudential policy. We spent some time discussing the use of such a tool, and the loan-to-value (LVR) policies already in place, to manage house price increases.

Some of us consider that LVR policies provide a better way of managing house price increases in a more moderate manner than DTI policies would do, because a household’s balance sheet is much more important than its income statement. We put it to the governor that, although the debt-to-income ratio may have increased, so has the value of the asset.

The governor told us the Reserve Bank sees things differently, and considers that DTI policies complement LVR policies. DTI policies can reduce the risk of forced sales because borrowers have a higher income-to-debt ratio and can service their loans better. This reduces the risk of forced sales, which is important in a market with high house price inflation. LVR policies also help the banking system, because in the event of a forced sale, borrowers have higher equity in the transaction. DTI policies therefore reduce the possibility of forced sales, and LVR policies protect the bank in those situations.

We wanted to know under what conditions the Reserve Bank would start using a DTI tool, were it available. The governor explained that the situation would be one where house price inflation started to pick up in Auckland and elsewhere, and commitments expanded with continued increases in high debt-to-income ratio loans. We asked how the tool would be used and heard that the bank would probably apply a “speed limit” on banks’ lending above a certain DTI level. For example, the United Kingdom allows only 15 percent of banks’ mortgage lending to take place at a DTI over 4.5 (that is, where a mortgage represents 4.5 times the borrower’s annual income). We heard that the group most likely to be affected would be investors, because they tend to have higher debt-to-income ratios. However, the proportion of high debt-to-income lending among first-home borrowers has also been rising.

An important feature of a DTI policy is that the borrowing capacity of constrained borrowers grows in line with their incomes. The Reserve Bank recognises that borrowers with elevated DTI ratios are vulnerable in a period of reduced income or higher interest rates. This can present a risk to the banking system and the wider economy. We heard that DTI policies are not new, and at least 10 advanced economies and seven Asian economies apply a limit on high-DTI lending.

Restrictions on mortgage lending at high LVRs were introduced in October 2013 in response to rising housing market vulnerabilities and concerns that the scale of high-LVR lending was accentuating those vulnerabilities. We note that the financial stability report says that LVR restrictions have reduced the share of risky, high-LVR loans on bank balance sheets, and improved banks’ resilience to house price falls. Changes to the LVR policy in November 2015 and October 2016 have started to reduce banks’ exposure to investors with high LVRs.

Off-shore speculation

We asked whether, to address the demand side of the housing market, New Zealand should be looking at measures to manage offshore speculation. The governor said that such judgements are up to the Treasury and the Minister of Finance. He pointed out that New Zealand’s trade agreements require domestic and foreign investors to be treated equally.
**Dairy sector indebtedness**

Although there are signs that financial conditions for dairy farmers have begun to improve as dairy prices have recovered, the Reserve Bank has highlighted the dairy sector’s indebtedness as a risk to New Zealand’s financial stability.

At around $40 billion, dairy lending accounts for more than 10 percent of the banking system’s gross lending. Half of that debt is owed by 20 percent of dairy farmers. Their farms are of particular concern from a financial soundness perspective, as they are most vulnerable to low dairy prices, and are the farms to which banks are most exposed.

**Impact of international conditions on New Zealand**

We discussed the international conditions that pose risks for New Zealand. They include likely changes in the United States of America to increase government spending, corporate debt in China, the Bank of Japan’s decisions to set a bond-rate target, challenges around Brexit, an increasing risk that Italy may withdraw from the Eurozone, and New Zealand being seen as a safe harbour for global capital. We were interested in the governor’s view of the implications of these risks for New Zealand’s domestic situation.

The governor acknowledged that there are a number of challenges. We were told that fiscal stimulus in the USA would start to build up inflation pressures, and that this is partly why long-term interest rates have been rising. Higher interest rates would put pressure on borrowing, which has increased—in New Zealand and internationally—over recent years in response to very low interest rates. The Reserve Bank considers that increased interest rates would not be “a bad thing”. The governor told us that having zero interest rates globally on an ongoing basis is not healthy. However, he said the bank would like to see a gradual correction in interest rates, not a rapid rise.

**Consumer credit situation**

With the household debt-to-disposable income ratio at a record high of 165 percent, we asked whether the bank could see any underlying trend emerging concerning household debt levels. We heard that apart from growth in housing credit and other household credit, consumer credit growth is very moderate at the moment. Consumer credit grew at 3.1 percent during the year to September, compared with 9.2 percent for housing-related credit.

**Bank lending by sector**

We asked the governor for comment on figure 4.6 in the report which shows annual growth in bank lending by sector. Business lending is flat if agriculture is excluded. We wanted to know to what extent the Reserve Bank has the tools, or would want the tools, to direct lending elsewhere.

The governor said that it is up to individual banks to make judgements around sector allocation. The Reserve Bank’s responsibilities are around financial stability and systemic risk. While it can adopt policies that protect the financial system against systemic risks, the governor considers that a lot of the potential distortions, and the momentum for other developments, lie with the Government and banks, and the frameworks within which they make their decisions.
Appendix A

Committee procedure
We met on 30 November and 14 December 2016 to consider the Reserve Bank of New Zealand’s Financial Stability Report, released on 30 November 2016. We heard evidence from the Governor of the Reserve Bank, and received advice from our independent specialist adviser, Brendan O’Donovan.

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Appendix B

Transcript of hearing on 30 November 2016

Committee members
David Bennett (Chairperson)
Andrew Bayly
Chris Bishop
Hon Clayton Cosgrove
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour

Witnesses
Reserve Bank of New Zealand
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Dr John McDermott, Assistant Governor and Head of Economics

Chair
So Governor, if you want to, give us a brief introduction—then we can open up to questions from members.

Wheeler
Well, thanks Chair, and I will be brief. Good afternoon, and it’s good to be back here. On my left I’ve got Grant Spencer, who’s the Deputy Governor and the head of financial stability, and on my right is Bernard Hodgetts, who’s the head of the macro finance department.

New Zealand’s financial system is sound, with strong capital funding and liquidity buffers, but continues to face risks. Global growth is subdued, and financial market volatility—financial markets remain volatile due to heightened political uncertainty. Dairy prices have recovered and the average dairy farm is expected to be profitable this season; however, debt levels have increased over the past two seasons and problem loans are expected to increase for a time.

House price inflation in Auckland has softened recently, but it’s uncertain whether this will be sustained. Auckland’s house price-to-income ratios remain among the highest in the world, and prices continue to rise rapidly in the rest of the country. The Reserve Bank has asked the Minister of
Finance to agree to add a debt-to-income tool, with a memorandum of understanding on macro-prudential policy. And while the bank is not proposing use of such a tool at this time, financial stability risks can build up quickly, and restrictions on high-DTI lending could be warranted if housing market imbalances were to deteriorate.

The banking system’s reliance on offshore wholesale funding is beginning to increase due to a widening gap between credit and deposit growth, and banks could become more susceptible to increased funding costs and reduced access to funding, in the event of heightened financial market volatility.

Damage from the Kaikōura earthquake is being assessed, and while it’s too early to estimate the cost to insurers, the sector is well-positioned in terms of catastrophe insurance cover and capital buffers.

So thanks very much to you—happy to answer questions.

Robertson  Yeah, thanks, Governor. On the point that you make around your overall concerns around the vulnerabilities of the housing market, what work have you done to assess what levels of interest rate increases might cause significant problems for highly leveraged borrowers? Have you got some model in mind or a percentage increase that’s particularly concerning for you?

Hodgetts  Well, we’ve certainly taken a close look at the level of debt that the household sector has on its books now compared to the last time interest rates were in the upper part of the cycle. And, you know, movement in interest rates back towards the sort of levels that we saw back in 2005-06 would certainly put parts of the household sector up against considerable pressure, the reason being that our households are carrying significantly higher average mortgage sizes than they were back then. So there is certainly a vulnerability there, but there’s no sort of magic figure where you can say that this is going to be stressful above this level or not. But, certainly, that would be the concern—that as interest rates rise with higher average mortgage sizes, some parts of the sector would be more under pressure. Of course, it will tend to be the households with lower incomes or high debt-to-income ratios.

Robertson  Because, obviously—what have we got—a 165 percent household debt-to-income ratio. Those are very high mortgage levels themselves. So for you that is the crux of your concern about the financial stability vulnerabilities?

Wheeler  There’s certainly a vulnerability there. I mean, if you look at the proportion of mortgage borrowers that are on either floating mortgages or fixed for one year, it’s almost two thirds of the total volume of mortgages. And we’ve seen probably the bottom now, I suspect, of long-term global interest rates. We’ve seen US 10-year rates go up 50 basis points since the presidential election, and that’s been repeated in various parts of the world. And, of course, our long-term rates have gone up to the extent that the banks have to resort to more offshore funding, either to refinance or roll over existing
loans, or because their credit growth exceeds deposit growth and they can’t get the deposit growth needed. They’ll need to access international capital markets at higher funding costs.

So there are concerns. And then if you look at the DTI ratios, the proportion of lending now—to take an example of first-home buyers with DTIs over 5, that’s been increasing.

On the other hand, there’s good news in the sense that if you look at the amount of commitments that have taken place over the last six months—say, since May—you’ve seen quite a dramatic fall in the value of those commitments with investors, something of the order of 30 percent, which is large, and something of the order of around 8 percent for other borrowers.

Robertson: I notice that in addition to the increases, you’ve also expressed some concern about the spread to other areas outside of Auckland. And there are some—the CoreLogic numbers that you’ve got in figure 3.1 are somewhat eye-watering in places like Queenstown and Tauranga, and most definitely here in Wellington as well. How big a concern for you is the spread around house price inflation around the country?

Wheeler: If you look at house price inflation in Auckland, it’s been coming off for a few months. We’re unsure whether that’s going to continue, because you’ve still got low interest rates and high migration flows, but it’s running roughly at around nine and a quarter percent. If you look at inflation around the rest of the country, house price inflation’s running at around 15, but that also has been coming off just in the last month or two. Again, it’s too early to say whether that will continue.

If you look at the house price-to-income ratios, you’ve got Auckland standing out at, I think, now 9.6. The rest of the country, on average, is around 5.5, but there are places that you’ve pointed to, for example, that it’s been rising quite rapidly.

Robertson: And that represents, you know—if that trend did continue, that would represent a concern for you?

Wheeler: Yes, that would represent a concern.

Robertson: Just on to another matter—it’s sort of a little counterintuitive; I mean, dairy has been recovering a bit in recent times—but you also are highlighting that as a vulnerability. I presume that’s to do with the high levels of debt that dairy farmers have?

Wheeler: If you look at dairy debt, it’s around $40 billion, and I think, from memory, back in about 2003 it was around $12 billion. But the interesting thing is—or worrying thing, in many respects—is that half of that debt is owed by 20 percent of the dairy farmers.

Robertson: And, again, if we get back to the interest-rate question, there’s another vulnerability that arises there as well, isn’t there?

Wheeler: Correct.
Scott: Thanks, Governor. On to the debt-to-income ratios again, I would submit—and I know we’ve talked about it before—I would submit that the DTI idea is at best unnecessary, and at worst a bad idea, because of [Inaudible], you know, sort of unintended consequences. And, in fact, the LVRs are a much better way of ensuring that the housing market price increase is managed in a more moderate manner, because—I submit that the balance sheet is much more important than the income statement of the household, and that, although the debt-to-income has increased, so has the value of the asset. And so that equity that is there is what is going to protect the banks from—and, at the end of the day, the household—from defaulting.

And my other submission would be that, in fact, it is the banks’ role to determine the lending to a household base and consider the income of that household, not the RBNZ’s role. Do you have any comments on that?

Wheeler: Well, I think we see the general thrust of your comments differently from what you would. These DTIs are not a new instrument; they’ve been around for a long time. They’re used in 10 advanced economies and seven Asian economies, so they’ve been around. They are used.

The DTIs can complement the LVRs in terms of, basically, reducing risk to the banking system. For example, the DTIs can reduce the risk of distressed or forced sales, and that’s simply because, by and large, relative to the amounts they are borrowing, the borrower has a higher income to the debt ratio and therefore can service that loan better in that situation. So the risk of forced sales is reduced, and that’s important in a market where you’re seeing a lot of house price inflation.

The LVRs also help the banking system because in the event of a forced sale, it basically means that borrowers have higher equity in that transaction.

So one reduces the possibility of forced sales or distressed sales—that’s the DTI. The other protects the bank in terms of a situation where you are having distressed sales. So I think they can complement each other very well.

We’ve also said—and I’m happy to go over the reasons, if there’s interest—we’ve also said that at this point in time, if we had the authority to introduce DTIs as a macro-prudential instrument, that we wouldn’t be using them at this point.

Scott: Imagine a farmer who is in distress, and his neighbour wants to buy him. And the wealth that—the neighbour who has the purchasing power to buy him has a great balance sheet. In fact, he may have no debt at all. But his income is low—his income is zero; his income might even be negative—because he’s been farming in the dairy sector. So his income, being zero, would not allow him to borrow money to buy his next-door neighbour’s farm. That’s an unintended consequence of a DTI.

Spencer: And if you can’t afford the debt service, you shouldn’t be borrowing.

Scott: Well, he can, because he’s got the balance sheet, and the bank’s willing to
lend on the basis of the balance sheet, and the combined business and the
combined debt across those two farms—

Spencer But the banks look at both things. So, the banks look both at collateral
and—

Scott Yeah, I’m talking about the unintended consequences of a DTI.

Chair I think we’re sort of—yeah, I think you’ve made your point.

Scott I’ve made the point, Mr Chair, thanks.

Shaw So, you talked about some of the international risks, and there’s been an
elevated sense of risk in the last few weeks with likely changes to US
economic policy resulting in, probably—if the plans go through—increased
expenditure but reduced revenue, and therefore much greater US debt.
Changes—Bank of Japan decisions around the bond market; corporate debt
in China, which has been fairly well flagged; increasing risk of Italy
withdrawing from the euro and thus the break-up of the eurozone. And
what we have seen recently in New Zealand is it’s kind of been seen as a
safe harbour for global capital, and thus, as you said, some pressure on our
own interest rates.

I guess I just wanted to see—in terms of some of that kind of more recent
news, I have to say that your assessment is not as sunny as Treasury’s, or
the Minister of Finance, who was here earlier, who had a somewhat—well,
actually, a very optimistic view. There’s a great deal more risk that you are
outlining here than they were.

What’s your sense of—not that all of those risks will necessarily come true,
but there does seem to be quite a high likelihood in each of those—what
that would do in terms of New Zealand’s exposure?

Wheeler If you look at the economy, it’s growing at around 3.5 percent, and there are
a number of drivers that are doing that. One is the extent of construction
throughout the country, commercial and residential. Some of it’s due to the
record migration flows, the record tourism, and the historically high labour-
force participation.

Now on the other hand, there are some aspects of the economy that aren’t
as flash. Our labour productivity growth is normally low, and it has been
particularly poor during this cycle. Business investment hasn’t been as
strong as you’d want. We’ve got a housing market that has a number of
serious imbalances in it, and we would like to see the exchange rate a bit
lower. So we face the world with that set of assets and liabilities, if you like.

And as you look out there, you see all sorts of challenges around Brexit,
given that article 50 is—according to Theresa May; her announcement—it
will be triggered by March, and that starts a 2-year time-clock running.
We’ve got President-Elect Trump, who’s indicated that he would like to
do double the growth rate. So he’s got an economy growing at 2 percent,
which is around about potential output growth in the US, so if you did
have the substantial fiscal stimulus that is being suggested, then you
would have an economy that is starting to build up inflation pressures,
and that’s partly why long-term interest rates have been rising. So there’s all sorts of challenges around that. And no one at this point knows what he will do in respect of trade liberalisation.

In particular, we know what’s likely to happen with TPP, but what happens in terms of NAFTA and what happens in terms of TTIP—the relationship between trade and services and regulatory standards between the US and Europe. What role does China play if there is a vacuum out there? Japan is committed at this point to try and keep 10-year interest rates at zero.

So there is, indeed, a number of challenges out there. World trade growth is, for the last 5 years, the weakest since the early 1980s. Protectionist measures are higher now at any point than 2009. So we’re in for a fairly tough ride in many respects.

Shaw

So then my question is, the implications of that, in terms of the risks you have outlined here—because I’m just following on from Grant’s question about the impact on interest rates—in that kind of world, what does that then mean in terms of the impact on the domestic situation, in terms of interests rates and other—

Spencer

When interest rates turn, it’s going to put pressure on borrowing. And over recent years, with very low interest rates, debt has increased—not just here but internationally. Though if interest rates started to move and to trend up, that is, obviously, going to put pressure on and going to expose vulnerabilities. But in itself, that change in the trend is not a bad thing, because having zero interest rates globally on a continuous basis is not a healthy phenomenon.

Shaw

It is a massive asset bubble.

Spencer

So the normalisation process, I would say, is a positive thing. What we don’t want to happen is a sudden lurch back up, because if it’s a sudden move back up in rates, it’s going to cause a lot of problems. But if it’s a gradual normalisation, I would say that that’s a positive thing.

Shaw

One or two of the banks have said that they think that there is a distinct possibility of a correction in house prices over the next 12 to 24 months, as their own capacity to provide further lending comes at a higher cost because of the requirement for offshore capital. What’s your sense of that risk? Because opinion seems—naturally, opinion is divided about the extent of the risk and the timing of it, but I would be curious to get your—

Spencer

Well, we think it is a risk and we have been talking about it for a number of years now as the pressure’s gone up. And the more the market gets stretched, particularly the Auckland market, the greater the risk of a disruptive correction. But what we’d like to see is a gradual correction, not just a sudden, but we have to acknowledge that there is a risk it could be sharper, particularly if rates—rapidly upwards.

Shaw

Because that does seem to be quite different from Treasury’s assessment this morning, earlier, which was that, essentially, they couldn’t see any probable changing conditions that would lead to that kind of correction.
Wheeler Well, if you look at the sort of demand aspects out there, you’ve got net permanent, long term—sorry, net permanent migration flows at historic highs. And you’ve got a low-interest-rate environment now. Interest rates will be increasing, so that will be something that gets passed on, one would think, and mortgage rates, and we are already starting to see that. The banks have been tightening up on some of their credit criteria, particularly in respect of overseas borrowers and the financing—taking a good look at the financing conditions and the risks around apartment development.

And the other thing is we’re seeing quite a sharp fall in what I mentioned in terms of commitments, particular with investors but also with other borrowers. So there is the chance, on the one hand, that you’ve got factors that will still be there in the demand side—presumably, strong migration and interest rates low but, on the other hand, starting to rise; bank credit conditions tightening, and commitments now starting to fall off quite significantly. So we’re in a situation where we’re watching that very carefully.

If you look at supply, for the country as a whole we’ve got consents running at around 30,000, an 11-year high, up about 11 percent on last year. Auckland’s close to 10,000, an 11-year high also, and up about 14 percent on last year. But it’s still not enough. We need more supply, much more supply.

But the dynamics in the housing market are now starting to change because you’re are seeing the move on credit policies, if you like, interest rates—and uncertainties about migration, of course, will continue. And housing supply is picking up, but albeit not enough. So that’s why we’re watching it pretty carefully and we can’t conclude at this point that house prices—the moderation we’re seeing—is going to continue, but it may well.

Seymour Governor, these proposed debt-to-income ratios, how would they handle debt and income that a purchaser held offshore?

Spencer Well, the declaration of the borrower should include all their total debt holdings and all their income, whether it’s domestic and offshore.

Seymour But it would be much easier to enforce New Zealand debtor income—

Spencer That’s right.

Seymour —declarations than foreign debtor income declarations.

Spencer That’s right, and that’s why the banks, you know, recently have taken the approach of discounting foreign-based income, because of the uncertainties around verification of that. But in terms of the tool that we would be using, we would not be differentiating, but the banks would still make those assessments.

Seymour Well, it’s—at the margin, the difference that your proposed DTI would make is that it would be discriminatory against New Zealand - based homeowners whose income and debt was based in New Zealand.
Spencer  It would not be discriminating, we’re just saying income of the borrower—it would be up to the lending bank to make assessments about the individual borrower. We’re not going to do that.

Seymour  With the greatest of respect, if the constraints on loans being made is the discretion of the bank, then we wouldn’t need to be having this discussion or we wouldn’t need DTIs.

But can I ask a different question? Governor, does it frustrate you that while you’re proposing DTIs and LVRs to prevent people getting over-extended or putting too much of their assets into the housing market, the Government persists in introducing policies such as the KiwiSaver HomeStart grant adjustments that actually encourage more people to put more of their net worth into the housing market—or we even see proposals in the public domain that people have their student loan repayments subsidised so that they can again put more of their net worth into the housing market—when you’re introducing banking regulations to stop them doing so?

Spencer  What we’re trying to do is address the systemic risks to the banking system. So macro-prudential policy, be it loan-to-value ratios or debt-to-income ratios, are really designed to reduce the systemic risk that might be associated with a significant downturn in house prices. And we can only do what meets our responsibilities, and these sorts of tools can be helpful. The Government has all sorts of distribution objectives and other priorities, and, really, those sorts of decisions—as with taxation and regulatory policy—very much lie in their hands, as indeed does the decision whether to have DTIs introduced in the MOU.

Seymour  Finally, after all the criticism—

Chair  OK, Jami-Lee Ross has got a question. Jami-Lee Ross.

Seymour  Could I just ask one more, Mr Chairman?

Chair  No, Jami-Lee Ross has got a question.

Seymour  Mr Chairman, you’ve allowed several members to ask three, four, five questions, even have—

Chair  Including yourself. Jami-Less Ross, OK.

Seymour  Well, now hang on a second, Mr Chair. You might want to check up Standing Order 201(2), because if you can’t fairly allocate questions in a committee, then I’m going to invoke it next time.

Robertson  I’ll be with you on that.

Chair  Jami-Less Ross, OK.

Seymour  Yeah, and you might find you don’t have the numbers.

Ross  OK, hi. I’ve got a couple of questions about the debt-to-income ratios. I know we’re running out of time, so I’ll get them all out first. Firstly, your report shows that high loan-to-value ratio loans are reducing. It also shows that high debt-to-income ratio loans have been increasing. Do you see a
connection between the two—and I note that you said you see both tools as being complimentary.

I’m also interested to note, when you say that you wouldn’t implement them now—debt-to-income ratio limits—what are the conditions under which you believe you would like to start using the tool, were it available to you?

And finally, if the Minister was to give you this tool, and we as Members of Parliament were asked by our constituents “How would this impact on me?”, can you tell us how you’d envisage the tool would be used and what sector of lenders—what category of lenders—would be impacted?

Wheeler: Well, let me answer your second—

Ross: I don’t need any supplementary questions now.

Wheeler: —second and third question. It’s good that you got three out at once, right?

Clark: Yeah, yeah, yeah, and we noticed.

Wheeler: Look, on when we would use them, we’ve indicated that at this point in time, if we had that included as an instrument, that we wouldn’t use it because we’ve seen house price inflation moderate in Auckland and we’ve also seen it moderate outside of Auckland. But the latter is more recent, and we really would want to see further data to see whether that trend is going to continue.

So what would concern us would be if we saw house price inflation starting to pick up in Auckland and elsewhere, and if it was clear that that was credit-driven—with commitments expanding and continued increases in DTIs—if we started to see those things, then that would concern us a great deal.

What we are seeing is an increase in DTIs. But we are seeing a significant fall-off, since May, in the number of commitments, the value of commitments—primarily with investors, but also with other borrowers. And we’re seeing house price inflation moderate, as I said. So they would be the conditions in which we would consider using the DTIs.

Now, in terms of DTI borrowing and any restrictions, we would probably set—if we were to introduce them, we would probably set a limit, like a level, and then a speed limit. So let me give an example. If you look what they’ve got in the UK, they have a DTI requirement of 4.5 and 15 percent of lending can take place at a DTI over 4.5. Now, that’s not to say for one minute that we would introduce a 4.5 level if we were, but that concept is probably what we would do.

If you look at—let me see, the third question was around who’s affected primarily, wasn’t it?

Ross: Yep.
Wheeler  If you look at DTI lending, the borrowers that have the highest DTI ratios are investors and high-income borrowers. Now, the proportion of first-time borrowers, in terms of transaction volumes, has been pretty stable since 2014. It’s been around 20 percent. But what we’ve found is that the proportion of high DTI lending—say, over 5—has been rising with first-home borrowers. But then, the DTIs, in particular, tend to be quite high with investors, and they would be the group that’s most affected if we were to introduce a DTI restriction.

Ross  Is there a connection between the DTIs and LVIs?

Wheeler  Yeah, lenders [inaudible]

Chair  We’ll move on to Grant.

Robertson  Thanks for that. The bells will start ringing in a minute, and I think my colleague David Clark might have a question.

I just want to go back to the question of the increase in housing supply, which you’ve said is important to taking pressure off. You’ve also said, on page 17 of the report, that banks, while they are report strong demand for credit from property developers, have a limited appetite to increase their property-development sector exposure. Figure 3.5 five shows a tightening of the standards there. What effect do you think that’s going to have on the ability to increase supply sufficiently?

Spencer  It will potentially have some dampening effect, but the existing pipeline is very great. I mean, why the banks are getting nervous about additional lending to development is that really large number of projects they have on their books—the large pipeline. And so as a normal risk management practise, they’re limiting the amount that they want out at any one time.

Robertson  But this is not a short-term problem, is it? So that what’s in the pipeline now doesn’t even quite get us to where we need to be to stand still.

Spencer  Well, all I’m saying is that as things get completed, then there’ll be more going in the pipeline. But yeah, there are limits to the rate of construction, but all I’m saying is there are a lot of apartments under way right now—a lot of apartment projects.

Robertson  Just very briefly on to the demand side, because you’ve said that many times when you’ve been here, that you need friends in order to be able to manage these issues—is it your continuing view that on the demand side, New Zealand should be looking at something to manage offshore speculation? The Vancouver-style taxes or—I know you’ve expressed not supporting a total ban previously, but is that still a policy area you feel there needs to be more work in?

Wheeler  In essence, that sort of judgement is up to the Treasury and the finance ministry. One of the complications is the equal-treatment principal for investors—i.e. treat domestic and foreign investors the same under the trade agreements that we have. If you said “Are there distortions in terms of the treatments of different asset classes?” yes, there are. If you have investors with the power to have considerable ability to deduct interest rates
as an expense and don’t have a significant capital-gains tax, then that’s a distortion, for example.

Bayly I think I’ve got the lucky last. Governor, just looking at the household debt-to-income at 165 percent—you know, during the GFC we went through a period of debt leveraging and lot of people saving a lot more. We’re now seeing that trend going upwards. What I was quite interested in is—you note in the report that some of that increased credit demand is coming for investing in houses and things like that, but I’m more interested in the household credit, other than that. Are you seeing any trends that show the worrying trend where people are going on spending blitzes—and I’m not suggesting that, but is there any underlying trend that you can see emerging with these increasing household debt levels?

Hodgetts Outside of the housing credit growth and other household credit—you know, consumer credit is actually very moderate at the moment. I mean, it’s in single digits in terms of the growth rate, so almost all the credit growth we’re seeing has been in the housing-related credit series, not the consumer credit.

Bayly That’s one good thing, isn’t it?

Seymour I was just going to ask if you feel relieved, after the criticism of the last year or two, that people are now concerned that inflation and interest rates won’t come back?

Wheeler It’s interesting how times change. We’re probably, I think, past the bottom of the inflation cycle. We expect, with the December CPI, that we’ll be back inside the band, albeit maybe just a bit above 1 percent. There are, I think—there tends to be, depending on what happens with fiscal policy in the States, issues there about how quickly interest rates will need to rise, given inflation pressures. And we’re starting to see more upward movement in commodity prices. I mean, they’ve been recovering pretty well since the beginning of the year, albeit fairly slowly, but you have been seeing some quite significant movements recently in things like copper. And iron ore continues to rise, and things like that. We’re seeing that with whole milk powder.

Clark My question relates to figure 4.10 and 4.6—4.10—I assume these aren’t inflation adjusted in figures; I think they’re nominal. And that shows that non-bank lending, for a variety of reasons, is about half of what it was in 2009. And then in 4.6 it has, if you combine agriculture and business—which I suppose are both types of business lending—they’re on a downward trend at the moment. The business lending itself is flat if you exclude agriculture, and with agriculture it would be on a downward trend. And housing growth is continuing up.

If you introduce DTIs and other measures or used other macro potential tools, you’ve got the ability to curb, perhaps, some of that housing spend or lending. But my question is to what extent have you got the tools or would you want the tools to direct lending elsewhere? I mean, if the banks choose not to lend in the housing sector, what is to push that money toward the productive sector? Is that a failure of Government to set the right
incentives? Do you have tools that you could use to help strengthen the underlying economy?

Wheeler  I don’t think we want to get into issues around sector allocation. That’s up to the banks to make those judgements. Our responsibilities are around financial stability and systemic risk, so where we get concerned about asset-price inflation is on housing. And then it’s a question of supply, it’s a question of regulatory policy, tax policy, developers and infrastructure providers, permits, that sort of stuff.

Clark  I guess—sorry, the preface to my question, which I cut out due to the time limitations, is that a few decades ago business lending was well above household lending. That was where the real strength—and that drove the productive economy. Now, a few decades on, we’ve got a picture where we’re worried about housing lending being more than business lending, and the trend is going in the wrong direction. So I do think that affects the stability, and I think you’ve indicated a concern around that consistently.

Wheeler  Well, what you’ve seen in all the advanced economies—in fact, most of the advanced economies—is business investments being fairly weak in this cycle, and New Zealand isn’t a an exception in that regard. If you looked at it from a macroeconomist point of view, would you like to see strong business investment? Yes. If you like to see a housing market that doesn’t have high inflation and potential financial stability risks, yes. Are those things that the Reserve Bank can do? Well, we can help adopt policies that will protect the financial system against systemic risks, but a lot of the potential distortions and the momentum for these other developments lie with Government; they lie with the banks and their own decisions, and the frameworks in which they make those decisions.

Bennett  Thank you very much, Governor. I appreciate your time. Thank you, everyone.

**Conclusion of evidence**
Budget Policy Statement 2017 and Half-Year Economic and Fiscal Update, 8 December 2016

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(Chris Bishop, Chairperson)
February 2017

Presented to the House of Representatives
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Budget Policy Statement 2017 and Half Year Economic and Fiscal Update, 8 December 2016

Recommendation

The Finance and Expenditure Committee has considered the Budget Policy Statement 2017 and the accompanying Half Year Economic and Fiscal Update, and recommends that the House take note of its report.

Introduction

The Budget Policy Statement 2017 lays out the Government’s strategy and priorities for Budget 2017. It is based on the Treasury’s forecasts about New Zealand’s economic and fiscal situation over the next four years, which can be found in the Half-Year Economic and Fiscal Update (HYEFU). Both documents were published on 8 December 2016.

This report summarises the main points from the two documents and our hearing with the Minister of Finance and the Treasury on 8 February 2017.

The House is required by Standing Order 332(4) to hold a debate on the Budget Policy Statement and this report.

Date for Budget 2017

The Minister announced at our meeting that the Budget will be delivered on 25 May 2017.

Summary of Budget Policy Statement 2017

Budget 2017 will continue to pursue the Government’s four main priorities, which have been updated slightly following the recent earthquakes. They are: responsibly managing public finances, building a more productive and competitive economy, improving public services within tight financial constraints, and rebuilding Christchurch and responding to the Kaikōura earthquakes.

While the damage from the November 2016 earthquakes was significant to the Kaikōura community, the associated costs will not significantly alter the Government’s books. The HYEFU assumes that net costs to the Government from the earthquakes will reach $1 billion, leaving a projected operating surplus of $473 million for 2016/17.

In light of this, the Government’s overall fiscal strategy remains unchanged: to keep a tight rein on public spending, to focus on getting better results from public services, and to start paying down debt.

Given the positive fiscal and economic outlook, the Government’s short-term fiscal priorities are:

- maintaining rising operating surpluses so that net debt begins to reduce in dollar terms
- reducing debt to around 20 percent of GDP in 2020
- beginning to reduce income taxes if economic and fiscal conditions allow
• using any further fiscal headroom to reduce net debt faster.

With the fiscal situation improving, the Government has the potential to progress these objectives while also investing in priority public services and infrastructure.

Operating and capital allowances for new spending

In response to higher-than-expected population growth, the operating allowance for Budget 2017 will remain $1.5 billion, slightly higher than in 2009–2015. This recognises that some extra investment will be needed in key public services such as health and education.

Since the Budget Policy Statement was published in December, the Prime Minister announced $503 million in new spending on police. The Minister of Finance confirmed that this would come from the 2017 operating allowance. Future allowances in each Budget through to 2020 will remain unchanged at $1.5 billion.

The Government has identified a number of capital and infrastructure projects to support continued economic growth and to improve public services. As a result, the capital allowance for 2017 will increase to $3 billion and then drop to $2 billion a year from Budget 2018 onwards.

Long-term priorities

When it is affordable, and when economic conditions permit, the Government would like to lower income taxes. However, reducing debt and responding to the earthquakes are of higher priority. While the HYEFU does not make explicit provision for tax reductions, the Government will consider options for doing so either in 2017 or after.

The Government is forecast to resume contributions to the New Zealand Superannuation Fund in 2020/21, in line with the current policy to resume payments once net debt falls below 20 percent of GDP. Net core Crown debt peaked at 24.6 percent of GDP in 2015/16 and is expected to drop to 18.8 percent by 2020/21.

Economic and fiscal context

The Treasury's latest economic forecasts in the HYEFU predict stronger-than-expected economic growth for 2016/17 and beyond.

Real GDP is expected to grow at 3.5 percent for the next two years, and at an average of 3 percent over the five-year forecast period to 2021. Stronger GDP growth would flow through to a higher tax take, with tax revenue expected to be $7.7 billion higher over the period to 2020 compared with Budget 2016. This increase in tax revenue is likely to be offset by a number of factors, such as higher social welfare expenses, higher new capital expenditure allowances, and the $1 billion estimate of net fiscal costs as a result of the Kaikōura earthquakes.

As noted above, the Government’s operating surplus is expected to reach $473 million in 2016/17. This is forecast to rise yearly to $8.5 billion in 2020/21. Debt is still forecast to increase in dollar terms over the next two years. However, as a proportion of GDP, net debt has peaked and is forecast to fall to 18.8 percent of GDP in 2020/21.
Summary of the Treasury’s economic forecasts

The table below summarises the main economic and fiscal forecasts from the HYEFU.¹

<table>
<thead>
<tr>
<th>Economic (June years, %)</th>
<th>2016 Actual</th>
<th>2017 Forecast</th>
<th>2018 Forecast</th>
<th>2019 Forecast</th>
<th>2020 Forecast</th>
<th>2021 Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (production measure)</td>
<td>2.8</td>
<td>3.6</td>
<td>3.5</td>
<td>2.9</td>
<td>2.4</td>
<td>2.3</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>5.0</td>
<td>4.8</td>
<td>4.6</td>
<td>4.2</td>
<td>4.3</td>
<td>4.3</td>
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<tr>
<td>CPI inflation</td>
<td>0.4</td>
<td>1.5</td>
<td>2.0</td>
<td>2.1</td>
<td>2.0</td>
<td>2.1</td>
</tr>
<tr>
<td>Current account balance</td>
<td>-2.9</td>
<td>-3.0</td>
<td>-3.8</td>
<td>-4.1</td>
<td>-4.4</td>
<td>-4.4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fiscal (June years, % of GDP)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Crown OBEGL</td>
<td>0.7</td>
<td>0.2</td>
<td>1.2</td>
<td>1.8</td>
<td>2.2</td>
<td>2.7</td>
</tr>
<tr>
<td>Net core Crown debt</td>
<td>24.6</td>
<td>24.3</td>
<td>23.8</td>
<td>22.2</td>
<td>20.3</td>
<td>18.8</td>
</tr>
<tr>
<td>Net worth attributable to the Crown</td>
<td>35.5</td>
<td>35.1</td>
<td>35.5</td>
<td>36.6</td>
<td>38.4</td>
<td>40.7</td>
</tr>
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</table>

More recent fiscal and economic data

Providing more recent information since the HYEFU was published in December, the Treasury said that the economic and fiscal outlook has further improved. A rise in commodity prices has contributed to higher forecast GDP growth than previously projected. The Government’s forecast tax take is also higher than in the HYEFU, mainly because of a higher GST take. The outlook for global growth has also improved, although this remains subject to a number of risks and uncertainties which we discuss below.

International outlook

The strong outlook for New Zealand’s economy is open to risks from the global economy. The performance of overseas economies can have a big impact on New Zealand’s growth because of the importance of exports. New Zealand’s forecast growth is higher than that of many other developed economies, such as the European Union, the United States, Australia, the United Kingdom, Japan, and Canada. In addition, China’s economic growth is expected to slow. While growth amongst trading partners is expected to trend upwards from 2018, the effects of Brexit and the United States election result are still uncertain.

We discussed the potential effect of slowing growth in China on New Zealand’s economic prospects. The Treasury said that China’s slowing growth was expected as it transitions from export-led growth to consumption-led growth. Consumption is remaining steady in China, giving opportunities for New Zealand businesses to increase exports there. We heard that China’s GDP growth is still expected to reach 6.7 percent in 2017, which is significant given the size of China’s economy as a whole.

The Treasury said the major international threat to New Zealand’s prospects for growth comes from the rise in protectionist sentiment being seen across parts of the world. We heard that if protectionist arguments prevail and global trade begins to decrease, New Zealand, as a small trading nation, will be adversely affected compared with other, larger economies.

The Treasury emphasised that, while these uncertainties in global trade exist, New Zealand maintains strong trade relationships with a diverse range of growing economies throughout...

¹ Half Year Economic and Fiscal Update, 8 December 2016, p. 5.
the Asia-Pacific region. The Treasury considers that the Asia region presents the best opportunities for New Zealand exports.

**Migration**

Unprecedented migration to New Zealand continued in 2016, with net immigration reaching 70,600. With such large numbers of people arriving in the country, we asked if migrants provide a net benefit to the economy. The Treasury views migration as positive for the economy, as migrants’ contribution in taxes tends to outweigh any costs associated with supporting them. We also heard that the demographic break-down of net migration in 2016 is also important. The number of New Zealanders that left the country dropped, while the largest group of long-term arrivals was New Zealanders returning home from living overseas.

The HYEFU projects that net migration to New Zealand will decline year-on-year from 2016’s record high, to 20,000 by 2021. We asked what assumptions the Treasury bases this projection on. We heard that migration is difficult to predict and that the Treasury is very cautious when doing so. In the past, larger numbers of New Zealanders emigrated to Australia in search of better economic prospects. With New Zealand’s economy now performing well, this trend has reversed. New Zealand’s recent net immigration levels have therefore been unprecedentedly high. The Treasury prefers to assume that migration will revert to the long-term average.

**Housing**

House prices grew strongly throughout most of 2016, mainly because of high demand, high population growth, low interest rates, and a shortage in supply. While prices remained steady toward the end of 2016, early data for 2017 suggests that price growth is picking up again. The Minister said that increased housing construction will address the supply shortage. He also signalled the possibility of a rise in interest rates, cautioning New Zealanders against taking on extra debt.

**Debt-to-income limits**

We heard that the Reserve Bank has spoken to the Minister about the possibility of including debt-to-income (DTI) limits in their memorandum of understanding as a tool to manage risks in the housing market. The Minister expressed reservations about the idea, citing the complexity of quantitative tools and the potential for adverse effects on first-home buyers. Despite this, the Minister told us he has instructed the Reserve Bank to undertake a full cost–benefit analysis of DTI lending limits so that he can make a more informed decision about the merits of making such a tool available to the Reserve Bank. Public consultation will begin in March. There was no indication as to when the analysis would be completed.

**Inflow of foreign capital**

In light of the large volume of foreign capital being invested in New Zealand, we asked if the Minister would consider implementing a stamp duty, similar to that introduced by the British Columbia Government in 2016. The Minister said that the significant international capital flowing into New Zealand is a very good thing as it is a sign of our strong economy.

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Rather than restricting foreign capital investment, the Minister said he would prefer to address housing issues by increasing the housing supply.

**Social housing**

We voiced submitters’ concerns that the availability of the income-related rent subsidy has declined since 2014, and asked whether the Minister has confidence in the Government’s social housing strategy. The Minister said that the accommodation supplement should also be taken into account, as both schemes provide housing support to similar groups of people. He pointed to significant changes at Housing New Zealand aimed at improving the delivery of housing. He also noted that the Ministry of Social Development is working alongside other providers to increase the availability of social housing.

**Funding for disaster responses**

Following the Christchurch and Kaikōura earthquakes, the Earthquake Commission (EQC) has used up most of the Natural Disaster Fund. The Government will need to replenish the fund if it is to be able to respond to any future disasters. In light of the Minister’s indication that tax cuts are possible in the 2017 Budget, we asked how the Government could afford the cost of recovery if another major earthquake were to strike.

The Minister pointed out that, if needed, EQC’s liabilities could be covered by reinsurance. The Budget Policy Statement emphasised that responding to the earthquakes is a higher priority than reducing taxes. He said that, if necessary and if finances allowed, the Government would be willing to contribute significantly to any disaster recovery, as was the case in Canterbury following the 2011 earthquakes.
Appendix A

Committee procedure

We met on 8 and 15 February to consider Budget Policy Statement 2017 and the Half Year Economic and Fiscal Update, published on 8 December 2016. We heard evidence from the Minister of Finance and the Treasury.

We received eight submissions, and heard oral evidence from four submitters.

Committee members

Chris Bishop (Chairperson)
Andrew Bayly
Hon Clayton Cosgrove
Hon Craig Foss
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
James Shaw
David Seymour
Michael Wood

Fletcher Tabuteau replaced Rt Hon Winston Peters for these items of business.

Evidence received

Copies of the submissions we received, and additional information from the Minister of Finance, are available at www.parliament.nz
Appendix B

Transcript of hearing 8 February 2017

Members
Chris Bishop (Chairperson)
Andrew Bayly
Hon Clayton Cosgrove
Hon Craig Foss
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
James Shaw
Fletcher Tabuteau
Michael Wood

Witnesses
Hon Steven Joyce, Minister of Finance

The Treasury:
Gabriel Makhlouf, Secretary and Chief Executive
Struan Little, Deputy Secretary, Budget and Public Services
Tim Ng, Deputy Secretary, Macroeconomics and Growth

Chair
OK, we’ve got 45 minutes, Minister. I invite you to speak and present and then I am sure members from both sides will have questions.

Joyce
Thank you, Mr Chair. Perhaps if I make a number of observations based on the Budget Policy Statement, including some updates from that, and then I’ve just got a few comments on macro-prudential tools, if that’s all right. Starting with the economic forecasts, they are pretty strong for New Zealand. The BPS and the HYEFU showed an expected growth rate of 3.5 percent for each of the next 2 years and then averaging 3 percent over the 5-year period. It’s driven by exports, especially services, also construction, general job growth, and migration.

The prediction—the forecasts are for strong employment growth of 150,000 jobs by 2021 and the average annual wage is expected to reach $66,000. If we go and have a look at last week’s household labour force survey, once again we are seeing strong employment growth. We’ve passed a new mark for New Zealand—2.5 million people are employed for the first time.

In the quarter we saw an interesting story of 19,000 more people employed and a growth of 17,000 in the working age populations. What happened in the quarter was that the participation rate went up high to 70.5 percent. That’s the highest ever. We also have our highest ever employment rate that
we’ve ever had—the highest ever rate of employment of adult New Zealanders.

Wages have grown by around 1.6 percent over the last year—that is an average annual wage now of just under $59,000. In terms of the risks to both the current situation and the future projections, it’s an interesting time, I think, when just about all of those risks are international risks, as things stand. Of course, we’re all familiar with things like Brexit, and the uncertainty of that, provides the new administration in the US—could describe it that way. And they’ll have some interesting affects, which may not be the ones that are at the most top of mind at the moment. For example, the effect of Brexit might actually bring forward trade opportunities in both Europe and the UK. It’s yet to see how that unfolds.

The main thing will be to be adaptable and agile around those opportunities.

The other part that hasn’t had much air time recently is still the risks around China and any potential for a harder landing economically there, though those seem to have receded a little bit more recently. The IMF is now posting a more positive story for global growth in the next couple of years, but that is yet to be seen.

Overall the economic activity that we’re seeing in this country is flying through into a stronger fiscal position for the Government. I probably don’t have to remind you that Government deficit peaked at $18.4 billion at the height of both the earthquakes and the GFC. We achieved the $1.8 billion surplus last year. HYEFU is predicting a surplus in the current year of $458 million after $1 billion is allocated to the Kaikōura earthquakes, and that rises to $5.4 billion in a couple of years’ time.

Since the BPS and HYEFU we’ve had the Crown accounts for the 5 months to November—it’s slightly ahead of the half-yearly update—$460 million in terms of tax revenue, and it’s really too early to say whether it’s going to flow through over the rest of the year. I think we might have to get a few more months of Crown accounts before we get a sense of whether we’re actually going to overshoot the HYEFU numbers.

In relation to that, that does bring, however, options for the Government. One option—well, one important thing to focus on, is the investment in public services and Better Public Services, and we saw that with the announcement around Police last week—it’s about $500 million over the next 4 years. But it is also about the social investment story, which is using evidence-based analysis to come up with better programmes, but I think also focusing very much on people with complex needs and that’s something that’s going to be a focus of the public services investment in the Budget.

We, of course, have more options around building infrastructure. The infrastructure story is actually very big—currently predicting the run rate in infrastructure spend to be $32 billion over the next 5 years. That compares with $18 billion over the last 5 years. So it is a big increase.
Chair      Can you just repeat that?
Joyce      About $32 billion over the next 5 years, as against $18 billion in the last 5 years. And this year we’re expecting around the $7 billion run rate on Crown-funded investment, and you compare that historically the run rate’s been more about 3 or 4.

Budget day of course will be through until discussed as we prepare for the Budget. That will be announced on Thursday 25 May and we’re making that announcement publicly today.

I just want to touch on the housing market and macro-prudential tools. The housing market is a story, I think, of three significant influences at the moment, in terms of particularly the higher house prices in Auckland. So they’re the result of historically low interest rates—which is sort of at 50 year lows, or have been—a very strong economy compared with most of the countries we compare ourselves with in the developed world, and a shortage of housing supply. So those three things have acted together to drive the prices that we’ve seen.

There are a couple of points I wanted to note in relation to that. Firstly, the supply gap is closing. I don’t think there’s any argument now—or maybe there is, but we’ll find out—that New Zealand is in the middle of its biggest ever building boom. We have the largest—the [Inaudible] recorded the largest ever construction workforce that this country has ever had, 240,000. The number of consents in Auckland has topped the—it’s the highest in 12 years. There’s also been strong growth nationally.

The other thing I would note, as well as the supply starting to come in quite strongly, is you’ve also got interest rates showing signs of coming off these historic lows. All of that suggests that there’s probably not that much upside in house prices and people should think about that.

And I would make the comment through this committee today, that what I have been saying in other forums, which is that I’d counsel housebuyers to be cautious about the prices they’re prepared to pay at this point, or feel they have to pay. It’s not about what you can afford, necessarily, now but what you might be able to afford in 3 or 4 years’ time if interest rates start to track up.

In terms of Reserve Bank matters, we’re all aware of the announcement of Graeme Wheeler to stand down at the end of his term in September. I wanted to make a couple of comments if I could on debt-to-income limits. It’s been a pretty topic of conversation. So I’ve had a discussion with the Reserve Bank Governor about this since I’ve taken up the role and I’ve decided that, consistent with good regulatory practice, I want them to do the full cost-benefit analysis in consultation on the possibility of using debt-to-income limits before they ask to have it included in the MOU. You’ll recall we have a memorandum of understanding around macro-prudential tools and the Reserve Bank came last year and said: “We’d like to have this tool.” As part of it they actually said they didn’t intend to use it at this time but they might want to have it available in future. I’ve had a look at that and
really feel that it’s important that they actually go and do the regulatory work and go and do the full rigorous cost-benefit analysis and then come back and tell me what they think, and then we’ll all have the benefit of that analysis before I make a decision as to whether to include it or not. I’m interested in a number of things in that analysis.

Quantitative tools: they can be complex, and we’ve had political debates about how they affect different borrowers in different ways—we’ve had that debate about LVRs and we’ve also started to have that debate about DTIs. So one of the things I’m interested in is the impact it will have on different, or could have, on different classes of buyers, including first homebuyers. Anyway, they’re going to do that work. My understating is they’re intending to commence public consultation in March and go through the first half of this year and then they’ll report back to me.

Roberston 24 September?
Joyce No, I suspect earlier than that, thank you Grant. That, Mr Chair, is my overall summary. I am sure there will the occasional question from committee members.

Roberston Welcome to the Finance and Expenditure Committee, Minister. Just to pick out the comments on DTIs, does that indicate—the reason you’ve taken that approach, does that indicate that you’ve got some concerns about how DTIs would impact on, for example, first homebuyers, perhaps in different regions of New Zealand? Is that why you have said let’s do a full cost-benefit analysis?

Joyce What you’re assessing is one of the reasons that contributes to it. Because I just think that actually we should be cautious whenever you have these tools, and I just feel we’d better get it around the right way: do the analysis, make it pretty rigorous, get the feedback and consultation, and then make a decision as to whether it’s something that I feel as Minister and the bank feels should be in the tool kit. I just feel much more comfortable with that than just sort of going in blind and saying: “OK, we’ll throw it in and then you guys do your analysis later.”

Roberston Well presumably the Reserve Bank doesn’t go in blind to anything. They’ve been working on this for some time. It’s an internationally used tool, so you must have some specific concerns that have led you to do this, or do you just not want to discuss it and come to a decision before the election that you’ll get blamed for?

Joyce No, that’s not my concern. In terms of—my concern is that we do a full and proper regulatory analysis before the decision is made. That’s just a principle that I’m bringing to it.

Roberston Was that done for LVRs?
Joyce It was done in a slightly different way for LVRs but then I’m the finance guy now and I get to make the call.

Roberston Oh, so Bill didn’t do his job properly.
Joyce  He did do his job properly. He was very good at his job actually. Just go and have a look at his track record.

Robertson  One of the concerns that we’ve raised in this committee before on this is that New Zealand’s housing market does have some regional aspects to it. Is that a specific issue? Would you be of a mind to approve the introduction of DTIs that were targeted either regionally or to specific classes of buyers?

Joyce  I’m not going to write my response to a report that hasn’t been written yet today, Grant. Let’s just wait and see. Let’s do the analysis and let’s have them do the analysis and then come and talk about it. The sort of questions you’re raising are the questions that I want to be very confident about before the decision’s made.

Chair  We’ll just come back to that topic—sorry, a different topic, but I think there are a few supps. So Jami-Lee and then—

Robertson  That’s on this topic?

Chair  On this topic, yeah.

Ross  I wanted to ask the Minister about what you are looking for and what would give you greater confidence. And if I can give some background to my question—well we’ve had the Reserve Bank Governor here. Their documents show that in I think it’s about 3 or 4 years’ time, they’re expecting house-price inflation to drop to below 5 percent. They’re also expecting net migration to drop off considerably in about a similar period of time and, as you quite rightly said, their advice right now is that they’re not expecting to be able to use—they’re not expecting to use debt-to-income ratios, they just want to have it available there as a tool. What are you looking for in that extra work, to give you confidence, before you unleash that option on the New Zealand public and give them that tool?

Joyce  You make the fair point that actually at this stage the intention is not to use it, which is why I think we have the time to do that cost-benefit analysis now, before a decision is made to include it in the MOU. It’s a little bit different around the LVRs. The timing was a bit different. But, I think, generally the good principle for regulatory processes is you do the regulatory analysis and then you make the decision. It’s just—call me old-fashioned, and that’s what I want to see happen in this instance.

Tabuteau  Look, just to give me an indication, you look at the debt-to-income conversation, do you have a preference yourself? Like, I’d be particularly concerned about first homebuyers as opposed to investors being brought into some kind of scope in this nature. Have you given some consideration yourself to the outcome of that report and have a preference to how it’s applied?

Joyce  Well I’ve noted in my comments earlier that I am interested particularly in the impact on first homebuyers. I share your interest in that space, making sure it doesn’t unduly impact on them. The Reserve Bank’s done some work, and I know the Governor will be here tomorrow and he might expand on it for you, but they’ve done some work, obviously, and they believe that the higher debt-to-income ratios are concentrated in Auckland,
which won’t be a surprise, but also amongst investors. But again, I think if we can actually do the full analysis between the Reserve Bank and the other banks, and then I think we’ll have a much clearer picture for everybody to have a look at.

Seymour

Just wondering about—would a DTI be able to capture borrowing offshore, and, if it couldn’t, then wouldn’t it systematically advantage people who might have access to capital from offshore markets, for example, New Zealand residents who might have family connections offshore?

Joyce

Well, I stand corrected and, again, this will be some of the questions that get answered on the way through. But it’s not the debt—it’s not the source of the debt that would be the primary concern. The concern in this instance—might be in other areas—the concern in this instance would be the ratio between the amount of debt and the income of the individual that’s making the loan. So I’m not sure that that would have the debt itself. The origin of the debt would have a strong impact on that.

Seymour

Can I just clarify, the question is: would the bank have the ability to detect borrowing that had occurred offshore?

Joyce

Right, you mean in addition to the borrowing that occurred in New Zealand?

Seymour

Exactly.

Joyce

OK, I get you. Well, again, those are the questions we’ve got to answer. Those are the questions that the bank needs to address [Inaudible] the validity of the policy, and that’s why I think we need to go through all those eventualities, go through the public consultation process, because people like yourself and others will have contributions to make in terms of the questions like this that you want to ask.

Foss

Earlier today we had the Earthquake Commission in here discussing their state of affairs, and one of the things that was interesting—I think particularly for the committee—was that they’d pretty much run out of funds if there was to be another event, and they are engaging with Treasury right now under their own Act to help to replenish themselves. So I note in the Budget statement, when you go on to talk of the possibility of the consideration of tax cuts, however responding to earthquakes and reducing debts are currently of higher priority. So at what stage are you at in those discussions and, also, what are those kind of considerations that you would pursue—considerations of tax reductions particularly for lower and middle income earners as we write in this statement?

Joyce

Yes, Treasury is in discussions with the EQC currently, as it is with any number of Government agencies, and we’re well aware of EQC’s limits, and that will have to be part of being addressed in Budget 2017. So, as you will know, Craig, from your experience, there’s a whole lot of bits—of some of varying high quality, some of, you know, interesting quality, and the Cabinet will have to go through and make some decisions on those. I said in my opening statement we may or may not have the opportunity to do something on the income side for people this time around. It really depends
on how that shakes out. But I think it’s important that we always keep in
mind the origin of the money that we spend, and people who provide it,
and their quite reasonable view that they might think of better ways to
spend it sometimes than the 121 people sitting down here. So I just think
that that’s something that we need to keep very top of mind.

Seymour  Yes, I agree it’s very important to think about the origin of Government’s
funding, the taxpayer. Your statement says that you’ve found an additional
$7.7 billion forecast this year, that you didn’t anticipate last year. How much
extra money do you need to find before taxpayers actually become a priority
in the Budget because, at this point, tax cuts are not a Budget priority.

Joyce  Well it’s the old story, you’ve got to—there’s forecasts and then there’s
reality. It’s important to state that those numbers you referred to are
forecasts, and we’ve got to have some confidence about those forecasts,
and then we can think about how that money is allocated across those four
priorities that I proposed. And they all have valid claims to them, and that’s
actually the Budget process—is to go through that. But I understand your
view on this matter.

Seymour  Just to clarify, you don’t rely on the forecast to set the Budget priorities?

Joyce  Well you do, to a degree, yes. It all comes to confidence and as we get closer
to the Budget, we’ll have a more up-to-date economic forecast and fiscal
forecast. We have another few months of actual out-turn. So that will be the
opportunity for us to assess it and at some point we’ll have to make a
decision as a Government on what we think those things are.

Seymour  So, just to address the original question: if an extra $7.7 billion over the 4
years isn’t enough to make tax cuts a priority, how much do you think it
might have to be, if you could rely on the forecasts?

Joyce  The preposition to your question is not something that I agree with. I’m just
saying let’s just see how things unfold.

Tabuteau  One of the early submitters spoke about the efficacy of tax cuts for low-
income earners in and of themselves as a tool to combat poverty. They gave
examples along the lines of go from 10.5 to 9.5; there would be a 1 percent
reduction in the tax rate. Actually, the cost of it would be close to $450
million and the end result of that would be in the hand $3 extra a week for
an average-income earner in that bracket of $14,000. It doesn’t sound like a
great way, when you’ve got submitters who are proponents or those at the
lower-income stream saying: “Actually, we’re going to have to look at this in
a different way.”

Joyce  And you raise, I think, an interesting view on one aspect of it. I’m not going
to try to reverse engineer though by ruling out a whole range of things
today til we end up with what we haven’t actually done yet. I know you’d
like me to. I just noticed that you’re called Megan Woods today. That was a
surprise.

Robertson  We’re very interchangeable in the Labour Party.

Joyce  That’s what Willie Jackson says, mate.
Robertson
We’ve got them queuing up out the door to join us.

Joyce
So, you raise a valid point. That’s why I think you’ve got to have the discussion around taxes and transfers because, as you know, there are other targeted ways of doing things. We have to make those assessments.

Shaw
I just wanted to [Inaudible] the primary question about choices between essentially earthquake expenditure and tax cuts. Obviously, we’re not projecting another earthquake, but if you say that tax cuts are a higher priority and then you essentially reduce Government revenue and then there is another event, what do you do?

Joyce
That’s your proposition; I’m not saying that. What I’m saying is we have to consider all these things and it’s important that we consider EQC. You should note of course that a fair bit of EQC’s potential liability is covered off with reinsurance but there is a significant amount that isn’t and we then have to cover off in the case of Kaikōura, for example. I think it’s just one of our priorities—a very important priority—and we have to be sure that EQC is capable of doing that.

But as we’ve seen, our experience through the last big event—they’re all big events, but one was more massive than the others—is that another way to do it is for the Crown to lean on its own balance sheet provided its balance sheet is in order. We’ve done that through there. We had that big deficit that I referred to earlier of $18-and-a-bit billion where the Crown basically shouldered the wheel for the people of Christchurch and the surrounding districts.

As well as talking about what you allocate to EQC, it’s important to talk about the overall debt levels and getting those down. That’s one of our important considerations as well and why we put that figure of net debt of 20 percent of GPD by 2020 or 2021, because it’s a very important anchor point should another economic shock come—and they always come at some point—or you get another, and we hope not of course, another significant seismic event.

Seymour
Just a supp on the debt. It says we’re running at about 22 percent core Crown—

Joyce
I think it’s about 24 at the moment—24 and a bit, predicted to be at the end of the year.

Seymour
Core Crown for next year, it says 22.8. In any case, we had an interesting observation this morning from Susan St John that that doesn’t include the Cullen fund or the NZSF. And so, if you were to count that, what do you think New Zealand’s real net public debt is, because that is ultimately a public asset?

Joyce
You can count it, and I’m sure there’s people over here that can give you that exact number right now. You can change the way you calculate the debt if you like. What’s more important is the trend over time. I could make you feel better and say we’ll add back in Super fund and so on and suddenly it’s gone from 24 to, I don’t know, very low figures.
It would be about 15.

But I could also put it the other way, as has been done politically, and talk about gross Crown debt as well. We could suddenly scare ourselves with that, which is how much we’re actually borrowing. The important thing is in terms of the Crown’s net debt position, we’ve taken the view that the Super fund is off to one side, that ACC’s off to one side. They are effectively hypothecated to a particular purpose, and then we look at the net ground debt as excluding the Super fund. Others can take a different view. They’re welcome to do that.

Just getting it back to risk levels though, particularly you are talking about the global situation. I suspect you wouldn’t advocate borrowing against your mortgage to play the sharemarket, but that’s effectively what the Government’s done with 10 percent of GDP.

You’re referring to the Super fund now?

Yeah.

Well, Governments can take different approaches at different times and actually you could make the same argument about ACC because actually we fully fund ACC and we let them go and make investments on that basis. I actually think that that’s proven to be a prudent approach to take over time. But, yip, you can make that argument. It is not one that this Government is making. We feel comfortable both where we're at with the ACC and where we are at with the Super fund is appropriately cautious for New Zealand’s environment.

Just looking at the BPS, page 4, in terms of your plan for debt reduction, we don’t actually see any real reduction in dollar terms until 2020. That’s right, isn’t it?

There’s two ways, of course, of reducing debt as a percentage of GDP. One is growing GDP and the other’s shrinking the debt. The most important thing is your debt relative to your income, particularly in a country concept because I am presuming that we won’t all one day just decide not to work anymore and wander off. Our debt to GDP ratio is more fundamentally important than the actual dollar amount of debt.

To be absolutely clear, that reduction that you’re proposing relies on those exact same growth forecasts that you were somewhat cynically addressing before, doesn’t it?

No. All I’m saying is that you have to adjust your circumstance you flow through. Treasury does its best forecasts at the time and we respond to those, but we also have to make an assessment as to what the risk levels are. That’s something that we’ll adjust through this process but you have to make Budget decisions based on the knowns. Now, it is a matter of degree, because you could scare yourself silly and not do anything or you could just go nuts and completely rely on every projection forever. I suspect the middle path is the more appropriate than either of those.
Robertson: You mentioned in your preamble the announcement around the Police funding package that was made post the BPS. Where’s the funding for that coming from?

Joyce: That will come from this year’s Budget and this year’s operating fund.

Robertson: From the new operating funding—new operating allowance?

Joyce: That’s correct.

Robertson: That, the Prime Minister reiterated yesterday, is going to remain at $1.5 billion. There’s a huge call on that for health and education, which you have already outlined. What will give in order to accommodate this package?

Joyce: Well, the operating allowance is $1.5 billion, which is of course $6 billion over 4 years. This is a half-billion-dollar commitment. So, yes, there’s capacity for other things.

Robertson: Something’s going to have to give, isn’t it? You put this together—

Joyce: Not necessarily. When you say something has to give, nothing has to come out of any baselines. What we’re going to end up debating through the Budget round, as we do—there might be things that come out of [Inaudible] when they’re finished and so on, but in terms of the big Budget items, it’s going to be the level of extra investment, it’s not about cash flow.

Robertson: That’s exactly right. Your predecessor has been in this room telling us that there is extraordinary pressure on health and education services with population growth and telling us that there will be a huge draw on that funding.

Joyce: I’m not sure you’re paraphrasing correctly.

Robertson: Presumably, the amount of money you have available now to fund health and education is challenged. That’s right, isn’t it?

Joyce: No, it’s not necessarily challenged. We are obviously working on the Budget numbers every day. We’ll make some calls. I’ll tell you what I am incredibly confident about: we won’t be offering to spend anywhere near as much as you would, and, what’s more, our debt will be lower than you claim it should be. You have a different approach to the world, and I respect your approach. I prefer ours.

Robertson: Well, no. You’re the one who’s put in front of us a Budget Policy Statement, didn’t mention this commitment that you’ve made subsequently at all. You’re telling me today it comes from a spending allowance that your predecessor’s indicated that there is a lot of money. That means health and education don’t get the priority they should. It’s that simple.

Joyce: No, that’s not correct at all. If you go back and look at health and education, they don’t get all the operating allowance. Other things get money from the operating allowance. I counsel you to wait and see.

Bayly: Minister, I’m just continuing with this line of spending lots of money—capital expenditure: you’re obviously rejecting to increase it up to $32 billion. What is driving that expenditure?
Joyce There’s quite a lot. You’ve got, obviously, big transport spend both around
the country and in Auckland, and you’ve got the Kaikōura earthquake—
State Highway 1, in particular Picton to Christchurch. You’ve got ongoing
spends in things like ultra-fast broadband, which continues to roll out. You
have very big spend in schooling around the country—in terms of schools.
I think it’s the biggest investment that we’ve seen in many, many years. So
that’s very significant.

And you have a range of other capital projects. I was on the West Coast the
other day and we had a look at the Grey Base Hospital, which is 70-
something million. We’ve been making very significant investments in
hospital facilities around the country. Then you’ve got things like the
Housing Infrastructure Fund, which is now out for proposals. So I think
compared with any historic sort of numbers the run rate on capital projects
is unusually high—by historic rates.

Bayly And presumably transport’s the biggest component of that?

Joyce Yeah, it is. Well, yeah, I think it’s the biggest single component—that would
be fair wouldn’t it? And you’re going to see some of that come to pass. The
Waterview tunnels are going to open in the next few months. You’re going
to see—you’ve already seen the Northwestern in Auckland open. There’s
significant projects widening the Southern Motorway out towards where
you live, but also through past Onehunga, SH 20, and so on. There’s some
very big investments there. Then you have, following on fairly fast, the
East-West link and the Northern Motorway extensions.

The other part that’s quite significant, which often central government
doesn’t get a massive amount of credit for, is some of the very big regional
projects. Up where I live, which is Dairy Flat, north of Auckland, the
Albany highway, there’s a joint venture between Auckland Transport and
the Government—it’s about a 50/50 spend. It’s been a very big investment
there. Out where Jami-Lee is, the [Inaudible] on around the country as well.

Member All the key electorates.

Joyce Fortunately, I’ve got lots more for you. And so you can just go down the
West Coast, Taramakau bridge—not our electorate but we’re working on it.
Work’s being done in Christchurch around the motorway system, which
benefits all people in Christchurch, including even a couple of Labour MPs.

Scott Thanks Minister. We’ve talked about, perhaps some would say, a very
conservative approach. You know, we haven’t talked about—well, you
haven’t included ACC and Government superannuation, and if you did
things would look even more stronger than ever. And we’ve got these
conservatives like Grant Robertson who would just love to get hold of
some more money and spend it—borrow and spend. Why don’t you just
take that approach? Because, you know, things are in good shape. Why
don’t you just borrow and spend more?

Joyce I think, in short, every Government faces choices around three things:
strengthening the balance sheet, investing in the stuff that Government
provides, and then returning funds back to taxpayers—you know, the
people who work hard to pay the money across in the first place. And there are different priorities at different times and different things that you can do in different times. I don’t think that changes. I think we do take a conservative, smaller government approach. But, also, we do that to also drive harder at efficiency gains and getting better results from the money that we spend in Government. And we’re working very hard on that—things like the Better Public Services targets, the social investment.

One of the things I want to focus on is improving the productivity. As services grow and as population grows it doesn’t necessarily follow that you should have to add a dollar for every additional thing you want to buy—there should be economies of scale that you’re starting to see. And if Governments don’t take a focus on that then they can end up just chewing up a lot more dough for doing the same things, and, you know, no disrespect to my friends opposite on the committee over here, but there was a fair bit of that from the last Government.

Wood Minister, we have received a very good submission from Caritas this morning, and one of the things they pointed out is that the number of income-related rent places has declined from 69,000 in 2013 to just over 61,000 now to bounce back to about 67,000 by 2020 under what you’ve outlined. My question is: if you have such confidence in the social housing reform programme, which is reliant, effectively, on the income-related rental scheme why are you planning on delivering it to less families by 2020 than had it in 2013?

Joyce Actually, I don’t think you can take income-related rents on its own without also looking at the accommodation supplement as well, because the two are both providing housing support to, in many ways, quite similar groups. One is obviously doing it through the private rental market and one is doing it through the social housing market, which includes both Housing New Zealand and the CHPs—the community housing providers.

I think you raise an interesting point about the importance of delivery and actually we’ve made some significant changes around Housing New Zealand to encourage better delivery on what they’re committing to. And I think having MSD contract social housing and also bringing in other providers will encourage better meeting the targets of increasing the availability of social housing places.

So, I think we’ve made very significant investments in this space. The new Minister for Social Housing is Amy Adams. She is very focused on the execution of the plan and I think that will be the proof of the pudding. But I am confident that MSD and the social housing providers, including HNZ, are up for that. But, again, I just counsel you that you don’t consider it in isolation [Inaudible] of the accommodation supplement as well.

Robertson Can you confirm that Housing New Zealand’s 3-year plan in Auckland will see a net gain of only 722 State houses?

Joyce I can’t confirm that at this point because we are still discussing their plan over the next 2 or 3 years so—
Robertson: You wouldn’t be satisfied with that though, would you?

Joyce: What I would say is I want to wait and have a look at their plan and what they are actually proposing to do.

Shaw: Back to the issue of housing, you were talking about the three reasons why we’ve had such high house-price inflation: interest, a strong economy versus other economies, and housing supply—and I accept all of those. The middle one—strong economy versus other economies—how I interpret that is that when New Zealand’s economy is doing well and other economies are doing not so well, we’re seen as, essentially, a safe haven for international capital that would otherwise be facing more difficult challenges.

Joyce: That’s not actually what I meant, but yip.

Shaw: Because where I then go with that—I would like to know more about that. If you’ve got an inward flow of capital, particularly from economies with also low interest rates and large scale quantitative easing—and that’s essentially a sort of fire hose of capital into what is a fairly small economy here, which when the other conditions of low interest rates here and a constraint on housing supply are also present have a significant distortionary impact on house prices at the margins. So I just wanted ask if you agree or concur with that analysis and, if so, would you consider things such as British Colombia’s stamp duty and so on to try and take some of the heat of that out?

Joyce: In terms of my reference to a strong economy, I am referring to the fact that the level of economic activity is growing in this country faster than all but four of the entire OECD currently. And that is encouraging Kiwis to return home, it’s encouraging Kiwis to stay home, and it’s encouraging people to want to come and live and make their lives here. And that’s what I mean by “strong economy”.

That’s creating demands for housing, but the only alternative I see to that is—the strong economy argument—is to tip the economy over, and, you know, if that’s your argument, it’s fine, but I’d prefer to solve the housing market issues in other ways. And that is why we’re focusing very much on the supply side.

I think, in terms of your capital argument, I think that’s more reflected in very low interest rates. So even though there is a lot of capital around the world, New Zealand’s interest rates are at 50 year lows currently. And I don’t think that’s a problem in itself. If you talk to your average mortgage holder, they’re probably pretty happy that interest rates are at that level. I think the bigger risk that I think people should just think about is the potential for interest rates to now rise in the years ahead. And we’re seeing that with the bond rate, and that’s why I think it’s really important that people don’t overextend themselves at this point.

And I think we’re seeing signs of that cooling in the Auckland property market. It’s interesting to see yet whether that’ll be sustained or not, but I think it’s just something that people should be aware of, that we may not,
you know—it’s often a case in economics that once people have something for a while, whether it’s low oil prices or high oil prices or low interest rates, they seem to assume that it will last for ever, but generally it doesn’t.

Shaw

So I accept that demand has increased and there is a supply crunch, but are you saying that international capital plays no role in house-price inflation, or has played no role in the recent housing bubble?

Joyce

No, what I’m saying is capital flows tend to respond to opportunities, and New Zealand’s economy and the strength of its growth is attracting activity to occur here, including capital and labour, which I think is a good thing—unambiguously a good thing overall. The job is, for all of us—it’s not just Government; we have a very comprehensive programme, but it’s not just Government—is to make sure we can ensure that the market operates to supply sufficient land to build the houses that we need because we don’t have people travelling off to Australia all the time to find their futures these days.

Chair

Thank you, Minister, we’re well over now so we’ve got to wind it up. Thanks very much for your time. Thank you all. Thank you, Secretary. We’ve given you 45 minutes. As you can see, we’re running a bit over, but we’ll do the full 45 as long as members have questions, if that’s all right with you. Do you want to make some opening remarks? OK, in your hands.

Makhlouf

Thank you, Mr Chair. I mean just to introduce my colleagues: Struan Little, who’s the Deputy Secretary, Budget and Public Services, on my left, and on my right, Tim Ng, who’s my chief economic adviser.

So I’d just like to open with a short recap of the main points from the Half Year Economic and Fiscal Update—what we call HYEFU—which we released in December, and I’ll cover a few developments so far in 2017. HYEFU reflected the Crown’s balance sheet being in solid shape and a more positive outlook for the economy than we had assumed in Budget 2016. GDP is forecast to grow at 3.7 percent this year and average about 3 percent over the next 5 years. And despite an estimated $1 billion net spending increase because of the Kaikōura earthquakes, the OBEGAL surplus is expected to be about half a billion dollars in 2017, rising each year to $8.5 billion by 2021.

As we’ve just heard, infrastructure is a priority, and capital spending allowances have increased by $5.4 billion over the next 4 years, and HYEFU shows net debt forecast to reduce to 20 percent of GDP by 2020, and it’s also signalled that contributions to the Super fund are expected to resume in 2021.

So these forecasts represent the Treasury’s best professional judgment, but there are potential risks that could affect them. We would be concerned if there was an international shock that lowered our trading partners’ growth and increased global financial market volatility. It could prompt a fall in export demand, asset prices, the New Zealand dollar, and, terms of trade, leading to lower investor and consumer confidence. And in such a scenario, nominal GDP tax revenue and OBEGAL would all be lower than forecast.
However, so far the economic outlook has improved a notch since HYEFU. Commodity prices have increased, contributing to New Zealand’s nominal GDP being a bit stronger than we forecast. And although it is early days, tax revenue is up on forecast too, particularly GST. Annual inflation is also up to 1.3 percent, after spending the last 2 years under the 1 percent mark.

Our net migration numbers are still higher than expected. The latest figures from Statistics New Zealand show a record 70,600 more migrants arrived in New Zealand than left in the 2016 calendar year. The biggest groups arriving were New Zealand and Australian citizens and working visa holders. Our assumption HYEFU is for net inward migration of 20,000 people in 2020, and then reverting to 15,000 in 2022, although I should add that we regularly put our assumptions under review.

There’s just a hint of sunshine starting to come through in forecasts of global growth, as opposed to the Wellington weather. As the Minister mentioned earlier, the IMF’s world economic outlook in January was more positive than early reports, with the IMF raising its GDP growth forecasts for the developed world in 2017. And, as expected, growth in China is slowing at a steady pace, but we should remember it remains at a quite healthy level. China’s growth was 6.7 percent last year and is still forecast to be 6.5 percent next year, and 6 percent the year after. And while international trade is certainly a hot topic, right now what I’d say is that 22 percent of our goods trade is with Australia, 24 percent with China, and 29 percent with 10 other major Asian economies in total. So our markets are diverse, and our trade relationships are strong, especially with the Asia-Pacific region. That’s all I want to say as an opener.

Robertson
Yeah, thanks, Secretary. Just one specific question: I’m just trying to find the table, but you mentioned, and the Minister mentioned, the capital spend. Is it correct—yeah, there it is, page 42—there’s only $200 million of new capital spend, I think, budgeted for 2017? There’s only $200 million of new capital spending budgeted for 2017? Page 42. I mean, I appreciate you’ve got money in the out years, but we’ve just been—

Makhlouf
Struan’s got the book in front of him so he’ll answer it.

Little
Correct me if I’m wrong, but that chart shows the incremental spend of the allowances, but it doesn’t include all the capital expenditure.

Robertson
No, I’m aware of that. I’m talking about new capital spending in addition to previously budgeted for.

Little
Yes, but that chart is dealing only with the allowances of the $3 billion, the $2 billion, the $2 billion and then allocates that over the years that we’re anticipating. That’s what that chart indicates. But it doesn’t indicate all capital spending, because that’s flowed through in the past, funded off other balance sheets.

Robertson
Absolutely understand that, but both—well, the Minister particularly emphasised the ramping up of capital spending and new money, and the $3
billion, the $2 billion, and the $2 billion is the new money, and only $200 million of that is forecast to be spent in 2017.

Makhlouf  I mean, this is capital spend, and what the Minister’s announced in the Budget Policy Statement is that the capital allowance is nearly going to be tripled from what it was previously. I think what that’s reflecting, in part, is earlier decisions as well as what’s happening now. I mean, in 2017 you’re talking about big capital projects. Whether we’re going to spend all the money by the end of June in a calendar year is obviously an issue, but it’s undoubtedly the case that—and I think this is important that we tend to talk about new spending by just focusing on the incremental increase announced in the Budget. But, of course, there is lots of new spending that takes place outside of those Budget numbers because they’re, essentially, off agency balance sheets, for example.

Little  On the previous page, in table 2.6, that shows the actual spending and—

Robertson  —the history of it, yes, which declines, so you want to be careful about that one. Can I ask you about the migration numbers? I know you’re constantly revising them, but even working yourself towards 20,000 by 2020 has run counter to what we’ve seen for whatever reasons. We discuss them often here. The Reserve Bank takes a slightly different view to you and other forecasters take another view. Could you run us through what some of the assumptions there are because it has felt that we’ve simply been looking at graphs that return us to the long-run average? That is no longer, in my view, reflecting reality. Can you run us through how you are revising it, how you are reviewing it, what are the assumptions?

Makhlouf  I will ask Tim to come in on that in a minute. One thing I want to just flag is that—because you make a very valid point. We’ve always been extremely cautious, if not reluctant, to forecast net migration. Our economic forecasts cover 4 years going forward. We’ve tended to only forecast migration for part of that and assumed a return to the long-term average is happening within that 4-year period. At HYEFU we decided because of the evidence that that assumption should be changed, which is what I mentioned earlier. It used to be 12,000—the long-term average. New Zealand has revised that number now to 15,000. We’re assuming that we’ll achieve the 15,000 by 2022, outside of our forecast period.

But, certainly, as I’ve said before to this committee, one of the biggest variables for us is what happens to the Australian economy. That remains the case. It means forecasting these numbers is difficult but, I mean, we have to make a professional judgment and that’s what will override what we have.

Ng  The only thing I’d add to that is distinguishing the citizen flows from the non-citizen flows. We have the working visa arrangements and other people coming in on temporary but longer than 1 year visas. A lot of those people change their visas or apply for residents’ programmes and so on. Trying to predict those people is difficult and we look at the numbers and try to incorporate that outlook into the forecast.
Then on the citizens’ side, with New Zealanders and Australians really, the reversion to the mean is a question of the relative performance of the two economies anchored by the fact that the Australian wage level tends to be higher than New Zealand; it is 20 percent higher on some measures. That’s what we think is the main driver behind the typical net outflow of New Zealand departures to Australia. So that number is very close to zero at the moment, which is unprecedented historically. So part of the forecast is that until the economy is normalised, we will see a resumption of the flow back to about near 20,000 or so.

Robertson

It is more the ski jump nature of the graph that I find a little hard to believe. It’s more the ski jump nature of the graph where it drops dramatically from where it is now that I find that a bit hard to take.

Shaw

Good to see you again. The Minister in his comments said that threats to the New Zealand economy were primarily international and fairly well documented of late, but the Reserve Bank still considers two significant threats to the New Zealand economy to be domestic, which is the house-price bubble, and also dairy farm debt. I just wanted to get your sense of where you fall between those two, kind of, views.

Makhlouf

I don’t think those views are inconsistent with the Minister’s—the Reserve Bank’s views. He made the point, which I completely share, that household debt, especially in a period, as we look forward, of increased interest rates, is potentially a risk for us, which is the Reserve Bank’s view. Certainly, I share the Minister’s perspective that people who want to purchase property and take on high levels of debt should just think about whether they could afford paying a mortgage at higher rates of interest than are currently available, absolutely.

I’ve got a lot of confidence in the Reserve Bank’s work on financial stability. We do rely on them to keep a good eye on what’s happening and obviously we’re deeply involved with them on a range of issues, including the macro-prudential framework that you heard earlier. But I agree. I don’t use the word that you used—the word “bubble”. We’ve seen a moderation of house prices, especially in Auckland, recently. Loan-to-value ratios have certainly had an effect. I think the tax changes are probably a bit early but I think they’ve probably also had an effect, but it absolutely remains a risk for us.

As we’ve already seen in the markets, the reality is that our banks borrow offshore so the fact that the OCR may stay flat for a while doesn’t mean that mortgage rates will stay flat for a while. So I think that’s quite an important thing. We’re seeing slowly—albeit slowly—monetary policy around the world is normalising. I say slowly because it’s got some way to go to get to normal. Dairy prices were—I think a year ago when we talked about this, we had a slightly different scenario in front of us and it was bleaker. It’s now a bit more positive. Certainly, we’re still expecting a trend of dairy prices will increase over the medium term, and that will certainly help those farmers who are highly leveraged.
The Reserve Bank obviously has a mandate. You mentioned that they do very good work around stability of the financial system but their remit doesn’t go terribly much further than that. Obviously, it’s possible for there to be an economic shock which doesn’t have a tremendous destabilising effect necessarily on the financial system because the banks are well capitalised and stable and so on, but other sectors can be quite badly affected. I guess that’s where I’m interested in kind of drilling into your sense of the risk around housing and, to an extent, dairy farm debt because obviously they’re both affected by the potential for interest rate rises. Even if the banks are OK, because they and the RBNZ have done their job, actually householders and dairy farmers are not. To get a sense of what you think that that likely path or some of the scenarios are around interest rates over whatever period of time.

I’ll ask Tim to come in on that. I think we need to just bear in mind that the dairy sector’s survived a pretty big shock pretty well recently. So, in terms of commodity prices—I mean, that’s obviously another area of shock that may not directly impact the commercial system, but is relevant. Tim do you want to—

Yeah, I think your characterisation’s right that if we think of the LVR and DTI measures, for instance, when we’re targeting what limits are on types of borrowing contracts, and so they will affect the vulnerability of the borrower as well as the banks—the borrower goes bust then the bank wears it. Also we’d agree that there’s an issue around the motivation for applying DTI and LVR limits in that it’s—most people would agree it’s well within the mandate of the bank to fix the financial system, but where it gets fuzzier is around, you know, how far do you go? How much should you take into account the impacts on households of debt stress beyond the impacts on the financial system? That’s the kind of ongoing conversation we have with the bank. It’s an issue that’s a big part of the Bank’s public consultation and cost/benefit analysis on DTIs that the Minister alluded to, of course. I’d also reinforce what the Secretary said around the dairy sector where the recent dairy price numbers are favourable for the average dairy farmer situation. On the household sector there’s still a long time to run before we can feel more comfortable on that score.

Do you have a sense—I mean, you’re sounding caution around the potential for interest rate rises, which means you must have a sense of what you think they’re likely to rise to, and some sense of the period of time. Because, otherwise, the alternative is to say, well, keep going because we don’t anticipate that they’re going to rise.

Well we are anticipating that they’re going to rise and they’re going to be getting back to—we see inflation rising and getting back to the middle of the target band, which implies that we expect the OCR to also move up. Markets are—at the moment I think—markets are pricing in at 60 percent chance of an increase in the OCR this year. Of course, the man to ask is the guy who’s coming in tomorrow to talk to you about his Monetary Policy Statement. He’s more on top of it than we are.
I just want to pick up on James’ first point about international risks, and the Minister talked about it before. So, obviously we’ve got trade issues going on, which have been well canvassed, but China’s just announced this morning that its foreign exchange reserves are below $3 billion.

We see in Australia that there’s concern around the cost of borrowing for houses, and obviously bankruptcy rates are now one of the highest they’ve ever been, in Australia, and there’s a whole lot of other indicators in Australia showing that the economy’s not doing well. So I’m just interested in your perspective around that international context because, going back to China, there’s rumours more about increasing restrictions on foreign currency being allowed to leave the country—the January outflow was huge. So what do you think about the impact here in New Zealand and I’m just interested in the way that works for the rates forecast.

The debate that’s happening at the moment on trade is it’s primarily about the rise of protectionism and whether or not that manifests itself ultimately would depend on events which are yet to come. What’s happening right now is the IMF has indicated that it’s forecasting more positive growth. The UK’s most recent data has been pretty positive. The Australians yesterday, whenever it was, I think it was yesterday—the RBA kept interest rates low. I mean, they’re forecasting 3 percent—with confidence at 3 percent GDP growth in Australia. The issues in China for us—there’s two issues in China. One is, as I indicated earlier, the ongoing slowdown in growth as they shift their economy from an export focus on to a consumption one. The GDP growth rate is still pretty high—6.7 percent is the most recent—and we’ve got to keep remembering that it’s 6.7 percent on a very, very big number. It’s almost equivalent to 14 percent, 10 years ago, compound effect—we’ve got to bear that in mind. And consumption in China appears to be holding up.

The biggest concern of China at the moment is less the fall in their growth rates, but more in the impact that credit growth in China has on the stability on essentially their financial system. So that’s what we worry about. They’ve got capital controls. I can’t really comment on how effective they are, but the fact that their reserves have dropped to below $4 trillion, is an indicator of capital outflow, but it’s also an indicator of a whole bunch of other things, too, which I think we shouldn’t just assume that it means one thing in particular.

I think the short-term global picture is relatively positive. I think the concern that I would have, and I have, is the medium to longer term one, principally because of the potential fall in trade, in global trade, and whether that—if that is going to happen, for a small trading nation, far away from markets, we’re likely to be the most impacted. So, that’s a concern for us, and if it creates shocks in particular trading partners that would be probably one of the first exposures that we would have to risk.

But I think we’ve got to keep remembering that the growing markets for New Zealand’s products are in Asia and, at the moment anyway, in all those
Asian markets, and I include Australia with that—in all those markets the debate actually is about how do we trade more? How do we grow more? They’re not having the debates that other parts of the world are having. So we need to sort of—you know, if I’d encourage people to do one thing, it is to focus on how we seize the opportunity of the markets closest to us wanting to trade, and we avoid importing paradigms that are happening elsewhere and sort of debating those rather than concentrating on what can we do.

Bishop Can I ask a question—new line of questioning about migration? So there’s lots of things people say about migration into New Zealand, which has been strong, obviously, over the last few years, but one of the most common is that migrants are a net drag on the economy. They take out more than they put in, I suppose you would broadly say it. The New Zealand Initiative have done some work recently on trying to investigate that and found that, actually, migrants make a net contribution rather than a drag. Does Treasury broadly agree with that? What’s your latest thinking on migration’s effect on the overall economy?

Makhlouf I haven’t read the NZI’s report, but our basic position is that migration is net positive, that the contribution in terms of taxes outweigh the extra costs and I think we published something last June. But that is our position. It’s really important to remember—and I think I may have said this to the committee before—what this net migration number is composed of. One of the critical things is the fact is—that New Zealanders are not leaving. That’s quite an important thing to remember. Then you’ve got, obviously, the New Zealanders coming back and the Australians also coming across. You’ve then got around, if I remember rightly, around 20 percent, 21 percent, of migrants are actually students, overseas students, and they bring all sorts of benefits to the economy. And then you’ve got your skilled-visa people. But basically, having said—I haven’t read the New Zealand Initiative’s report, what you describe their conclusion as being would be consistent with what we see.

**Conclusion of evidence**
Reserve Bank of New Zealand, Monetary Policy Statement, February 2017

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(Chris Bishop, Chairperson)
March 2017

Presented to the House of Representatives
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Recommendation

The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, February 2017, and recommends that the House take note of its report.

Introduction

This report summarises the contents of the Reserve Bank’s Monetary Policy Statement released on 9 February 2017, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

Official cash rate unchanged

The Monetary Policy Statement announced the Reserve Bank’s decision to leave the official cash rate (OCR) unchanged at 1.75 percent. The global outlook has improved, although surplus capacity in many advanced economies and rising geopolitical uncertainty pose significant challenges.

New Zealand’s financial conditions are somewhat tighter, with long-term interest rates rising and continued upward pressure on the New Zealand dollar. The exchange rate remains higher than is sustainable for balanced growth.

The domestic outlook remains positive, with economic growth supported by strong population growth, increased household spending, rising construction activity, and accommodative monetary policy. House price inflation slowed in the final quarter of 2016, which the Reserve Bank attributed partly to restrictions on mortgage lending to investors at high loan-to-value ratios (LVRs). The Reserve Bank is uncertain whether such price moderation will continue as there is a continued imbalance between housing supply and demand.

Annual inflation was at 1.3 percent in the December 2016 quarter, which is within the Reserve Bank’s targeted range of 1 to 3 percent. The Governor expects inflation to gradually revert to the 2 percent mid-point, where it is expected to remain long-term.

Market expectations of an increase

We asked whether a rise in the OCR is likely in the near future, given that financial markets anticipated and priced-in such a move. The Governor said that the markets had got ahead of themselves; the Reserve Bank thought the risks of adjusting the OCR either up or down were evenly balanced. With the economy performing well in terms of output, inflation, and unemployment rates, the Bank did not see the need to adjust interest rates.

Some of us are concerned about a cycle of rate increases given increased levels of household debt.
Uncertainty in the housing market

House price inflation

On the morning of our hearing, Statistics New Zealand released figures indicating that the number of building consents issued fell 7.2 percent in December 2016, following a 9.6 percent fall in November.\(^1\) We discussed what these figures meant for the housing market, given the Governor’s assessment that demand for housing continues to outpace supply.

The Governor said that such statistics are concerning, particularly when house price to income ratios in Auckland are amongst the highest in the world.\(^2\) The Reserve Bank would be analysing their implications.

He was more optimistic about recent data which shows house price inflation moderating. Between August and December 2016, house prices nationwide increased on average by 0.1 percent a month, down from an average of 2.1 percent a month for the previous five months. We heard that a number of factors are helping to reduce house price inflation, including the LVR restrictions, a fall in loan commitments, and a tightening of lending criteria amongst banks.

The Governor said it was too early to say whether such price moderation will continue. We heard that immigration plays a major part but is very difficult to predict. With interest rates likely to remain low, it is possible that house prices may start to rise again.

Application of debt-to-income limits

The Reserve Bank has proposed having debt-to-income (DTI) limits available as a tool it could use to curb house price inflation. However, the Minister of Finance has reservations about the effect such limits could have on first-home buyers, and has asked the bank to undertake a cost–benefit analysis to determine the efficacy of such a tool. Any analysis would involve public consultation. In order to implement such a tool, the Memorandum of Understanding between the Reserve Bank and the Minister would need to be amended.

We asked whether DTI limits would systematically advantage people who have access to sources of capital other than New Zealand banks, such as family wealth or borrowing offshore. The Reserve Bank acknowledged that funding in part of the housing market comes from offshore or family sources, but it says this cannot be controlled through credit policies. It said that funding in New Zealand’s housing market is predominantly by credit. While the bank was “not covering all the bases”, policies such as LVR and, potentially, DTI limits can have a significant effect.

We asked whether the Reserve Bank had considered how an individual with low income but high collateral could access debt if DTI limits were to come into force. The Reserve Bank said that there are always special cases such as this. The bank said it would use “speed limits” to ensure that not all new lending would be done at a fixed DTI ratio, allowing a proportion to remain available for circumstances where risk may be mitigated through factors other than income.

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Some of us think that LVR and DTI limits are not good for the efficiency of the market, as they distort it unnecessarily. Some of us believe the system is working as it should, because rising mortgage rates will deter people from borrowing.

**Accuracy of projections**

The Reserve Bank has forecast a decrease in annual house price inflation to below 5 percent by 2019. We asked whether the Reserve Bank is still confident in its projections, given that house price inflation has been lower than was predicted in the November monetary policy statement.

The Reserve Bank reiterated that there is a lot of uncertainty in the housing market, making it difficult to accurately predict trends. Its house price inflation forecast was based on assumptions that net migration will drop to around 7,000 by 2019, and that construction activity will continue to grow. This would lead to a drop in demand for housing, and an increase in supply. However, the number of long-term arrivals is hard to forecast and any major changes could translate into errors in the bank’s projections.

**Effects of record net migration on the economy**

New Zealand’s working-age population grew by 2.7 percent in 2016, mainly driven by record net migration of 60,300 working-age people. We discussed the effect that such a large influx of people has had on wages and house prices.

We heard that demand for housing went up with the increase in population. With housing supply not keeping pace, this contributed significantly to a 13.7 percent rise in house prices throughout 2016.

Despite employment growth averaging 3.5 percent over the last three years, the increase in the supply of workers in the New Zealand economy resulted in wage moderation in the labour force. However, real wages have increased somewhat because nominal wages have grown at a faster rate than inflation.

The Governor said that, if net migration continues at its current rate, the likely effect would be further house price inflation and ongoing wage moderation. However, he said that real wage growth will largely be determined by productivity.

We asked what the likely effect would be if net migration significantly lowers to the level forecast in the monetary policy statement. We heard that pressure on house prices would reduce, and it is possible that the moderating pressure on wages would weaken.

**Factors influencing the unemployment rate**

Some of us asked whether the Governor thought that, given New Zealand’s strong economic performance, the unemployment rate should be lower than the 5.2 percent reported in the monetary policy statement. The Governor said that unemployment stems from a combination of different flows. While employment has grown, the labour force participation rate has also grown to a historic high of 70.5 percent. Female participation in the workforce is also at a historic high, meaning that more people are actively looking for jobs. The Governor added that the Reserve Bank projects the unemployment rate to drop to 4.5 percent by 2018.

**Risks in the international outlook**

The international risks for New Zealand’s economy have become slightly more balanced in recent months, but remain skewed to the downside. Risks include the possibility of more
inwardly focussed policies, increased political tensions, and a hastened slowdown in China. There is an upside risk that global activity could accelerate if policy stimulus is greater than anticipated in the United States or China.

We asked about the potential threats posed to the New Zealand economy from the increasing instability, isolationism, and protectionism being seen in some parts of the world. The Governor said that the greatest threat comes from protectionism. He highlighted the OECD’s estimate that if trade costs in the United States, China, and the European Union were to increase by 10 percent, GDP growth would lower in those economies by about 2 percent.3

We heard that such a drop in the growth rate of the world’s three largest economies would have an adverse flow-on effect for growth throughout the rest of the world. New Zealand would face increased trade costs through tariffs, as well as having to adjust supply chains and which countries we trade with.

The Governor said that “numerous uncertainties remain” in the international outlook, and that monetary policy may need to adjust accordingly.

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Appendix A: Committee procedure

Committee procedure
We met on 9 February and 8 March 2017 to consider the monetary policy statement. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
Chris Bishop (Chairperson)
Andrew Bayly
Hon Clayton Cosgrove
Hon Craig Foss
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
Alastair Scott
James Shaw
David Seymour
Michael Wood
Appendix B: Transcript

Members
Chris Bishop (Chairperson)
Andrew Bayly
Clayton Cosgrove
Grant Robertson
Jami-Lee Ross
Alastair Scott
David Seymour
Stuart Smith
Michael Wood

Witnesses
Graeme Wheeler, Governor, Reserve Bank of New Zealand
Grant Spencer, Deputy Governor and Head of Financial Stability, Reserve Bank of New Zealand
Dr John McDermott, Assistant Governor and Head of Economics, Reserve Bank of New Zealand

Bishop  Welcome to finance and expenditure for 2017. You’ll see that we have a new chair and we have a new deputy, and we have a new member, Michael Wood, representing Labour, so welcome along today.

Can we just start by acknowledging your announcement, I think it was earlier this week, and just say we’ve noted that and acknowledged your service to the bank and to New Zealand. We’ll see you again, no doubt, between now and—

Robertson  That’s when it’s your shout.

Bishop  Yeah, yeah. Shout on the financial stability, I think might be the last time. But, anyway, we’re in your hands, as always, and then I’m sure members will have questions.

Wheeler  Well, thanks very much, Chair, and congratulations to those that you mentioned—and not quite dead and buried yet, as I’ve been saying this morning.

But, look, good morning. On my left I’ve got Grant Spencer, who’s, as you know, Deputy Governor and Head of Financial Stability, and on my right John McDermott, who’s the Assistant Governor and the chief economist. So I’ll be brief, Chair, in my comments.

As you know, the bank left the OCR unchanged at 1.75 percent. The global outlook has improved, but major challenges remain, with ongoing surplus capacity in the global economy and rising geopolitical uncertainty. Global
inflation and long-term interest rates have increased. New Zealand’s financial conditions have firmed, with long-term interest rates rising and continued upward pressure on the New Zealand dollar exchange rate. The exchange rate remains higher than is sustainable for balanced growth, and a decline in the exchange rate is needed. Economic growth has increased as expected, and is steadily drawing on spare resources.

The outlook remains positive, supported by ongoing accommodated monetary policy, strong population growth, increased household spending, and rising construction activity. Recent moderation in house price inflation is welcome, and in part reflects loan-to-value ratios and higher mortgage rates. It’s uncertain whether this moderation will be sustained given the continued imbalance between supply and demand. Headline inflation has returned to the target band and is expected to return to the mid-point of the target band gradually. Longer-term inflation expectations remain well anchored, at around 2 percent, and monetary policy will remain accommodative for a considerable period.

Numerous uncertainties remain, particularly in respect of the international outlook, and policy may need to adjust accordingly. So thanks very much, chair.

Robertson

Thanks very much, Governor. Can I just add, to the chair, my acknowledgment of your announcement and your good service to us, and also acknowledge Grant Spencer’s announcement as an interim governor from September. We look forward to working with you in whatever capacity we have at that time.

I want to ask you about a couple of your uncertainties. It seems that they’re sort of Donald Rumsfeld-like—known unknowns and certain uncertainties. I’m keen to know, firstly, around the housing market and your last comment that you just made there that, obviously, you’ve acknowledged—and we acknowledge—some of the changes in terms of house prices, but we’ve got numbers out today from Statistics New Zealand that indicate that consents are down in the last couple of months. I just wonder if you could reflect on your judgment on where things are actually going. You make the specific reference to the imbalance between supply and demand. That’s obviously still an ongoing concern for you. Where do you see that heading?

Wheeler

Yeah, it is an ongoing concern, and particularly when house price to income ratios are so high. As you know, they are close to 10 in Auckland, and around 5½ in the rest of the country. Demographia put out its survey for this year, and I think Auckland house prices on that ratio measure, I think, were fourth—I think maybe even third—amongst 400 cities around the world, 400-plus. So it is a worry.

The good news, in essence—and it’s still too early to say whether it will be maintained—is we are seeing house price moderation start in terms of house price inflation. Let me just give you a couple of numbers. If you take the REINZ stratified index for the last 5 months of data, which is August to December, for New Zealand as a whole the increase was 0.1 percent a
month. So that is half a percent for those last 5 months of data. The previous 5 months of data was 2 percent a month for New Zealand, so it was growing about 10 percent or so in those 5 months. Now it’s growing at around half a percent in those 5 months. For Auckland, the last 5 months has been growing at about 0.3 percent a month, so say 1.5 percent for the 5 months.

There’s many reasons for that. I think the LVRs are part of it. I think the fact that commitments, loan commitments, have fallen significantly—they’re down about 14 percent for the year for investors, and about 2.5 percent for all borrowers—and put in, also, the fact that the banks have tightened up their lending criteria; we’ve seen that in a number of situations, I think that’s all led to the moderation. It’s too early to say that that’s going to last. Migration we’ve consistently misforecast, like most people. We can usually do OK on the departures, but the arrivals are very hard for us to forecast. So interest rates are likely to remain low in terms of the OCR, and, you know, we could be in a situation again where house prices take off.

If you look at supply, consents for the country as a whole are running at around 30,000—highest in 11 years, up about 12 percent over last year. Similar story for Auckland—10,000, 11-year high, up about 10, 12 percent over last year. But the answer is the houses have to be built and put in place.

Robertson There is a graph that shows a slight gap building between consents and actual builds.

Wheeler Yes, that’s correct. So we need completed houses on the ground, yeah.

Robertson You may not have seen it, because you’ve been a little busy this morning, but those Stats NZ numbers do show a 22 percent drop in Auckland from December last year to December this year, so any growth of that trend would be of a concern to you, I presume?

Wheeler Yeah, I haven’t caught up with the numbers yet, but we’d certainly need to look at it, yeah.

Robertson Just while we’re on housing, before I move off that to the international topic, clearly, you’ve got a very clear signal now from the Minister of Finance about what he expects with debt to income ratios. I’ve heard your comments already from today that you weren’t planning on using them now, so you’re happy to go back. Is that an approach you would take with LVRs as well? If that didn’t happen with LVRs that are—

Wheeler No, the LVRs—we signed a memorandum of understanding (MOU) between the finance Minister and myself, so Bill English and myself, and that contained four instruments in it, which LVRs was one of them. And then when we felt that there was a good case to use LVRs, we had discussions with the Government and then went out with a consultative paper. So the difference is now consulting about whether this should be in the MOU or not.

Robertson I would’ve presume that in, you know—there was some dialogue going on towards the end of last year, and you actually spoke to us briefly about it
when you were in the committee. Was that not that exercise of going through benefit cost?

Wheeler Well, we were talking to the Government about what we felt were the benefits in cost. We were showing them some of the data that we had. We also said we had more work to do on it. We were still collecting some of the data and analysing it. But, you know, we had thought that, maybe, the approach might follow the previous one and consult if we're going to use these.

Robertson OK. I want to move to the other uncertainty that you dwelled a bit on, both when we were here and in the press conference, and that is the international situation. I think everybody is concerned about what that might mean for New Zealand—horrendous crystal ball exercise, but if you could be a little bit more specific about what you think the impacts on New Zealand would be if it takes the path of, perhaps, greater protectionism or greater isolation or more insecurity in relationships, potentially, between two large trading partners—the US and China.

Wheeler Yeah. The worrying thing is that the talk about protectionism is taking place at a time when the growth and the volume of merchandise trade is some of the weakest that we've seen in decades. So if you take the last 5 years, you've seen the weakest growth since the early 1980s. So that's worrying. Trade growth is slow. Also, the protectionist measures by G20 countries over the last 12 months—and this is a WTO observation—have been the highest since the GFC. So that's the second bit of background.

And so, to hear the Trump administration say “Well, OK we're not going to ratify TPP.”, that T-TIP, which has been the discussions with Europeans over trade and investment, harmonisation of standards, and different things, will stop and NAFTA will be renegotiated, is very worrying. So what would be the consequences for New Zealand?

The OECD has done some work that I haven't looked at in any detail, so I only know the summary results. But they said: let's say there's a 10 percent increase in trade costs in the US, Europe, and China— so the US imposes measures, China retaliates, and Europeans retaliate. Then, in essence, their conclusion was that that would lower GDP growth in those countries, in those regions, by 2 to 3 percent, which is very significant. And so that would spill over into the rest of the world.

You'd see slower trade growth. You would see the US Federal Reserve having to probably tighten interest rates as inflation starts to increase because protectionism is driven up. And so you'd see weaker external demand. You'd see the costs involved in adjusting your supply chains that would affect New Zealand, for example, just who we trade with, the costs of doing that, the, you know, the boundaries for protectionism out there. So it would have major confidence effects on the global economy and,
possibly, could spill over into liquidity and funding costs quite quickly. So it's all—

Robertson
Cheery outlook.

Wheeler
Yeah. It's worrying.

Robertson
Yeah. You don't have a 24/7 monitoring team like MFAT does?

Wheeler
No. We're not—we're not waiting up in the early hours, watching tweets. Ha, ha!

Bishop
Not yet. OK. Jamie-Lee?

Ross
Afternoon, Governor. Can we just go back to housing and house price inflation—we chatted about this back in November. Can I refer you to page 30, the house price inflation graph, which shows in 2019 house price inflation dropping below 5 percent. This all has changed except in the shorter term. House price inflation is, in fact, slightly lower than you were predicting back in November.

You mentioned all the, you know, good news story: consents are up, investment's up, migration’s expected to track down. There's a lot of supply in the Unitary Plan—there is. Can you give us a sense as to how confident you are, or still are, around house price inflation and your projections there?

Wheeler
Well, maybe some initial thoughts, and my colleagues will say—I mean, we find it difficult to forecast migration, and we’ve also said that the OCR track is in a neutral stance, and these are highly conditional projections, so lots of assumptions can bounce that track around. And we also find difficulty trying to estimate the wealth effects and how that spills over into consumption and things like that. So there’s a lot of uncertainty around it.

We’ve seen house prices slow, I think, at the beginning of last year and then they started to pick up again. So I would say a reasonable degree of uncertainty, but the things that are dragging on house prices are quite significant. The LVRs are binding, and that’s really changed the dynamics of investor activity in the market. So that’s pulled down, significantly, the investor share of transactions.

I think you’ve seen the mortgage rate adjustment has been a factor, and also the tightening of credit conditions or lending conditions in respect of, say, foreign purchases where the bank can’t be assured as to the debt servicing capacity of the borrower. And, also, you’ve seen the banks pull back to some extent on lending to apartment developers. So all those things suggest that there are some constraints out there that are quite significant, but there’s still a lot of uncertainty. But let me ask John or Grant.

Spencer
Yeah, I mean, I’d say that that profile of house price inflation coming off is—the main assumptions underpinning that are the migration cycles. So, on the previous page it’s showing our projection is that migration will come off, and also, on an earlier page, that construction will continue to grow. So that supply, demand, and balance, we’re assuming, will be diminished sort
of from both sides. So if either of those assumptions goes wrong, in terms of supply or demand, then, obviously, this can go wrong.

Ross

In your projections—not demonstrated here, but do you do house price inflation projections on a regional basis in your internal workings?

Spencer

No. The projection—correct me if I’m wrong, John—is, essentially, on an aggregate basis. We monitor them, obviously, regionally, in terms of history, but not projections.

Ross

Can we just turn to a slightly different topic around the Reserve Bank’s neutral bias around interest rates and the market’s expectations that there would be a hike in the future. I understand you were asked some questions on this from the media, and you’ve obviously had quite a view to express. Can you give us more of your view on the long term and the way in which the markets are pricing in a hike, and the error of their ways, if you view it that way?

Wheeler

Well, if you back to November, we were saying that there was a 20 percent probability—or possibility—of a further interest rate cut. So the track built in five basis points of reduction. What we’re saying now is that we think the risks around the OCR being adjusted either up or down are very evenly balanced, and we’ve moved to a neutral interest rate stance. And some of those risks are ones that we’ve talked about this morning, be it protectionism, be it the international developments in Europe and China, be it, also, risks around migration and the strength of consumption and all of those sorts of things. So we think that’s evenly balanced.

We think that the market has got ahead of itself in its pricing. Now, you know, the market sometimes—and New Zealand is no exception; other central banks face it as well—the market quite often wants to drive interest rates down very low and then drive them up again. And we’re in a situation where we think, you know, the economy is performing very well at this stage in terms of output, in terms of inflation, in terms of unemployment or participation rates. The current account deficit isn’t too bad. And we don’t see the need at this stage, given that inflation is starting to rise, albeit gradually, to adjust rates. But let me see if John wanted to add anything?

McDermott

Those cover the main points, but, again, the market will look at the recent observations. It’ll look at the international scene, particularly the prospect of expansion or fiscal policy, and will react and extrapolate that information. And, yeah, we can understand that. When you’re thinking about policy, you can recognise what’s just happened, but you have to also counter the fact that that might be reversed in a few months, and so you tend to move very slowly and wait for the data to confirm that trend before you bake it into your forecasts. So we’ve been much more circumspect about these developments.

Ross

Are you seeing anything that you believe the market may not be seeing, or is the market just moving faster than the Reserve Bank?

McDermott

So the market has seen dairy prices rise rapidly. We’ve seen the prices rise even above the sort of medium-term prospects that we think are viable.
And we said: “Well, the likelihood here is you might get some reversal of that.” What the market will price—that’s the data, and we’ll price to it without thinking too far ahead. So we understand—

Wood

Mr Wheeler, just turning now to migration, which is peppered quite a bit through the statement, which you’ve described as being at unprecedented levels. You’ve also talked about keeping wage pressures down relative to what they might otherwise be, and the knock-on effect to house prices. Can you just reflect a bit on the desirability of those settings from a monetary policy perspective? And then, further to that, what you’ve also predicted, notwithstanding all the caveats, you’ve predicted that ski-jump drop in migration levels, in line with others. If that is to play out, what do you see the likely flow-on effects to house prices and wage growth pressure?

Wheeler

We’ve been surprised, like other observers, about the strength of the net migration flows. I mean, if you go back to the start of this cycle, in terms of net immigration of working-age population, it’s about 190,000 people, which is 5.5 percent of the labour force, and that’s very, very large. So that’s had a significant effect in terms of house price inflation, it’s been a factor that we know about in terms of the demand for housing. It has had less impact on the economy in terms of inflation than we might have thought, and that’s largely due to the composition of the migrant flows, and we’ve talked quite a lot about that in our work, but it’s also had an impact on wage moderation, because, in essence, if you have a supply shock—if I could call it that way in economic speak; if the supply curve moving out to the right of that magnitude—then you will, for a given level of labour demand, you will get wage moderation.

Now, if the migration flows were to continue at a very high rate—say, at 60,000 a year—rather than tail off, then that would feed through, one would think, into house price inflation. Probably you would see ongoing wage moderation. But, you know, in the end, how much real wages rise will largely be determined by productivity, but it will affect nominal wage moderation. And—yes, I think that’s probably the main points I was going to make. John, did you want to add something?

Wood

The second point was just, I guess, the flow-on effect: if we do see the decline that’s been predicted, you’ll logically see the converse apply?

Wheeler

Yeah, you would see that the pressure on house prices would reduce, and, yes, you wouldn’t see, perhaps, the same degree of wage moderation—perhaps.

Robertson

I just want to take you back to—in the course of that answer, you talked about an impact on wages and you talked about a significant effect on house price inflation. Do you want to expand on what you mean by that?

McDermott

I mean, one of the interesting features here with adding all the extra people—basically, we’ve gone more into the labour market than previous cycles, so that the demographics are such that there are more of the working-age population. So the labour market has been incredibly responsive to the demands. So this economy has generated a huge job-
creation machine; nevertheless, there’s been the extra supply there to meet it, and we haven’t seen much of a nominal wage response. Oh, we have seen real wages increase somewhat, because nominal wages have been going faster than inflation, but the other thing that—

Robertson: Sorry, John, I don’t mean to interrupt you, but the question I was specifically saying was—the governor used the phrase “a significant impact on house price inflation” as opposed to an impact on wages, so I just want to focus in on the house price inflation.

McDermott: On the housing market—yeah, this has come up in a number of discussions. I mean, there’s an array of things going on in the housing market. One is you’ve physically got more people out creating the demand. You’ve got very low interest rates allowing the credit expansion and the asset price to actually increase into that. And, you know, it’s very hard—and this is where there’s very low elasticity of supply in any housing market. You can only build so many houses at a certain rate, and so you get that squeeze where demand rises much faster than supply in the early part of the cycle. And the longer this goes on, the more significant the issue becomes.

Robertson: Shall I carry on? Just a couple of slightly different matters: you mentioned before around the unemployment rate, which is sitting at 5.2 at the moment. Would you not expect that to lower a bit further given the growth rates that we’ve got?

Wheeler: I think, you know, just like a fiscal deficit is a combination of flows of spending and revenue, unemployment is a combination of different flows, as you know. So what you’ve seen is very strong employment growth—so it’s been averaging 3.5 percent over the last 3 years, which is very strong. You’ve also seen a rise in the labour force participation rate, so it’s now at a historic high of 70.5 percent, and female participation’s also at a historic high. Now, that’s a great thing. People are looking for work—they’re either in jobs or actively looking, but they want to participate in the economy, in essence.

So on that side of dynamics, in terms of employment and people actively looking for jobs, the issue is also: well, how much is the labour supply increasing? So we saw the unemployment rate tick up, I think from memory, by about 0.3 with the last HLFS, but the labour force participation rate was the reason for that.

Robertson: I mean, at the risk of you and I having another conversation about the natural rates of unemployment, when you’ve got an economy that is growing at that 3 percent plus area, surely you’d like to see that at least come closer to even your rate—at 4, or whatever it is?

Wheeler: Yeah—

Spencer: We are projecting it to come down to 4.5 in the next couple of years.

Robertson: It’s a slow sharing of prosperity, isn’t it? The other question I wanted to ask was—again, it’s another Stats NZ announcement today that you possibly haven’t had a chance to have a look at, which is around looking at inflation and its impact on different types of people. So you’ve got Stats saying that
beneficiaries in low-spending households experienced the highest inflation over the past year, relative to other actors in the economy. Is that something that you look closely at, and have you seen any trends in that over time?

Wheeler  Yeah, it’s a very good question. I mean, we all have a different consumption basket, so we all get affected by consumer price inflation in different ways, so it’s the aggregate that we look primarily at, in terms of monetary policy. But in terms of the disaggregation, let me ask John if he—

McDermott  We’ve done virtually no work on this particular issue. This is data that Stats New Zealand have only really just been producing. This is brand new, and we really don’t have, you know, a good sense of how valuable this is or whether it’s got useful informational content.

Robertson  I think, I mean it’s interesting because we have discussions about aggregate measures of inflation and CPI and all of that, but I think this is interesting because it does show that in an economy people can be affected in quite different ways, and it’s obviously a concern to us that those who are already on the lowest incomes are those who are experiencing the highest inflation. We’ve certainly seen that, for example, with rents and so on going up to the way they are. So I would have thought this was an important aspect of understanding what inflation and controlling inflation means.

McDermott  No, no, I’m not trying to dismiss the question; it is an important question. Even without that disaggregated data, what we would have known before is the proportion of the population that suffers the burden of inflation more than any other are those on low incomes and the general poor. That’s something that’s well established and we’ve known for 20 years, and it’s one of the reasons why we really don’t want to see inflation get out of hand.

Seymour  Governor, I just had more of a theoretical question about DTIs, particularly the equity of them, because it seems that being able to access debt is a great leveller for people who don’t have a great deal of capital of their own. But this is a policy that deliberately limits that access. Would it not systematically advantage people who have other sources of capital? Two come to mind: one is family wealth and the other is the ability to borrow offshore. So, anecdotally, we have a lot of people who may live in New Zealand but, through overseas contacts, are able to borrow more cash. I just wonder, you know, if you’ve thought about or had any way of quantifying what that effect might be, if you think it’s likely to happen. I’m assuming that the bank is never really going to be able to—-it might be able to control borrowing within New Zealand, but it’s not going to have much control over borrowing that occurs offshore.

Wheeler  No, it’s a good set of points. Let me check if—-Grant.

Spencer  I think, definitely, you know, there’s a part of the market, that sort of cash market, where the funds are coming from elsewhere, offshore or from family sources, etc. What we do—can’t control that through credit policies. But I would say that I think the housing market in New Zealand is dominated by credit—credit plays a huge role, just through the traditional
channels, whether it be first-home buyers, movers, investors. A lot of that pressure in the housing market is coming through the credit channel.

So you’re right. We’re not covering all the bases, but those policies we’ve put in place—LVRs and, potentially, DTIs in the future—can have a significant effect. But you’re right, they’re never going to be all-pervasive.

Seymour
So I guess what you’re saying is that you accept the premise but you can’t really quantify, at this point, the impact.

Spencer
Well, we will attempt to quantify the impact of—and we did that with the LVRs, and if we were doing DTIs we would attempt to quantify it ahead of time. Our estimates of impact haven’t been far off the mark. The difficult thing has tended to be the timing, in terms of how long these things continue to have the effect, particularly the LVRs.

Scott
With the interest rates, mortgage rates rising as they are, that will restrict people. That is going to deter people from borrowing more, obviously, and investing and so on. So the system is working—the system is working as it should. I’m a bit with David in that any interference with the system is only going to favour one group over another. So these unintended consequences of the DTI, and even the LVR, as I say, distort the market. I know you say LVRs are only a temporary thing—I’m not going to ask you when you’re going to take the LVRs off. I guess it’s not really a question, so I apologise for that, but I do agree with Mr Seymour that these things do distort the market, and that is not good for the efficiency of the market.

Wheeler
Well, let me comment on that. I mean, every regulatory intervention has unintended consequences. So the Government collects taxes—it’s got unintended consequences, distorts behaviour. Some of it’s intended, some of it’s not. The macro-prudential instruments that we’ve used, the LVRs, are aimed at trying to reduce systemic risk in the banking system and to reduce the credit exposures of the banks. Now, the DTIs, in essence, are there to reduce the risk of default, right? We’ve seen DTIs increase for all borrowers over the last 2 years—for first-home buyers, for other homeowners, and, also, for investors. The group with the largest DTIs is not first-home buyers; it’s the investors. They’re the people that are most heavily exposed. Where the LVRs complement, or can be very helpful, is if the DTIs reduce the risk of default, the LVRs reduce the risk of the bank facing losses, because of the higher equity that the borrower has in the property.

Cosgrove
Just on that, presumably you’ve factored in a DTI regime where there might be low income but high collateral. So you may have an elderly person who’s got fixed, low income but owns three or four freehold properties. What’s the scenario? Presumably, in normal times they could go to a bank and get a lot of dough—if they could service it, obviously. But, in terms of risk, have you factored that in? What’s your thinking around that? How do you handle that?

Spencer
Both of those factors are relevant to credit risk and the loan assessment. So when a bank’s looking at the loan, they look at collateral and they look at the serviceability, and it really is a risky proposition to just focus on one and
say no, we’ll forget about the other. So it’s a balance between the two, and right now the system is moving to higher and higher debt to income ratios. So that servicing ratio is getting pushed. That’s where competition is, and so that’s why we think that that balance, in terms of those risk factors, is getting out of whack somewhat.

Cosgrove But you are likely to have scenarios of, I suppose, folks in the middle who have relative incomes but not high incomes, but are within the serviceability range, if you like, but could have—inheritance, whatever—high collateral, a number of freehold properties, whatever. So—

Spencer That’s right. There’s always special cases, and that’s why we tend to use the speed limits, which means that we don’t put a fixed limit on these ratios. Banks can still do part of their lending to these sort of exceptional cases where risk may be mitigated through other factors.

Wheeler Just to give an example, in the UK I think the DTI criteria is 15 percent of lending can take place over a DTI of 4½. So it’s that sort of concept.

Smith My question’s around—you were very conservative, or, perhaps, slow to lower rates on the way down with inflation. Are you going to be similarly conservative and slow to raise rates on the way up?

Wheeler Well, I think people would say seven cuts in interest rates is quite a significant move. Time will tell, as I say, whether we need to adjust the rate. We think those risks are neutral, if you like—evenly balanced—but if we feel that we need to raise rates then we won’t hesitate. But at this point inflation is under control, in a sense. It’s got back in the band. Inflation expectations are stable at the long end, and we’re not seeing any risk of a breakout of inflation. But if the inflation rate did overshoot the 2 percent then that’s something that we would try and be even-handed about. We’ve been under the target for quite some time.

Wood Mr Wheeler, the graph on page 34 reminds us that the last significant tightening occurred between 2003 and 2006 under your predecessor, quite a long time ago and under different conditions. If we look at your upside scenario of higher export prices, and if we, perhaps, imagine that that cooks away for a longer period, a bit more intensively than we might think—if, perhaps, we start to look at imported inflation from the scenario that we outlined before—do you think that your successor potentially faces a far more difficult task given the higher household indebtedness that we have, as compared to that last tightening cycle? Will it be harder, effectively, for them to make that call if it needs to be made?

Wheeler I don’t think it would be harder for the person to make the call, because they’ll have the institutional knowledge behind them, and I don’t think, given the mandate, they would hesitate. But if you look at debt to disposable income in the economy, in 1990 that ratio was 60 percent. In 2000 it was 100 percent. Now it’s 165 percent. If you look at DTIs, and I said they’ve been increasing over the last 2 years for the various types of borrowers, then, you know, the impact of interest rate changes on
households are likely to be greater in a situation where interest rates are rising.

Bayly I just want to return to the international market. Obviously, you talked about trade barriers between US and China, and the Brexit thing’s working its way through the Parliament, but, interestingly, when you look at the Chinese economy, you would agree, no doubt, that the foreign exchange reserve’s below $3 trillion now, and the impact that has on the ability to support the yuan, that currency, and also when you look at Australia, the high rates now of loan problems and, also, bankruptcies—I’m just interested, given those are the two largest trading partners to New Zealand, what your perspective was or whether you’re re-rating what’s going on in those two markets.

Wheeler Well, on China, over the last 7 years you’ve seen a massive build-up of corporate debt. It’s mainly in SOE debt, and the Chinese Government has not been especially ambitious in rationalising the SOEs. The State-owned enterprises have tended to be merged to some extent. So they’ve got a challenge there, and that’s a serious challenge. They’ve got large capital outflows that have been persistent, now, since the middle of 2015. In July-August 2015 they had capital outflows—it was mainly August-September—of around $100 billion. Then they repeat it again in January of last year. At the moment, they’re running somewhere, it seems on monthly data, between $30 and $50 billion, and that’s very substantial outflows. That’s what’s led to the reserves going from $4 trillion to $3 trillion. So the Chinese at the moment are trying to support their currency. It’s ironic that you’ve got the US saying “This is a currency manipulator.”, and yet the Chinese are trying to raise their exchange rate, and the IMF is saying that, basically, it’s fairly valued. But the main risks, I think, around China are around the debt.

Bishop All right, thank you very much, Governor. Thanks, all.

**conclusion of evidence**
Reserve Bank of New Zealand, Monetary Policy Statement, May 2017

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(Chris Bishop, Chairperson)
May 2017

Presented to the House of Representatives
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Reserve Bank of New Zealand, Monetary Policy Statement, May 2017

Recommendation
The Finance and Expenditure Committee has conducted an examination of the Reserve Bank of New Zealand’s Monetary Policy Statement, May 2017, and recommends that the House take note of its report.

Introduction
This report summarises the contents of the Reserve Bank’s monetary policy statement (MPS) released on 11 May 2017, and the main issues we discussed in our meeting that day with the Governor of the Reserve Bank.

Official cash rate unchanged
The monetary policy statement announced the Reserve Bank’s decision to leave the official cash rate (OCR) unchanged at 1.75 percent. On balance, it considers that developments since the February statement have been neutral for monetary policy.

The Reserve Bank expects headline inflation to remain anchored around the target midpoint of 2 percent over the longer term. With inflationary pressure remaining subdued, the Reserve Bank considers it appropriate to keep monetary policy accommodative. It said any premature tightening of policy could undermine growth, while further policy easing would risk generating unnecessary volatility in the economy. Accordingly, the OCR is expected to remain low for a prolonged period.

Global economic growth has increased over recent months, but major challenges remain with ongoing surplus capacity and continued political uncertainty.

New Zealand’s GDP growth was weaker than expected in the second half of 2016. However, the growth outlook remains positive, supported by accommodative monetary policy, strong population growth, and high levels of household spending and construction activity.

The trade-weighted exchange rate has fallen by about 5 percent since February. If this trend continues it will help to rebalance the country’s growth outlook towards the tradeable sector.

House price inflation has moderated further (nationally from 1.1 to 0.3 percent), partly due to loan-to-value ratio restrictions and tighter lending conditions. This moderation is projected to continue. However, the risk of a resurgence remains, given the ongoing imbalance between housing supply and demand.
Increase in inflation

Annual headline inflation\(^1\) increased to 2.2 percent in the March 2017 quarter. This was largely due to higher tradables inflation, particularly fuel and food prices. Fluctuating tradables prices are projected to cause headline inflation to vary over the next two to three years, but the Reserve Bank sees these effects as temporary. It expects core inflation to remain close to the Bank’s 2 percent target over the longer term.

We asked what factors influenced the Bank’s expectation that core inflation will remain stable. The Governor said that there inevitably is uncertainty in the inflation outlook. While headline inflation reached 2.2 percent in the March quarter, measures of core inflation range from 1.5 to 2.2 percent. The Governor highlighted that non-tradables inflation is not increasing significantly, and house-price inflation has moderated over the past eight months. Core inflation under the Reserve Bank’s preferred measure, the sectoral factor model,\(^2\) has been stable at about 1.5 percent.

The MPS notes that migration is contributing to a reduction in wage growth pressures, which concerns some of us.

The Governor acknowledged there is inflationary pressure from a fall in the trade-weighted exchange rate, and from inflation in construction costs, but the Bank does not expect these to cause a rapid increase in core inflation.

Conditions in the housing market

House price inflation

The Governor said he is pleased that house price inflation has moderated since mid-2016. Nationally, house prices have increased by about 0.3 percent per month in 2017, down from an average of 1.1 percent per month in 2017. This effect has been particularly pronounced in Auckland, where annual house price inflation has moderated from 16 percent in April 2016 to 8.3 percent in March 2017.

However, the Governor expressed concern about the “significant” imbalance between supply and demand in the housing market. He said not enough houses are being built at this point, despite a 10-year high in the number of permits being issued. The Governor also recognised that recent immigration has been higher than forecast, adding to uncertainty in the market.

Effects of increased capital requirements

In March, the Governor announced that the Reserve Bank would be undertaking a review to identify the most appropriate regulatory framework for setting capital requirements for New Zealand banks. Requiring higher levels of capital would improve the resilience of the financial system. We asked how increased capital requirements would affect the housing market.

We heard that increasing capital requirements would have a restricting effect on the availability of credit, and increase its cost accordingly. The Governor said that the ongoing

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\(^1\) “Headline” inflation focuses on the Consumers Price Index (CPI) measure of changes in prices for a basket of goods. Because the basket includes volatile elements such as food and energy prices, the Reserve Bank generally focuses on the underlying “core” inflation rate, which adjusts for these fluctuations.

\(^2\) The sectoral factor model of core inflation separates components of the CPI into tradables (products that are imported, or that compete with imports) and non-tradables (products that are not exposed to international factors). By distinguishing between the two, the model allows an interpretation of what is driving core inflation.
review of capital requirements may be a factor in banks’ increasing cautiousness about lending.

However, he thought that liquidity is a bigger factor. The gap between deposit growth and credit growth has increased, causing banks to seek funds offshore to finance their credit expansion, which is seen as a riskier source of funding. This has made banks more competitive, as they are attempting to lift deposit rates while conserving their funds more generally. The Governor said that this, combined with restrictions on lending at high loan-to-value ratios, has contributed heavily to the slowdown in house price inflation.

**Household debt**

New Zealand’s household savings rate has declined from 2.4 percent of disposable income in 2012 to -2.2 percent in 2016. This means that households are in fact dissaving: spending more than their disposable income. We asked what caused this change, and whether this trend was likely to continue.

We heard that households were much more careful about spending, and placed a lot more emphasis on saving, in the aftermath of the Global Financial Crisis. This resulted in a positive savings rate. However, more recently consumer confidence has picked up, particularly in the second half of 2016, causing a rise in consumption. The Reserve Bank said it is not clear why this happened in 2016, but it expects consumer confidence to remain high in the medium term. Its projection shows the household savings rate moderating to -0.5 percent by 2020.

Some of us remain concerned that household debt has risen significantly since the last monetary tightening cycle (2003–2008), meaning that many households may be extremely vulnerable in the next tightening cycle.

**Migration projections**

The Reserve Bank projects that net immigration will drop from about 15,000 in the November 2016 quarter to about 7,000 in the November 2019 quarter. We note that it has previously predicted reductions in net immigration that did not eventuate.

The Reserve Bank said it has been quite open about the difficulty of forecasting migration. It said while the net total number of immigrants to the country is important, so too is the composition of those migrants. Factors such as age and employment status determine how a person affects the supply and demand pressures within the economy.

We heard that the age profile within the current migration cycle appears to be younger than previous cycles. There has been an increase in arrivals of single people in their twenties who are looking to enter the workforce. This contrasts with previous cycles, when more migrants arrived with families, including dependents. Accordingly, the current migration cycle has brought more supply into the labour market, relative to previous cycles.

With an election taking place in September 2017, it is possible that political changes to migration policy could occur. Some of us think that the Reserve Bank’s forecasts should reflect the possible eventualities.

**Shortage of skilled labour**

In its summary of recent visits with businesses, the Reserve Bank said that employers expect increasingly to look offshore for skilled labour. We asked whether a shortage of skilled labour is a constraint on New Zealand's economic growth.
The Governor said that the shortage of skilled labour is a constant theme in discussions with businesses. However, he said the economy’s output growth is largely determined by the extent of employment growth and the productivity of those who are getting jobs.

The Governor acknowledged that the skills shortage potentially poses a risk to construction activities. Construction has been a key driver of growth for the economy, but growth in construction activity is beginning to moderate, and construction costs rose by 6.7 percent in the year to March 2017. The slowing of growth in construction activity and increase in costs may be the result of capacity constraints, which could tighten further should the shortage of skilled workers, such as engineers, planners, and electricians, worsen.

**Australian Government’s levy on banks**

The Australian Government recently announced a levy on banks that have liabilities totalling more than A$100 billion. As most of New Zealand’s major banks are owned by Australian banks, we asked if this levy could affect the cost of capital for New Zealand banks.

The Reserve Bank said that the levy will apply to wholesale funding of the Australian entities, but it is unsure if it will apply to whole-group funding. If this is the case, it could potentially increase the cost of funding for New Zealand subsidiaries of Australian banks. However, based on the information available, the Reserve Bank believes the levy will only apply to the Australian bank funding, and not to the subsidiaries.
Appendix A: Committee procedure

Committee procedure
We met on 11 and 24 May 2017 to consider the monetary policy statement. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
Chris Bishop (Chairperson)
Andrew Bayly
Hon Clayton Cosgrove
Hon Craig Foss
Brett Hudson
Rt Hon Winston Peters
Grant Robertson
Alastair Scott
David Seymour
James Shaw
Michael Wood
Appendix B: Transcript

Transcript of hearing from 11 May 2017

Members
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Alastair Scott (Deputy Chairperson)
Andrew Bayly
Clare Curran
Hon Craig Foss
Julie Anne Genter
Stuart Nash
Rt Hon Winston Peters
Grant Robertson
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Witnesses
Reserve Bank of New Zealand
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Dr John McDermott, Assistant Governor and Head of Economics

Bishop Afternoon, Governor and your team. Welcome to the Finance and Expenditure Committee. We’re in your hands.

Wheeler Thanks very much, Chair. [Introductions]. I’ll be brief. As you know, we kept the OCR unchanged. Global economic growth has increased and become more broad-based over recent months, however major challenges remain, with ongoing surplus capacity and extensive political uncertainty. The level of core inflation has generally remained low. The 5 percent fall in New Zealand’s trade-weighted exchange rates since February is encouraging. If sustained, it will help to rebalance the growth outlook towards the tradable sector.

The growth outlook remains positive, supported by accommodative monetary policy, strong population growth, high levels of household spending, and construction activity. House-price inflation has moderated further, especially in Auckland. This partly reflects loan-to-value restrictions and tighter lending conditions. Increase in headline inflation in the March quarter was mainly due to higher petrol and food prices. Non-tradables and wage inflation remain moderate, but are expected to increase gradually. This will bring future headline inflation to the midpoint of the target band over the medium term.
Longer-term inflation expectations remain well anchored at around 2 percent.

Just to conclude, developments since the February Monetary Policy Statement, on balance, are considered to be neutral for the stance of monetary policy, and monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly. Thanks very much, Chair.

Robertson

Thanks, Mr Chair. Thanks, Governor, for that update. I just want to explore your view around inflation expectations. Clearly, last year—or as we went through the cuts last year—you were looking at inflation expectations and you had concerns about them. You seem here to be telling us—and I don’t think this has been universally shared in the last few hours by commentators—that you’re confident about inflation expectations, particularly in the shorter-term period. Why do you believe that it’s stabilised to an extent that perhaps other commentators don’t?

Wheeler

I think that’s a very good question and I think that’s at the heart of the neutral policy stance. There’s uncertainty around the inflation outlook—as there inevitably is—but we’re not seeing the things that have caused this to perhaps be different from the markets, or some in the market, who see the need for an interest rate adjustment, perhaps earlier. We don’t see any sign of any significant acceleration in wage inflation. We also found—

Robertson

Sorry, that was acceleration you said?

Wheeler

Acceleration, yeah. Wage inflation is pretty weak, as you know. Output growth in the last half of last year was weaker than what we thought, so we feel that there’s a bit less capacity pressure than what we were expecting. If you look at the rise in headline inflation on an annual basis it did get up to 2.2 in the March quarter. If you look at it, it’s driven by the tradable sector. There was a run up in fuel prices and then there were the recent strengthened food prices. Now, they will, in terms of calculations of annual inflation, drop out of the series—I mean, they have to keep increasing in order to generate ongoing inflation in that sense.

If you look at the measures of underlying inflation, they range from 1.5 to about 2.2. The measure that we find the most useful is what we call a sector factor model, which looks at about 100 components of the CPI and says: how they are moving? That has been stable at around 1.5 percent for some time now. When we look at long-term inflation expectations, they’re anchored at 2 percent. And non-
tradables inflation’s not picking up significantly, and house-price inflation has moderated quite a lot over the last 8 months.

On the other hand, you see that the TWI has declined, so that will lead to some inflation pressure as that comes through. We see construction cost inflation running at around 8 percent in Auckland—6.5 to 6.75 nationally. So there are some cost pressures out there. But, in essence, we looked at all of these factors and said: “Do we believe that inflation is going to move rapidly on it?” We don’t believe that.

Robertson Just to pick up a couple of aspects of that—the wage growth one, particularly. I mean, clearly we haven’t seen that movement. Don’t you think, though, that with figures like 2.2 percent, particularly when it does relate to things like petrol and food, that actually the wage growth pressure is more likely to increase, despite the fact that those indicators may drop out. Isn’t there likely to be some kind of lag affect from the fact that people have experienced those cost increases?

Wheeler Yeah, there could be, but when we’ve looked at wage behaviour to see what’s driving it, the analysis that we’ve done suggests that a lot of it is backward-looking—a lot of it’s been based on actual inflation outcomes. So we saw in the last inflation expectation survey for 1 to 2 years it popped up to around 2.2. We think that was just driven by the current rate of inflation. So you look at the productivity story—productivity’s very weak in the economy. It has been for quite some time. You’re seeing the services sector facing a lot more international competition than it was in past years, if you go back a decade or so.

Robertson What would be the conditions that would see you going towards another tightening cycle? What would characterise those?

Wheeler I think we’d have to see evidence that inflation was starting to pick up and that inflation expectations were starting to increase. So the sorts of things that we’ve looked at that I’ve just described—we’d start to see some movement in these things. But let me ask my colleague John if he’d like to elaborate?

McDermott It’s always something we ask ourselves, and, in fact, even in the document we say, what have we got there—the sense about how much pressure was on this economy. We actually ran a scenario: what if the output gap is higher than we currently think? Given the uncertainties, that’s always a possibility and always something we have to watch out for. That would be one thing that would change our view going forward. While I’m speaking, if you’re talking about inflation expectations—if I can actually also perhaps draw your attention to figure 2.2 on page 6. The real message that we were trying to put across on inflation expectations is that, beyond the very short term, inflation expectations have been very, very stable at 2 percent,
and in the short term we’ve risen towards 2, as we hoped and anticipated.

Robertson

As is also your mandate. Before Mr Chair takes the question off me, I just want to go back to the housing issue and, just particularly, get you to say a little bit more about what you said in your overall statement around the risk of a resurgence in house-price inflation, given the continuing imbalance between supply and demand. I understand the numbers that are in here that show some levelling off of that inflation, but I take it that it is still your view that the lack of building, particularly in Auckland, represents a real risk.

Wheeler

Yes, I think the supply/demand imbalance is—we believe—significant, and not enough houses are being built at this point. When you see permits running at an 11-year high in Auckland, at just about 10,000 a year—30,000 for the country is also a 10-year high—so there is a lot a construction activity and that’s generating the construction cost pressure I talked about.

But we have been pleased to see the moderation in house-price inflation in the last 8 months. Nationally, it has increased by about one and a half percent. If you take the previous 8 months, then it was up about 12 or 13 percent. So it has really levelled off. In fact, house-price inflation’s become negative, if you like, in Auckland, slightly over the last 8 months.

But there is a lot of uncertainty still around this. I mean, the migration flows are stronger than we forecast—

Robertson

Your graph still looks just like it did every other time. I was hoping it might have looked different.

Wheeler

I am happy to say we can’t predict the future, and we do get them wrong.

Scott

Governors, vis-à-vis the housing market, my question relates to credit—not so much the absolute level of interest rates, but the access to the funds. We know that the Australian system is looking for—well they talk about “unquestionably strong” capital requirements. I think that was in a speech Grant gave a few months ago. You mentioned the tightening lending conditions, but I just wonder if you could expand on the effects that these capital requirements—these increased capital requirements—will have on, particularly, the housing market. I think we are already seeing some of those effects now. But I am just wondering whether you can expand on that and relate some of what you say to those capital requirements.

Spencer

I think it’s fair to say that if you push capital requirements up then it will have some restricting effect on credit, and it will increase the cost of credit at the margin, but not substantially. Now, we’re reviewing capital so we haven’t made any adjustment to capital ratios yet, but I guess you could say the banks may be—that may be adding to their caution, the fact that capital is under review.

I would say that I think the bigger factor right now, contributing to the banks’ caution on credit, is liquidity rather than capital, which is just the slow-down in deposit growth. In fact, they’re having to go more offshore, to offshore funding to finance the credit expansion, which is viewed as a
riskier source of funding. So that’s making them be more competitive on deposits, pushing up deposit rates as well as trying to conserve their funds more generally.

So that’s a liquidity issue and around just the amount of retail funding they are receiving, which is the gap between the deposit growth and credit growth, has increased. I think that’s the main factor that’s contributing to the caution.

Scott And that’s reflected in the house market?

Spencer I think it is, yes. So it’s that factor, plus the LVRs—the investment LVRs that we put in place last October—that’s obviously biting, particularly in credit to investors. Those two factors are the main drivers. Then there’s other things that are just uncertainty, for example, around property development—concerns about cost escalation in property development—it’s making them very cautious about funding new apartment blocks and development schemes. There is that broader caution.

Peters Can you look at page 28 of your report and the last paragraph on that page, and your graph 5.3 on page 29? First of all, the statement in that paragraph—that immigration is anticipated to continue over the next 3 years—I’d like to ask why you think that.

And, second, look at that graph and try and explain to me what on earth that chart means. Well if you look at that paragraph, then you look at the graph—the graph appears to contradict what you are saying in the last paragraph on page 28.

Genter Well it’s still positive. Net migration’s still positive.

Peters No, but it’s the next 3 years. Look where the arrow’s going.

Genter Well, yeah, it’s declining but it’s still positive so it’s not adding on top—

Peters Well one person coming in is positive, but I don’t think that is what the Reserve Bank is saying, with respect, and I’m asking them, not you.

McDermott I will answer. So the graph is showing that there will still be a net increase in immigration over the next 3 years, but it will be at a lesser rate than currently. That’s what the graph says. Hopefully it says the same thing as the books.

Peters Well will you explain what that graph there at the end of 2000—this graph here. What do you say that figure is?

Spencer That’s quarterly.

Wheeler Perhaps if I could help. If you take the net immigration of working age population since the beginning of 2012, if you added up the area underneath that to the vertical line, that would come to about 204,000 people. So it’s about 6 percent of the labour force. Then take the area underneath the other line, past the perpendicular, that’s about roughly
130,000 extra people. So it’s extra. The quarterly rate of increase is slowing, but the total migration is still expanding.

Peters

Right.

Spencer

So the peak is at 15, right? So that’s 15,000 per quarter, which is 60,000 per year, which is the working age population net inflows at present; that’s at peak.

Peters

You’re making that forecast less than 5 months out from an election. So you’re not listening to anything that’s going on out in the community. With respect, you should have had some options depending on circumstances. This is a bold statement. Election or no election, nothing’s going to change, or barely change, from 72, which we’ve got rounded up from 71,900 to 60,000—that’s not much of a change at all. You’ve not put any other alternative in, just that one. Perhaps you should tell us what you know that the rest of us don’t know.

McDermott

We have been making these forecasts because it’s necessary to do so. We’ve also been quite open that this is a very difficult measure to actually forecast. But, we also stress what’s important, in terms of our mandate, is not just the pure numbers, but the composition. So it’s who arrives, who leaves, the age profile, whether they’re working, whether they add to the supply of the labour market, whether they add to the demand pressures within the economy. It’s not just this chart that matters. It’s who is arriving and what are they doing that we also have to look at, and how they add to the inflation pressures. So that’s the focus. So this is only the starting point of our analysis.

Bishop

Just a supplementary on the compositional aspect. So, I understand in the press conference before you came down here this morning, you talked about how the composition of the migration in this cycle has been less inflationary than previous cycles. Do you just want to expand on that for the committee—why that is?

McDermott

We’re not saying we have all the answers, but one of them that goes to it is the age profile in the current cycle seems to be somewhat younger than previous cycles. We seem to be having more, sort of, 20-year-olds than in the past, who are single, not bringing a family, so all of them who arrive with a work permit are entering the workforce, relative to four people arriving with a family, two dependants who are going to school and who are maybe not working. So that’s shifting the supply into the labour market, relative to previous cycles.

Robertson

That isn’t what my sup was going to be about, but the Governor’s mentioned before issues around student visas and the release of them.
Presumably those single 20-year-olds are people who’ve either been students and are on their way to residency or not quite there yet?

McDermott  Yeah, fair point. Some of those numbers have indeed been students and some of them have an extra 20 hours of work available to them and are taking that option.

Robertson  That has its own pressures. My quick sup on that, just to be absolutely clear, that the sort of ski-jump like projection is just a return to the model—to the long-run average?

McDermott  A return to some kind of normal—[Interrupt]

Robertson  That’s the point. That’s the very point. I mean, I understand the limitations there are on you in forecasting this, but it’s not actually based on anything other than it returning to the long-run average, isn’t it?

McDermott  I hope my analysts look deeply into this and dig as hard they can and look at the—

Robertson  Because a graph that looks like that doesn’t really bear out what’s actually happened in recent years, does it?

McDermott  No, and also that is a fair point. But also I’d like to stress—had we taken this measure, which is a phenomenally high number, and mapped the previous cycle and said the behaviour was going to be the same, we would have made a massive error in our inflation forecasts. So it is important to recognise that it’s not just this chart; there’s a lot of work that goes into the consequences of these numbers and what makes it up.

Peters  That error would have been to massively underestimate it, right?

McDermott  Inflation?

Peters  Yes.

McDermott  Had we assumed the previous pattern we would have assumed much, much more inflation.

Bishop  So are you doing a bit more of a deep dive into the composition and the effect on—because the conclusions, obviously, were a bit tentative. You are doing a bit more research and things like that?

McDermott  Yeah, and there’s a range or documents and publications on our website that are available on that.

Genter  Along the same lines: I was actually wondering, because I noticed at the end of your summary of recent business visits that employers are expected to increasingly look offshore for labour, and how that fits with the forecast of declining net migration if we’re expecting employers to be looking to bring
people over to fill gaps and skills. It doesn’t really—they can be consistent, I understand that.

Wheeler A message we get consistently from businesses that we talk to—and we talk to hundreds of businesses during the year—is the shortage of skilled labour. It’s just a constant theme.

Genter Coming back to the risks around residential investment, you already answered some of my questions, but my understanding was that some of the proposed new developments in Auckland haven’t been able to get finance, in part not because there was anything wrong with the merits of the proposal but because the Australian banks are worried about their own domestic market and the risks there, and so that’s part of what’s constraining the lending. Have you heard anything along these lines?

Spencer I wouldn’t say it’s driven from Australia, no. I mean, sure, the group, the policies have an influence, but this is really about domestic circumstances and risk appetite of the New Zealand banks, and the New Zealand subs, and all the domestic banks as well.

Wheeler When we’ve talked to the chief executives of the banks, they’ve indicated that this is not driven by Australian, in general.

Genter Is there a problem, though, in that we’re—I mean, obviously the LVRs were set higher for investors in part to curb their activity in the market, but we need to increase the supply, and now, already, prices are just so high that first-home buyers can’t afford to buy homes so they’re not going to put up front the capital to get the new supply built.

Is there going to be a problem in us relying almost entirely on the private market to increase the supply when the need is actually with people who can’t afford to buy houses or homes at the prices that they’re currently at—like the marginal price of the new homes?

Spencer If that’s happening on aggregate then the prices will drop back, and they are dropping back to some extent. But there’s sufficient demand there—there’s still an excess of demand at the end of the day, and so there’s still that excess demand that will rise—

Genter There’s demand for a home, but there might not be the money to pay for it, right? Amongst the people who need it.

Spencer Yeah, that’s a distribution thing—it’s obviously much harder for first-home buyers.

Genter One final question about construction cost inflation: is there any way to increase the supply of building without increasing inflation in construction costs in Auckland? That’s obviously going to be a handbrake on the public sector meeting that demand for increased supply.

Wheeler If you look at, you know, part of the reason—there’s many reasons for why supply gets constrained. One of them is that the building industry is just dominated by builders who build one to three houses a year—the
productivity is so low. You put that next to a whole lot of regulation and planning.

Bayly I was going to ask you about something totally different: I was interested in what’s happening at a household level. We obviously know that household confidence is high, alongside business confidence. In here I see you’re projecting a continued dissaving of households forecast. So in the context of—obviously some of that will feed back into housing, but I was just interested in where you see what’s happening with household debt and what’s happening with the dissaving rates, and what’s driving all of that. Where do you see it all ending up?

Spencer Post GFC we saw a lot of caution by households and they were repaying debt and the savings rate went to positive. More recently—really in the second half of last year—consumption picked up, and there’s more confidence on the part of the consumers and a greater willingness to spend out of income.

Now, you know, explaining exactly why that was happening in 2016 is not that clear but it was pretty clear that it was happening. So after that adjustment period from the GFC there seems to be, now, more confidence and the savings rate has moved back down a little bit. So we’re assuming with these forecasts that that continued confidence continues—not at the same rate, necessarily, as the second half of last year, but at a reasonably buoyant rate.

Bayly Just to be clear, the figures in the back page here, when they’re negative in the next few years, that’s still saying that the households in general are saving, but that there’s a declining saving rate, as opposed to it being dissaving?

Spencer No, it actually means that people are dissaving. They are spending a little bit more than their disposable income.

Bayly Are we expecting to see household debt go up?

Spencer At the margin, yeah—a gradual increase. Credit, at present, is growing by 7 or 8 percent, and that is still at a higher rate than nominal incomes.

Bayly When you put that in the context of housing, you’ve made the point already around LVRs having an impact—it’s one of the three. So I’m just trying to understand how that all interplays, because is that going just into consumer goods, or—what’s happening? Is that where this dissaving amount’s ending up, in terms of housing?

Spencer This is consumption. Clearly people are also investing, separate from consumption, but, yeah, consumption’s going on goods and services, a lot of which is imported, but it’s a normal durable and non-durable consumption.

Wheeler You’re right. The household savings’ ratio goes negative, so, as Grant said, people are spending more than their income. So, the household debt to disposable income ratio’s currently now 168 percent—so it’s at an all-time high. It’s higher than it was before 2007, and you’ve seen the share of high-
DTI lending rising since 2015 for all of first-home buyers and owner-occupiers. It has now started to decline for investors because of the LVRs.

Foss: Since the February MPS, you’ve reset your forecast for the TWI—lower—and I was interested to where you see where the New Zealand invest [Inaudible] a more appropriate level for a fairer setting for that is what you think. Because on page 13 on your MPS, you mentioned that the United States’ Fed Reserve have increased their short-term rates and will continue to increase, so, the differential between New Zealand and the US is narrowing, so obviously that’ll flow through. So given your TWI reforecast, where are you anticipating New Zealand - US? Where do you think that will end up by the end of the year, or a more appropriate value?

Wheeler: Well those expectations that the Fed will tighten in the market perception is twice this year and a 90 percent probability that they’ll go in June—is what the market data is suggesting. That’s already built into relative prices such as exchange rates and interest rate settings. If you look at the exchange rate, we’ve been pleased with the 5 percent adjustment that’s taken place.

Now, the exchange rate’s affected by many factors, and interest rates don’t necessarily affect the exchange rates in a predictable way. For example, we cut interest rates seven times, and the TWI was 7 percent higher after that seventh cut than it was before we started. So there’s a lot of things that affect the exchange rate.

Foss: Given that TWI, the large component of that is the New Zealand - US, so what’s the New Zealand - US that contributes to a lower TWI?

Wheeler: I’m not sure of the overall weights.

Spencer: Well it would be—I mean, you’re right; it’s a significant component of that. So in terms of our assumptions that forecast we would be assuming a similar or even a greater part of it. You probably have a level that’s sort of low 60s.

Foss: Which is—because in the recent past you’ve said mid-60s, and you’re recalibrating down even further.

Wheeler: It got down to 62.8, from memory.

Hudson: I’d actually just like to explore a bit of the interplay between the forecast of net migration—slower rate of growth—and the projected annual economic growth. I appreciate there’s a lot of moving parts in all of this, but given the comments you’ve made about the scarcity of skilled labour, are we looking into an area where that scarcity of skilled labour is a constraint to our growth, or projections or a reflection of a slower economy, leading to slower or less migration?

Wheeler: It could be. I mean, what matters is the extent of employment growth and the productivity of those who are getting jobs. That’s what largely determines the rate of output growth in the economy. Now, one of the risks around these forecasts is will we see the construction activities—so residential building—continue at the pace that we are projecting here, given that there are skill shortages appearing. That’s a potential risk to these
forecasts that you’re already seeing—the inflation pressure’s there in the construction sector. And so there’s a need for engineers and skilled planners, electricians, etc. There’s shortages of them.

Peters

Some countries actually have addressed that concern about costs in the construction sector by having a full-scale inquiry into their practices—like Australia—and what is very apparent in New Zealand is it’s happening here and nobody’s doing anything about it. Are you concerned about the difference in the construction costs in New Zealand versus, say, Australia?

Wheeler

I think it’s a highly relevant point but, having said that, I don’t think the productivity of the Australian building sector is particularly great either.

Peters

I didn’t say that. The price differential between New Zealand and Australia.

Wheeler

The Productivity Commission did some very good work on this, and it basically said: “Look, the productivity of the Australian building sector is 25 percent higher than that of New Zealand.” That’s relatively low compared to, say, the States, and other parts. The other thing that they said is “Look, most of the housing construction’s done by builders who build one to three houses.” The economies of scale aren’t there.

Foss

In the Australian Budget, a levy was put on the parent banks, the large wholesale funders of the New Zealand banks. Do you see in any way that that would affect the price—the cost of capital—for New Zealand, or have any influence whatsoever?

Spencer

We’re pretty clear that this is applying to the wholesale funding of the Australian entities, but we’re not 100 percent sure that this is not applying to whole-group funding. If it was, then that would affect the funding of New Zealand subsidiaries of the four major banks. So then we would have to think hard about what the implications were, because that would potentially increase the cost of funding of New Zealand banks. You make
investigations, but, so far, our best guess is that it only applies to the Australian bank funding, not the funding of the subsidiaries.

Foss  Even if they fund on the global market, via their parent, down to New Zealand.

Spencer  Yes, but there’s less and less via the parent, because the parent funding of New Zealand subs has been restricted in recent times by APRA, so that funding, coming through the parent, has actually been wound out.

Foss  So it could actually increase the other way: come via New Zealand up to the parent?

Spencer  Well, that’s possible but—we’ll see about that. I think the parents will be the ones taking the impact of that additional tax.

Bayly  Have you got a view on what level the New Zealand subsidiaries, now, are funded by the Australian paired with that APRA—what was that percentage that they restricted?

Spencer  Well, it was basically down to zero, effectively. They can only have some funding—contingent funding—in a crisis. It has to be secured.

Bayly  They’ve moved that point now?

Spencer  They gave them 5 years to transition out of that funding and they are well into that transition now.

Peters  Incidentally, I know the Reserve Bank’s evolved in this respect—it’s not what it used to be—but is there any bank in New Zealand that you’ve got concerns about, in terms of its financial position?

Spencer  Not at this point. No.

Peters  None.

**conclusion of evidence**
Reserve Bank of New Zealand’s Financial Stability Report, May 2017

Report of the Finance and Expenditure Committee

Fifty-first Parliament
(Chris Bishop, Chairperson)
June 2017

Presented to the House of Representatives
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Reserve Bank of New Zealand, Financial Stability Report, May 2017

Recommendation

The Finance and Expenditure Committee has examined the Reserve Bank of New Zealand’s Financial Stability Report, May 2017, and recommends that the House take note of its report.

Summary of the Financial Stability Report

One of the Reserve Bank’s main functions is to support the stability and efficiency of New Zealand’s financial system. The Reserve Bank conducts regular surveillance of financial risks and reports on its assessments every six months in the Financial Stability Report. The following are the main points from its May 2017 assessment:

- New Zealand’s financial system remains sound and appears to be efficient relative to international peers and recent history. The banking system has capital, funding, and liquid asset buffers that are beyond current regulatory requirements.

- The outlook for the global economy has improved. However, elevated political and policy uncertainty remains, and debt burdens are high in several countries. Rising protectionism could also affect the trade-exposed sectors of the New Zealand economy.

- The Reserve Bank has conducted a stress test of current owner-occupier borrowers to an increase in mortgage rates. It is estimated that, if mortgage rates were to rise suddenly to 7 percent, 4 percent of all borrowers, and 5 percent of recent borrowers, could not meet their essential expenses (“severe stress”). A further 2 percent of all borrowers, and 7 percent of recent borrowers, would have only a small buffer for discretionary spending after meeting their mortgage payments and essential expenses (“mild stress”). A 9 percent mortgage rate would result in severe stress for 7 percent of all borrowers and 18 percent of recent borrowers.

- The Reserve Bank is progressing several regulatory initiatives, including reviewing bank capital adequacy and consulting on a restriction on lending at high debt-to-income (DTI) ratios. The Reserve Bank also recently concluded a review of its outsourcing policy for banks.

Key domestic risks

The Reserve Bank has identified that some key risks to New Zealand’s financial stability remain despite having reduced in the past six months. These are housing market vulnerabilities, bank funding pressures, and dairy sector indebtedness.

The outlook for the housing market remains uncertain. House price growth has lessened in the past eight months because of more stringent loan-to-value ratio (LVR) requirements, tighter loan serviceability criteria, higher mortgage interest rates, and affordability pressures. Despite this, house prices remain high relative to incomes and rents. Household credit growth has slowed but also remains high at 8 percent, and household indebtedness has
continued to increase in relation to incomes. Therefore, any resurgence in house price growth would be of concern.

The banking system has increasingly relied on offshore funding, exposing it to international risks that could significantly increase the cost or reduce the availability of funding. Banks have responded by increasing deposit rates and tightening lending standards on some forms of lending. This has helped to reduce the gap between deposit and credit growth during the past six months.

Conditions in the dairy sector have improved because of increased global dairy prices in late 2016. However, debt in the dairy sector has continued to increase, and the most indebted dairy farms remain highly vulnerable to lower prices or an increase in costs. Most dairy farms are likely to have returned to profitability in the 2016/17 season.

The remainder of this report discusses the main issues we considered during our examination of the financial stability report and in our discussion with the Governor of the Reserve Bank.

**Issues relating to the housing market**

**Building and consents**

We asked whether houses are being built at a fast enough rate to account for the high rate of net migration into New Zealand. The Governor cited figures from the Auckland Council that identified that 13,000 houses need to be built each year to make up for a shortfall of between 25,000 and 35,000 houses. He said that, although consents are running at a 12-year high of 10,000 per year, actual building completions are below that. The Governor said that it is clear from these numbers that not enough houses are being built to cover the net migration inflow.

**Debt-to-income limits**

We asked whether the Reserve Bank had a preferred DTI ratio to which banks’ lending to mortgage borrowers would be limited. We heard that the Reserve Bank does not have a specific ratio in mind. However, if it did have DTI limits available as a tool, then the ratio would depend on the circumstances at the time it was used. The Governor said that the use of DTI limits would involve a “speed limit” that would allow a certain share of a bank’s lending to remain available at a DTI ratio above that specified by the Reserve Bank.

We asked what conditions the Reserve Bank would consider using DTI limits under. The Governor said that he would not consider using DTI limits under present conditions. However, the Reserve Bank would reconsider if house price inflation were to increase again and if banks were still lending at high DTI ratios.

We asked how DTI limits would work with the Reserve Bank’s LVR restrictions. We heard that the two tools work in combination with one another. LVR restrictions help to reduce the loss to a bank if a borrower defaulted on their loan, and DTI limits would reduce the likelihood of a borrower defaulting in the first place.

The Governor said that the Reserve Bank’s LVR policy is designed to protect the banking system as a whole by requiring borrowers to have greater equity when they take out loans. DTI limits would protect the banking system against the risk of mortgage defaults in a downturn. If a downturn did occur while DTI lending remained high, the housing market could be overwhelmed with forced sales, which would depress house prices further and create risks to the banking system and the broader economy.
We discussed whether such a problem could occur under the scenario used in the Reserve Bank’s stress test, given that the ratio of average house prices to average household income has risen in Auckland from 6.5 to 9.5 during the past five years. The test found that, if mortgage rates were to rise to 7 percent, 4 percent of all borrowers would be under severe financial stress. We asked whether this level of stress would pose a risk of “contagion” to the wider economy, beyond those individuals affected.

The Governor said that such a scenario could generate effects that have the potential to accumulate. Having more households under severe financial stress may result in a rise in distressed sales, which could cause a significant decline in house prices in parts of a city. This could have broader contagious effects for the market. In addition, the further 2 percent of households under mild stress in this scenario would have to pull back on their spending, which would also have wider economic flow-on effects.

**Household debt**

Despite the recent slowdown in house price growth and new mortgage lending, New Zealand’s average household debt has increased to 167 percent of disposable incomes. We discussed the cause of this increase and asked where this borrowing is being spent.

We heard that the increase in debt is a result of debt levels rising faster than incomes. Although incomes are increasing, household debt is increasing at a faster pace of about 8 percent annually. The Governor said that, generally, borrowed funds have been invested in the housing market, but in the last six to nine months there has been a trend of reduced saving and increased consumption. However, he said that most borrowing is still spent in the housing market.

**Housing in the regions**

We asked whether the Reserve Bank had any concerns about the housing market in regions outside of Auckland. Some of us wondered whether the imbalance between supply and demand seen in Auckland also exists in the regions.

We heard that some of the biggest price increases relative to incomes have been in the upper North Island. Cities such as Tauranga and Hamilton have seen an increase in population and have experienced a “ripple” effect from the Auckland housing market. The Governor said that he believes that there has been a better supply response in Tauranga than in Auckland.

**Overseas and domestic investment**

We asked whether the Reserve Bank had statistics on the proportion of houses purchased by overseas investors. The Governor said that data collected on foreign tax nationals suggested they were responsible for about 2 to 4 percent of house purchases in New Zealand. However, he said that there is a lot of doubt about the quality of that data. The Reserve Bank believes that the bulk of housing investors are domestically based.

We asked whether the high level of investment into housing in New Zealand was reflected in lower investment levels in the productive economy. The Reserve Bank said that it has always acknowledged that housing is a favoured asset in New Zealand, which may restrict the flow of funds into financial markets. However, at present, this is not a constraint on business investment.

The Governor also noted that house price inflation has started to flatten out during the last eight months and that rental returns are at an historic low of about 3 percent in Auckland.
He said that investors’ expectations of capital gains and rental incomes are probably moderating as a result.

Some of us suggested that a register of house and land ownership could be a useful tool for the Reserve Bank to have reliable data on the extent of overseas investment. The Governor said that there are issues with what is, and is not, measured in the data that is collected. He said that, if there were a significant overseas purchasing interest in the New Zealand housing market, then it would be useful to have good quality information on the extent of that and the effect that it was having.

**International risks**

**Australian bank levy**

We asked how the Australian Government’s recently announced levy on banks could affect New Zealand’s financial stability. The Reserve Bank said that the levy will affect the banks’ New Zealand branches but that the flow of credit coming from the parents through the branches is diminishing because of the Australian Prudential Regulation Authority’s restriction on lending to external branches. We heard that, although there will be a small tax on this funding, the Reserve Bank does not expect it to have any effect on the overall cost of credit in New Zealand.

**Implications of protectionism**

We asked the Reserve Bank to elaborate on its assessment that protectionist trade policies pose a risk to global financial stability. The Governor pointed to comments from the United States’ President that have been very supportive of protectionist measures.

In addition, world trade growth during the last five years has been the weakest since the early 1980s, and the number of disputes being taken to the World Trade Organisation is currently the highest since the global financial crisis. The Governor said that he is very concerned about this trend because of the global economy’s dependence on trade.

**Revised outsourcing policy for banks**

The Reserve Bank recently concluded a review of its outsourcing policy for registered banks. The review was needed partly because of indications that the banking industry had misinterpreted the requirements and intent of the original policy. Some banks have been unsure whether the policy permitted or precluded them from basing their core transaction systems offshore. We asked how the new policy will help address these misunderstandings.

We heard that the policy has never required banks’ systems or core systems to be located in New Zealand. Rather, the systems are required to be under the control of the New Zealand subsidiary and its board of management. Over time, this requirement has not consistently been observed by banks’ system changes, with some outsourcing breaching the policy. The Reserve Bank said that this was partly because the policy was not very clear, so it has tried to clarify the policy and has given banks five years to comply.

**Solvency of insurance companies**

We asked whether the Reserve Bank has done any stress testing of the insurance industry’s ability to cope with another large-scale natural disaster, similar to the Canterbury earthquakes.
The Reserve Bank said that insurance companies have recovered from the Canterbury earthquakes and are now in a strong position. The Reserve Bank is confident in New Zealand’s insurance companies’ ability to respond to any major event.
Appendix A

Committee procedure
We met on 31 May and 21 June 2017 to consider the Reserve Bank's financial stability report. We heard evidence from the Reserve Bank of New Zealand and received advice from our independent specialist advisor, Brendan O’Donovan.

Committee members
Chris Bishop (Chairperson)  
Andrew Bayly  
Hon Clayton Cosgrove  
Hon Craig Foss  
Brett Hudson  
Rt Hon Winston Peters  
Grant Robertson  
Alastair Scott  
David Seymour  
James Shaw  
Michael Wood
Appendix B

Transcript of hearing from 31 May 2017

Members
Chris Bishop (Chairperson)
Alastair Scott (Deputy Chairperson)
Andrew Bayly
Barry Coates
Hon Craig Foss
Brett Hudson
Rt Hon Winston Peters
Grant Robertson
Jami-Lee Ross
David Seymour
Michael Wood

Witnesses
Reserve Bank of New Zealand
Graeme Wheeler, Governor
Grant Spencer, Deputy Governor and Head of Financial Stability
Bernard Hodgetts, Head of Macro-Financial Department

Chair Welcome Governor and your team. Thanks for coming. We’re in your hands.

Wheeler Thanks very much, Chair. Good afternoon everyone. On my left, I’ve got Grant Spencer, who’s the Deputy Governor and Head of Financial Stability, and on my right, Bernard Hodgetts, who’s the head of the Macro-Financial Department.

So let me be pretty brief. New Zealand’s financial system remains sound and the risks facing the system have reduced in the past 6 months. The outlook for the global economy has been improving; the political and policy uncertainty remains elevated, and debt burdens are high in many countries. A sharp reversal in risk sentiment could lead to higher funding costs for New Zealand banks, and an increase in domestic borrowing costs. New Zealand banks are seeking to reduce their reliance on offshore funding and to raise deposit rates. Dairy prices have recovered in the past 12 months, and most dairy farms are likely to have returned to profitability in the 2016-17 season. However, some farmers are carrying excessive debt burdens and remain vulnerable to a fall in income or an increase in costs.

House-price growth has slowed down in the past 8 months in response to tighter loan-to-value ratio restrictions, a more general tightening in credit, and affordability pressures in parts of the country. Residential building
activity has continued to increase, but not enough to meet the rapid population growth and the existing housing shortage. House prices remain high relative to income and rents, and any resurgence would be of concern. While the loan-to-value restrictions have increased banks’ resilience to any fall in house prices, a significant share of housing loans are being made at high debt-to-income ratios. Such borrowers tend to be more vulnerable to any increase in interest rates or declines in income. The Reserve Bank will soon release a consultation paper proposing the addition of debt-to-income restrictions to our macro-prudential tool kit. Thanks very much, Chair.

Robertson: Thanks very much, Governor. I just want to ask a few questions on housing, unsurprisingly. You’ve said that while activity’s increased in recent years, the rate of house building remains insufficient to meet the rapid population growth and address existing housing shortages. What’s your current estimate of how far behind we are in terms of house building, from where we need to be?

Wheeler: Well, I suppose my knowledge is greatest in respect of Auckland, and there I rely on some of the figures from the Auckland City Council, which talks about a shortfall of somewhere between 25,000 and 35,000 houses. They talk of the need to have 13,000 houses a year built. Permits are running at a 12-year high at 10,000; completions are less than that, and we’re certainly not building enough houses to cover the net migration inflow.

Robertson: In terms of just that specific point around consents versus actual building— I think we asked you the last time you were here—is there any change in the trend there? They’re certainly running less—building is running less than consents—but is there any change in the trend there?

Wheeler: I would have to check the numbers, or ask my colleagues if they’ve got—

Spencer: Not that I’m aware of, no. I’m not aware of the updated estimates.

Robertson: OK. It might be worth us coming back to that. In terms of DTIs, I just want to explore a couple of things with you. What ratio are you actually looking at in terms of the tool that you’re recommending? Is there a ratio that you are looking at?

Wheeler: Well, we hadn’t specified a ratio. What we’d done is made the case for how they could assist in terms of financial stability risks that we face. The Minister of Finance said: “Look, before you go out with a consultation document, can you put a cost-benefit analysis around that?”, and so we used some general numbers as part of that. But in terms of if we ever did use the instrument—if we did have it available—then it would very much depend upon the circumstances at the time. But it would probably involve some concept of speed limit, so it would sort of trigger and then a certain share of lending of DTIs above that.

Robertson: Like LVRs. In the UK it has been around 4:1 or 5:1. If you looked at the New Zealand market, what sort of percentage of lending would be over that 5:1 ratio in terms of both owner-occupiers and investors?

Spencer: If you look at the chart on page 29 of the report: in the top figure, A1, it shows shares of borrowers in different DTI buckets. So, for example, if you
look at over 5—for existing borrowers, the whole debt, there’s only about 10 percent of debt out there that’s over 5. But if you look at recent borrowers, which is the right-hand side panel, there’s 30 percent of that debt is over 5, which reflects the increasing trend.

Robertson: I was going to come to box A, fascinating piece of work that it is—that’s owner-occupiers not investors, isn’t it?

Spencer: For existing new borrowers, I think that’s owner-occupiers and first-home buyers.

Robertson: So not investors?

Spencer: Investors will be included in that. So it’s the whole three.

Robertson: In the box it’s in? There is a greater percentage of investors with DTIs above 5, though, than there are of owner-occupiers, aren’t there?

Spencer: That’s right. That’s shown in one of the charts, there, which shows the investors—that segment is the highest average DTI.

Robertson: Perhaps I will come back to the remaining box now and just ask a couple more specific DTI-related questions. I just want to get a handle on—I know you’ve said that you wouldn’t be bringing it in now, even if you had it—what are the conditions? If you can be as specific as possible about the conditions under which you would be using it.

Wheeler: Well, at the moment—you know, if you look at the last 8 months—house-price inflation for the country as a whole, on an annualised basis, is running at around 2 percent. The previous 8 months it was running at around 18 percent, so it is a dramatic slow-down. Where I think we’d be concerned is if house-price inflation started to gather steam again, and we saw that the banks were lending at high debt-to-income ratios. That would be a situation that would bother us.

Robertson: So, running at 18 percent is a scenario where you would be looking at this or—the rates we did see a few months ago, if they sustained themselves, you would look at using it?

Wheeler: Well I could imagine it would be something less than house-price inflation getting to 18 percent before we got serious about DTIs, yeah.

Robertson: Interesting. I just want to come then to, essentially, what’s covered in box A, but the predication for that is, what is the risk of the correction? You say that it exists. You obviously still have the concern that there is a risk of a correction, particularly in terms of Auckland.

Spencer: That’s right. I mean, with the stretch in the market, that’s the risk all along that the housing market would go through a rapid correction, and that risk is still there, but the fact that the market has moderated over the past 8 months or so is a positive sign that we’re getting a gradual correction. The longer the period of gradual correction, the less likely a sharp, precipitous correction.

Robertson: Well what box A shows us is that in terms of those recent borrowers, there is a percentage of them who are highly exposed, and, in fact, you’re talking
about here at a mortgage rate of 7 percent, around half of existing borrowers with DTI ratios above 5 are expected to face severe stress. So any form of correction—

Wheeler If rates are elevated, yeah, that’s right.

Robertson So any form of correction, which would be a precondition, presumably, of those rates going up, there is a reasonably large group of people then who are among those new borrowers.

Spencer That’s right and that group is increasing. As time goes on and if that upward trend in DTIs continues, then the vulnerability increases.

Scott Supplementary to that, do you see the DTIs—if it was brought in—to be working in conjunction—or on a condition of the LVR? So you might have a DTI, but if you’ve got a high value—if you’ve got a high level of equity in other words, 30 percent, say—would you see some room for the banks to above 5, above 6, because of that buffer? So you can have them both working together, or is it just going to be a blunt instrument?

Spencer Well, you’re right, they do work together and they cover different dimensions of risk. So the DTI impacts the probability of default, the likelihood of default, and the LVR affects the loss given default. In other words, if there is a default, is the bank covered with collateral? So if you have high LVR and high DTI, then that is increasing risk of both of those dimensions, but you can have different combinations. And you’re right, the bank, if it’s a very low LVR, may take a bigger risk on the other dimensions.

Scott So you see there’s room for flexibility in the DTI, given a high equity—

Spencer Well, to some extent there is. But I guess we feel that—from a system perspective, it’s increasingly getting stretched. So the average LVR as a result of our LVR policies is being moderated. But this other dimension—the DTIs are continuing to trend upwards, and that is our concern.

Wheeler Look, you’ve seen LVRs\(^1\) in Auckland over the last 5 years go from 6.5 to over 9.5. That is just in 5 years. Now, the LVR policy is basically trying to protect the banking system by requiring borrowers to have greater equity when they go in and get that loan. The DTIs are basically trying to protect the banking system against the risk of mortgage defaults in a downturn, so if a downturn comes, you don’t get a whole lot of forced sales coming on to the market that depress house prices even further and create a risk for the banking system and also the broader economy. So, the two of them can work very closely together.

Hodgetts I think in relation to your question around flexibility, that the use of the speed limit for debt-to-income ratios would mean that banks would have capacity to grant high DTI loans to borrowers if they felt their other financial characteristics justified it.

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\(^1\) The Reserve Bank has advised that this reference to LVRs was incorrect. The Governor was referring to the “ratio of average house price to average household income”.
Scott: So you’ve got the LVRs, the DTIs—now you’ve put another layer of capital: you talk about reviewing capital requirements? What is going to be the effect on the house market if there are tougher, more stringent, and more capital is required in the banking system?

Spencer: We don’t want to sort of get ahead of ourselves in terms of assuming that the capital is going—the banking system now is well-capitalised and we’re just saying as a general principle, when we’re doing this review, we think the New Zealand system should be well capitalised, maybe a bit more than at present. But we should have a conservative capitalisation, relative to international peers.

Scott: I agree, so what’s the effect on the housing market if the requirements—

Spencer: If it was a significant change then it might have some more significant impact on the cost of funds, but our analysis suggests that any smaller changes in capital ratios doesn’t have a big impact on the overall cost of funds of the banks.

Peters: So that “Joe Public” might understand, you use the word “correction”. What are the other synonyms for that word in the market?

Wheeler: Well, it’s probably another word like adjustment, price decline—

Peters: Collapse.

Wheeler: That would be a more serious form of it, yes.

Wood: Going back to box A, page 28-29, the first question is around methodology. From reading the text here, we’re just taking account of the effect of interest rate increases on mortgage rates. We’re not bringing into account the fact that some of these people might also have other forms of personal or business debt?

Hodgetts: That’s right. I mean, the data’s limited in terms of the amount of complete coverage of debt that households might have. Some of that extra debt may be in here, but—

Wood: So potentially we could be looking at a slightly elevated—in terms of stress and extreme stress. The second point is that you identify at 7 percent—we get to about 4 percent generally and about 5 percent in Auckland—of households who face severe stress. I guess the question is, at that sort of level, do you see that that is just a problem for those people? Or at that sort of level do we start to actually get a level of systemic risk where there’s a risk of contagion, loss of confidence, more people getting into a negative equity situation? At what point do we tip over into that sort of real system risk?

Wheeler: Well, I think one thing to keep in mind is that the marginal transaction sets the price of the stock, so if you are getting a series of distressed sales, for example, then the value of the stock will reprice, and so that’s when you can see the contagion effect start to build up.

Wood: So you think that’s a possibility if 4 or 5 percent of householders in Auckland are feeling severe stress, or—
I’d be interested in Bernard’s thoughts, or Grant’s, but I could certainly imagine a situation where you’re starting to see some significant decline in house prices in parts of a city that start to have broader contagion effects elsewhere.

If you look at any market, or where banking collapses, you know, if you started to get numbers over 5 percent, it tends to have systemic effects and serious effects.

We’re also reporting on here on the proportion of households who would be in what we call mild stress, which is more the case of having to pull back on spending and so on. Those effects clearly do have the potential to accumulate.

The economic knock on?

Yep.

Just picking up on that: the stress test that you’ve done, as you can point out in box A—as Mr Robertson and co. have pointed out. So you also mentioned in the report of strong projected growth and the general environment, low inflation, we’re still exposed to global risk, etc. But, overall, is it right to say that New Zealand is much more resilient to potential shocks or risk than we were, say, I don’t know, 10 years ago or so, albeit those global risks, of course, are always there?

I think that’s right. If you look at pre-GFC, the bank system was running much closer to the wind than it is now. So there’s been quite a beefing up of those buffers—resilience—since the GFC. And so you’re right. Historically, it’s in pretty good shape in terms of that overall resilience.

One of the significant improvements has been in the external debt position. I mean, that peaked, from memory, at about 85 percent of GDP in the mid-2000s. Now it’s—what—I think 60 percent of GDP is the latest number. So that’s a significant improvement.

I was going to ask you about that, as well as the current account on page 12. The current account has had a lot of interest by Parliament over the years and currently running off 2.7 percent—as low as it’s been for a long, long time. And linked to what you just described there, New Zealand’s external debt-servicing costs have gone from 20 percent in 2008, to 7 percent in 2016. What does that actually mean in dollar terms for the economy if it’s 13 percent—or 13 points—lower now than it was then? How much is that—13 percent of GDP?

I believe that is of GDP, yes.

GDP is roughly $250 billion, so 13 percent would be—what—$37 or $38 billion?

Exactly. So does that mean, in our economy—I realise that these are gross numbers—there’s actually less money being spent on debt servicing than for a long, long time, which has been part of the growth story of New Zealand and that resilience?
Spencer: There is two elements—one reason debt service is much lower is just interest rates are much lower globally, but the other reason is that New Zealand has had a better savings performance, post-GFC, than previously. So we’re not spending more than we’re earning. At least not to the degree that was previously the case. So you’ve got a true underlying improvement, but also this thing that the effect has just come from low interest rates.

Foss: And finally, so in households, in people’s homes tonight as they are looking at their mortgage rate which is around 5-ish percent or thereabouts—you’ve done a stress test there of 7 to 9. Not that long ago they were nudging double figures, those mortgage rates. So, if that was the case, what would that actually mean for the economy, if in fact we did have 9 percent interest rates on mortgages for some reason? What else would be happening in the economy?

Spencer: Well it could be just higher inflation as a result of global ramp-up inflation—something we haven’t seen for a long time—or it could be based on a risk premium. Higher risk premium attached to New Zealand and the higher cost of funding from New Zealand, which would have to be coming out of some sort of adverse shock to the country’s economy.

Hodgetts: Can I just clarify: the proportion of debt servicing that you’re quoting there was as a percentage of exports, not GDP, so you could probably reduce that $37 billion by about two-thirds lower.

Robertson: I do just want to jump back to housing again and talk a little bit about non-Auckland. I know you used Auckland as the example before, Governor—but the table 3.3, on page 15. I know the size of some of these areas are small, but you have some extraordinary issues in Queenstown, particularly—and in fact, I do wonder if you want to comment specifically on that region and what’s happening there—but more generally, you make the comment that there’s an underlying imbalance between demand and supply in many regions. I just wonder what reflections you’ve got about where the regions that you’ve kind of got under watch are, and what the extent of that underlying imbalance is?

Wheeler: On Queenstown, I’ll know more on Friday. I’m speaking down there on Friday, but the house-price inflation—I mean, if you look at a graph of house-price inflation in Queenstown over, say, the last 15 years, you see some enormous movements. I mean, it got up in one year to almost 40 percent or so. That’s in the earlier 2000s. The last 6 months, it’s come back a lot; it’s about 2 percent or 3 percent in the last six months, annualised, but these movements here, you know, they’re very significant. If you look at Auckland, and they’re of the magnitude I mentioned.

I have some figures, just for New Zealand as a whole. Let me see if I have them. So, the LVRs 5 years ago for New Zealand as a whole were 5.2 and now they’re 6.5. To what extent do regional shortages—you know, I don’t know enough about the individual regions. I know a lot more about Auckland, but let me see if my colleagues do.
Hodgetts Well some of the biggest increases have been in the upper North Island, as you can see—the Hamiltons, the Taurangas, and so on, have seen the biggest increase in house price - to-income ratios. I think there is a ripple-through effect from the Auckland housing market and probably more of a population increase in those upper North Island areas as well. It’s probably behind the surge in house prices that we’ve seen.

Robertson I guess the point you’re making here, and the point I’m just trying to draw out, is that the demand and supply imbalance exists here as well. So, OK, we’ve seen the increase in demand, but we’re—just as in Auckland—not seeing the commensurate supply increase either.

Wheeler You’re seeing a better supply response in places like Tauranga from what I’m picking up. What’s driven a lot of that house-price inflation in those regions has been investors. I mean, they’ve often contributed more than 40 percent of the transactions. That was certainly the case in Auckland—it was around 42 percent—and it’s been high in Hamilton and Tauranga as well. Now that’s started to come off, and that’s one of the reasons why house-price inflation is moderating. It’s not just because mortgage rates have increased by about half a percent since November and funding costs are rising for banks and they’re passing those on in their mortgage costs; they’re also tightening up their lending criteria, but it’s also the LVR restrictions on the investors. Their share of transactions has fallen quite markedly.

Robertson I know I’ve asked you this one before about their capacity to target DTIs to classes, to investors; is there any consideration of that at all, and/or regional targeting?

Wheeler Not that we’ve been thinking about, no.

Bayly Last time we met, I asked you about the level of dissaving that was going on at a household level—we noted that it was going negative and has just recently starting to trend in the negative direction. I was fascinated back here, looking at the level of debt going to households and, again, that’s showing an increase in debt—indebtedness—or lending to households. When you put that in the context of the discussions that we’ve been having before about the ability of the households to react and meet their interest repayments, my questions were: first of all, this level of increase in lending to households—are we actually seeing an increase in the amount lent per household, or does this reflect that there are more households borrowing? Secondly, where is this debt going that households are taking on? Is it going into housing primarily? Is it going into a whole lot of consumables? The third thing, really, is on the back of that, are you worried about this trend in terms of indebtedness of households?

Spencer Well we are worried about the trend, and it gets repeated at various times through the document. So, right, the population’s clearly increasing, so that’s part of the reason why incomes are increasing, and is an important contributor to growth. The debt is growing faster than that, so we don’t have debt per household as a number, but if debt relative to total income, total income of the whole population—the total debt is rising faster. So it’s currently growing at on a sort of 6-month basis around 6-7 percent, on an
annual basis 8 percent, whereas nominal income growth is obviously less than that.

Bayly Is that going into buying new properties? Or is that going principally into a whole lot of other stuff? Then you start to raise issues about what the nature of that debt is; whether it’s long-term core debt or whether it’s general credit?

Spencer Well generally, in recent years, it’s been going into housing, but, more recently though, in the past 6 to 9 months, maybe more is being spent—because, as you said, the household savings has sort of come off a bit, consumption’s strong, so, you know, there’s maybe a little bit of move back to this equity withdrawal. This is what we used to see—we saw, if you recall pre-GFC, we had the big boom and a lot of that credit was going into spending as opposed to into the housing or residential market. I would say most of it, though, is still going into housing.

Bayly This figure here takes me to [Inaudible] credit cards. So it’s all the three measures of growth through there?

Spencer Yeah, the household includes credit card debt. It’s a pretty small proportion—maybe 5 percent or so.

Coates I want to pick up on the 40 percent of house purchases coming from investors and to just ask for your view on the degree to which that’s being driven by capital investment, particularly from China or other countries. There is data from China to say that capital flight from China may be coming under control. To what degree do you think that 40 percent is domestically sourced versus foreign sourced, and do you think it would be a good idea if we knew that?

Wheeler I don’t believe there’s good quality data on that. We know that investors are a very significant part of the housing market transactions. We’ve got pretty good data on that from Demographia, and so we know how that’s changed over time and the LVR restrictions on investors have had a very significant impact. The data on foreign tax nationals, if you like, purchasing houses in New Zealand—it is collected—suggests somewhere in the ratio of 2 to 4 percent. I think there’s a lot of doubt around the quality of that data. But let me see if my colleagues wanted to add anything.

Hodgetts Well we know a lot of the established investors—meaning they hold multiple properties, so they’re not necessarily new entrants to the market, whether that tells you that they’re domestic or foreign-based, of course, is another question. We’ve seen it right across the spectrum from small-scale investors to larger-scale investors. I think it would be fair to say that the lion’s share of the growth in credit to investors has probably been onshore-related, would be my supposition.

Coates Do you see that investment as having an effect on investment that could have gone to other sectors? So, for example, if we have high housing investment, do you imagine that then would have the knock-on effect of lower-investment in the productive economy, potentially with impacts on productivity rates?
Spencer There’s potentially a case for that, but I doubt if it’s the case at present. You can say, well, if households are putting money into housing, then if they were putting less into housing, they might put it somewhere else like financial markets, equities, that would finance corporate investment. But, the corporate sector is not, I would say, highly cash or credit constrained. They tend to have good cash resources. Bank credit is not being stretched at all because there’s not a huge demand for bank credit for funding. And with the strength of the stock market—if companies want to go there—there’s ready supply, including from offshore. So I guess what I’m saying—in principle, we’ve always said that housing is a favoured asset and that may restrict the flow of funds into financial markets, and I think that general proposition is true. At the minute I wouldn’t say that’s a constraint on business investment.

Wheeler There is some, perhaps encouraging, feature at the moment. I mean, investors will look at their risk-adjusted returns, and they’ll compare that against the cost of capital. And so, if you’re an investor now, you see that house-price inflation over the last 8 months is starting to flatten out. We don’t know whether that will continue. You’ve still got strong immigration. You’ve still got relatively low mortgage rates. But if they look at rental returns, they’re at pretty well historic lows in Auckland now. They’re below 3 percent—or just below 3 percent. So the expectations of capital gains and a stream of rental income, you know, those perceptions, I think, are probably changing at the moment.

Peters Can I just ask—you must be in rather a difficult position, because most banks are seeking to analyse information, like you have been talking about, and would have a register of house and landownership. So rather than taking a stab in the dark on guessing around real estate agents, you’d know with some precision and exactitude what you are talking about. Is that not the case?

Wheeler Well it’s relying on the survey—is it LINZ that does the survey? I’m relying on that data. I think there’s some issues around what’s measured and what isn’t.

Peters Well, I mean there are some that are trying to say that the level of offshore buying and ownership is minimalist. There are others who seem to be in the market who think that it’s much higher than that. But a register of house-ownership and landownership would surely be an enormously beneficial tool for people like yourselves in terms of be able to analyse exactly what’s going on rather than guesswork.

Wheeler I think it’s certainly fair to say that if there were a significant overseas purchasing interest in the New Zealand housing market, you would want to have good quality information on the extent of that and what impact it’s having.

Chair Can I ask about the recent Australian Budget which proposed a levy on the big Australian banks? There’s a tantalising paragraph on page 8 of the FSR about it. You say that “The liabilities of their New Zealand subsidiaries are not expected to subject to the levy, but the liabilities of their New Zealand
branches will be included.” Can you expand on how you see that affecting New Zealand and affecting financial stability at all?

Spencer
Well we don’t think it will have much of an effect, because our understanding is that it will affect the branches, but not all the funding of the branches. It would affect some of it that is going to external assets, but the flow of credit coming from the parents through the branches is diminishing in any case, because there was a restriction that was applied a couple of years ago from APRA telling the parents to stop lending directly to external subs and branches. So, it’s on the decline, but there will be an impost, I think, on part of that funding, but it’s a very small amount. So we don’t expect it to have any impact on overall cost of credit in New Zealand.

Foss
Well just one other point, just [Inaudible] of the international risks, you talk about a comment on the US situation and potential protectionism and what that might mean for New Zealand. Could you expand on that a little bit? I mean, those risks have always been there, but—

Robertson
Tiny bit elevated now, Craig.

Foss
Well, maybe, but that constant vigilance for New Zealand to be more resilient is more pronounced than ever, but protectionism in itself—I just hadn’t seen that in a document like this from yourselves, I don’t recall. As in domestic US politics affecting our mortgage rate in New Zealand.

Wheeler
I think if you look at, say, world trade volume growth—because world trade’s a huge catalyst for global output growth. So, world trade volume growth, if merchandise trade in the last 5 years has been the weakest since the early 1980s and, at the same time, you’ve had an increase in disputes going to the WTO—they’re currently the highest since the global financial crisis.

Now the early indicators, earlier this year, were that world trade growth might be starting to pick up. I’m looking at monthly data, but then the latest monthly data is saying that maybe that was a false storm, so we’ll need more information to see on that. So, it’s against that background that comments about trade policy and protectionism, perhaps in the US, is deeply worrying.

So, you can see that the US—as we know, immediately President Trump pulled out of the TPP. He’s going to renegotiate NAFTA. He seems to have struck a deal with the Canadians on lumber exports. He seems to be in the process of striking a deal with the Chinese on steel exports. He was talking to Angela Merkel about automobile exports from Germany into the US. So, he hasn’t called China a currency manipulator, but the point of the matter is that, you know, the global economy depends hugely on global trade, and it’s against this backdrop of weak trade and rising disputes that these sorts of comments are deeply worrying.

Hudson
I’ve got a question about the [Inaudible] developments: the outsourcing policy, the new policy in particular, the history of this particularly around banks, IT systems, and related contracts. My experience in the industry is that you’ve got some great uncertainty about whether the policy permitted or precluded banks from having core transaction processing systems
offshore, and, to the extent where one or two did—one then repatriated it and others didn't. I'm just wondering what it is in the new policy, what the changes are, that will help to address those interpretative issues and the uncertainties that go with it?

Spencer  The policy has never required systems or core systems to be in New Zealand as such; it’s only ever required systems to be under the control of the New Zealand sub and its board of management. So, over time—the original policy was in '06 and some of those requirements were not observed by the banks' system changes and some of those core systems became outsourced and effectively breached the original policy, partly because the policy was, I would say, not very clear. So we’ve tried to clarify the policy, but we want to enforce the policy as well, and we’re giving the banks 5 years to come back on board with it.

Hudson  Do you have feedback from the banks on the new policy as to whether they see it as more understandable—clearly understandable?

Spencer  I think they do see it as clearer now, but it doesn’t mean they are happy with it, because some of them will have to spend money to comply with that policy, and there’s certain debate over what that cost might be. But, you know, there’ll be different ways of observing the policy in terms of achieving that effective control over core systems and the backups.

Robertson  We will be a bit up against time because of going to the House, but have you done any stress testing in terms of the insurance industry and its ability to cope with another Christchurch-level natural disaster?

Spencer  We do, effectively, such exercises, and the solvency of the insurance companies has certainly improved over recent years and since the Christchurch earthquake, so they’ve replenished what that cost them, and added to their solvency buffers. Now in recent times, those have come off a little bit, but they’re still certainly strong relative to what they used to be.

Robertson  So you’ve got a degree of confidence in their ability to respond to another—

Spencer  Yes, yes we do.

Robertson  There’s not enough time now, but it might be good to get some of that data. I can take that up with you.

Chair  We’re pretty interested in that as committee. I think we’ll leave it there, ladies and gents.

Conclusion of evidence
Inquiry into captioning in New Zealand
Report of the Government Administration Committee

Fifty-first Parliament
(Hon Ruth Dyson, Chairperson)
August 2017

Presented to the House of Representatives
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Inquiry into captioning in New Zealand

Recommendation

The Government Administration Committee has carried out an inquiry into captioning in New Zealand and makes the following recommendations to the Government:

We recommend that the provision of captioning content be a requirement for NZ On Air and Film Commission funding.

We recommend that further progress be made in improving captioning access, including all platforms from broadcast to online content, and film screenings.

1 Introduction

We initiated this inquiry because New Zealand compares unfavourably with other countries in its levels of captioning for television content, DVDs, and movie screenings. We also received the petition of Louise Carroll seeking legislation to ensure accessibility via closed captioning. We sought to investigate issues relating to captioning, and to endeavour to enhance captioning in New Zealand. We see this as consistent with New Zealand’s obligations under the United Nations Convention on the Rights of Persons with Disabilities.

Terms of reference

We decided on the following terms of reference for the inquiry:

- international comparisons of captioning access
- issues around royalties and intellectual property
- legislation and regulation in terms of export of films (import to New Zealand)
- public education/attitude towards captioning
- responsibility for the provision of captioning (e.g. comparison with the Relay Service, an obligation under the Telecommunications provisions for Telecommunications companies to provide)
- requirements under existing legislation and regulation in relation to advertising
- potential for Captioning Watchdog (as in the United Kingdom)
- and any other related issues which may arise.

Captioning is the text version of speech and other sound that can be provided on television, DVDs, online videos, and at cinemas and theatres. For more information, see the “Definitions” section of this report.
The United Nations Convention on the Rights of Persons with Disabilities

The Convention is an international treaty that establishes obligations on States that are parties to it to promote, protect, and ensure the rights of persons with disabilities. It reaffirms that all people with any type of disability must enjoy all human rights and fundamental freedoms.

New Zealand ratified the Convention in 2008. Accordingly, New Zealand is obliged to apply the relevant tenets and principles.

Some parts of the Convention are particularly relevant to the provision of captioning in New Zealand. Notably, Article 9 requires that appropriate measures are in place to “enable people with disabilities to live independently and participate fully in all aspects of life”. Article 21 deals with freedom of expression and opinion, and access to information. It covers the rights of persons with disabilities to receive information in accessible formats and using different types of technology. It urges both private entities and the mass media to make their services accessible. Moreover, Article 30(1b) of the Convention reads:

States Parties recognise the right of persons with disabilities to take part on an equal basis with others in cultural life, and shall take all appropriate measures to ensure that people with disabilities enjoy access to television programmes, film, theatre, and other cultural activities in accessible formats.

Submitters discussed the importance of these articles being fully implemented. The Office of the Ombudsman specifically recommended that the Convention be taken into account, with the understanding that it advocates the participation of disabled people in all aspects of cultural life and recreational activities.

Definitions

Captions

Captions are similar to subtitles, but the text is in the same language as the spoken audio. Captions also include descriptive text for sound effects like “door slamming”, “gunshot fire”, or “silence”. Often in this report, we refer to “captions” or “captioning” generally.

Closed captions

Closed captions (CC) are turned on using a button on a television remote control, or by choosing an option on a phone, tablet, or computer.

Open captions

Open captions do not require switching on.

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2 Overview of current levels of captioning in New Zealand

No legislation in New Zealand requires broadcasters or video on demand providers to deliver captioning.

We heard from Able, which is New Zealand’s television captioning and audio description service. It is fully funded by NZ On Air. Able provides captioning services for Television New Zealand (TVNZ), MediaWorks, and Prime television. Able is only funded to provide captions for free-to-air television.

Able supplied us with figures for levels of captioning available on four New Zealand free-to-air channels. These figures represent both new and repeated content, and are an average across a 24-hour period. The figures are from the 2015/16 financial year, except for Prime. Captions were launched on Prime in February 2016, following investment in the equipment necessary to broadcast captions.

**Current levels of captioning (based on the 2015/16 financial year)**

<table>
<thead>
<tr>
<th>Channel</th>
<th>Percentage captioned</th>
</tr>
</thead>
<tbody>
<tr>
<td>TVNZ 1</td>
<td>56 percent</td>
</tr>
<tr>
<td>TVNZ 2</td>
<td>73 percent</td>
</tr>
<tr>
<td>Three</td>
<td>30 percent</td>
</tr>
<tr>
<td>Prime</td>
<td>9 percent</td>
</tr>
</tbody>
</table>

We are also aware that a small amount of repeat captioning is available on the channels Bravo and Duke.

Closed captioning is currently available on 28 Sky television channels (including channels 1, 2, 3 and Prime). We understand that many of Sky’s channels originate overseas, and therefore have captions on their original broadcast in those countries. These are commonly referred to as “pass through” channels, meaning that they are sent to New Zealand without any changes. This does not mean that the captions automatically pass through as well—there are technical requirements for this to happen. We were informed that for these channels, Sky has worked with international distributors to enable the captions to pass through with the programme content.

Sky noted that one of the major costs it incurred in captioning Prime was a significant fee charged by state-owned Kordia, to include the caption file in the broadcast fee. Sky absorbed the costs of implementing systems to enable captions on the pass-through channels on the Sky platform. However, it submitted that applying captions to other channels would involve significant investment in equipment to align caption files with

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3 NZ On Air is the working name for the Broadcasting Commission, which is publicly funded under an agreement with the Minister of Broadcasting.

4 “What is Closed Caption and which channels support it?” SkyTV, available at: [https://skytv.custhelp.com/app/answers/detail/a_id/1374/~/what-is-closed-caption-and-which-channels-support-it](https://skytv.custhelp.com/app/answers/detail/a_id/1374/~/what-is-closed-caption-and-which-channels-support-it)
video content. There would also be personnel costs associated with quality control and delivery, and costs for sourcing or creating captions.

Channels not currently captioned in New Zealand include Māori Television and Choice Television.

Parliament broadcasts have been captioned since 9 August 2016.

**News programming**

We heard from submitters that the only news programme with captions is One News. No news is captioned on any channel between 11pm and 12noon the following day, and programmes such as Breakfast and the Paul Henry Show are not captioned.

**Live captioning**

We were told that TVNZ is the only broadcaster that supports live captioning. This means that live programmes on any other channels are inaccessible to deaf or hard of hearing people unless aired as a repeat, with captions.

However, we are aware that the National Foundation for the Deaf underwrote $200,000 to enable captioning on Prime. This funding allowed All Blacks rugby tests to be accessible, and coverage of the 2016 Rio Olympics. Able said that thanks to the creation of new live captioning facilities for the latter project, it will be well equipped for live captioning in future.

**Television on demand and video on demand**

Major developments in the on-demand content area in recent years mean that options for screen entertainment have expanded significantly. Video and television content can now be accessed from any screen with an internet connection. These services are subscription-based or free (often free services are funded by advertisements).

According to Able, captioning is not available on TVNZ OnDemand or 3Now. This is due to technical incapability. Other New Zealand-based video on demand services such as NEON (a division of Sky) and Lightbox (Spark NZ) do not have captioning.

Netflix, an American entertainment company, offers captioning on all its content.

**How many people use captioning in New Zealand?**

According to NZ On Air research from 2016, one in six people (17 percent) used captioning while watching television in 2016. This has grown significantly from one in ten in 2014.5

The Captioning Working Group6 believes that more than 250,000 New Zealanders are likely to have hearing loss severe enough to need captioning. As well, it believes captions would make many more people’s viewing experience easier and more enjoyable.

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6 The Captioning Working Group is made up of Louise Carroll, Robyn Carter, David Kent, Chris Peters, Robert Hewison and Helen Mackay. For more information, see [https://www.captionitnz.co.nz/who-we-are/](https://www.captionitnz.co.nz/who-we-are/)
Evidence is limited about the prevalence of hearing loss in New Zealand. However, a recent Deloitte report states that “the prevalence of hearing loss was estimated to be 880,350 people in New Zealand in 2016, or 18.9 percent of all people”.

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3 Views of submitters

The need for increased captioning in New Zealand

Many of the submitters we heard from acknowledged that broadcast captioning has increased in recent years—albeit from a low base—and were pleased with developments such as the introduction of captioning on Prime. However, most of them believe that progress is not keeping pace with the rapid increase in video media options. For example, we were told that significant upgrades of TVNZ’s on-demand service, and Lightbox as launched, fail to provide any captioned accessibility. The Captioning Working Group believes that the “access gap” is increasing as more non-captioned services are offered online.

In Able’s opinion, it is becoming clear that broadcasters do not see commercial value in providing captioning. Its justification for this claim is that although broadcasters carry the costs associated with broadcasting the service, they do not currently pay for producing the captioning for their channels. For this reason, most submitters acknowledge that the approach of encouraging broadcasters to implement captioning has had some effect, but in order to achieve a significant increase in the captioning available in New Zealand, the following options need to be considered:

- the Government should strengthen the obligations on broadcasters and video on demand service providers to provide greater accessibility
- alternative sustainable funding sources must be found
- broadcasters must be made to carry some of the costs.

The majority of submitters believe that more captioning is needed if deaf and hard of hearing New Zealanders are to have the same access as all New Zealanders. Many submitters seek regulation of captioning to achieve this, with a goal of 100 percent captioning of broadcast content, including on-demand content.

Captioning in other areas

In addition to broadcast media, submitters listed many other areas in which they would like to see increased levels of captioning. They include:

- civil defence, emergency, and other public broadcasts
- the judicial process, to enable access and understanding for those involved, such as jury members, witnesses, and people facing charges
- prisons
- airports and transport centres
- all public spaces
- hospitals
- theatres and cinemas
- television advertisements
• the websites of Government departments and ministries
• Facebook and YouTube videos
• live election coverage
• educational facilities.

**Social effects associated with the lack of captioning**

We were concerned to hear that, without captions, many deaf and hard of hearing people feel isolated, marginalised, and unable to participate in conversations about news, current affairs, movies, or the latest television programmes. Many submitters said that they often misunderstand speech and dialogue on television, and have to rely on people around them to get important information.

A number of elderly submitters who are hard of hearing expressed frustration about their inability to be fully informed and involved in society due to a lack of captioning.

The New Zealand Human Rights Commission considers that captioning plays a vital role in supporting disabled people to participate fully in society.

**Impacts on children**

Several submissions from young people raised concerns such as feeling left out because many children’s shows (such as WhatNow) are not captioned. Additionally, they are unable to participate in school activities.

We also heard from Annabel MacKay and Louis Cheftel, both aged 10 years old, who are deaf and hearing impaired respectively. Both children came to speak to us about why they need captions, and why increasing captioning in New Zealand is important to them. Annabel and Louis told us that there are a number of shows that they would enjoy watching that are not captioned, including Hanging with Adam, Descendants Wicked World, Air Crash Investigation, and Mythbusters.

We acknowledge that children are missing out on social opportunities, and that this will have a lifelong impact.

**Acknowledgements**

We thank all of the submitters who contributed to our inquiry. We share their motivation for better access to broadcast, online, and other video content in New Zealand.
4 Responsibility for the provision of captioning in New Zealand

New Zealand broadcast media captioning funding model

Captioning for free-to-air broadcasters is provided by Able, a media access charitable trust that receives $2.8 million per year from NZ On Air for captioning and audio description services. NZ On Air and Able agree on minimum captioning requirements across channels and the prioritisation of certain kinds of content. Able also offers commercial captioning services. The Captioning Working Group commends Able for its high-capability, good-quality captioning and independent service delivery.

Instances where publicly funded New Zealand content is not captioned

The Government, through Vote Arts, Culture and Heritage, funds two agencies that in turn fund film and television content: NZ On Air and the New Zealand Film Commission. Currently, neither agency requires those it funds to include captioning as a condition of funding.

We were informed that the Film Commission also does not require captioning as a matter of course in the feature films that it invests in. Captioning tends to be on a case-by-case basis and is often related to distributor requirements and overall budget. The Film Commission has also pointed out some technical issues around the technology required to play captions in cinemas. We were told that captioning is available through specific screenings with open captions, or closed caption devices attached to a seat.

The Brokenwood Mysteries, a murder mystery series, is an example of New Zealand funded content that is inaccessible to deaf New Zealanders. We heard that this series is available online in the United States and Canadian markets with captioning. However, in New Zealand, despite having significant NZ On Air funding (over $4 million) it aired without captioning, and was not available online with captions either. A second example is Terry Teo, for which NZ On Air granted $1.3 million to Semi-Professional Pictures for six 30-minute programmes to be produced. These programmes went directly to TVNZ OnDemand, without captions.

Options for requiring publicly funded content to be captioned

We were informed about three options for regulation that could require captioning of publicly funded content.

The first option would be to amend the Broadcasting Act 1989 and the New Zealand Film Commission Act 1978 to require that captioning be a condition of funding for film and television. The funding criteria would then be updated to reflect this.

This approach would ensure that captions were created for publicly funded content, but distributors might still choose not to use those captions, or might not have the technical capacity to do so. Furthermore, funding agencies might be expected to increase the funding provided to content creators to help with the cost of creating captions. TVNZ expressed concern in its submission that if funding for captioning was not provided as a top-up to
NZ On Air’s current resources, funds would be diverted away from the funding of local content.

A second option would be to amend the Broadcasting Act 1989 to require content distributors to caption publicly funded content. This would place more responsibility on the distributor to ensure that the captions are not only created, but used. If the regulatory requirements introduced were unique to publicly funded content, the associated extra costs and technological capability might be a disincentive for distributors to acquire this content. This could be partly addressed if regulations were developed with the aim of achieving an overall increase in captioning availability rather than specifically targeted for publicly funded content.

Option three would be to provide Able with additional funding to caption all publicly funded content. This funding would be in addition to current NZ On Air funding provided to Able. To date, broadcasters have been responsible for any investments needed to allow their platform to broadcast captions. Able’s funding is specifically for creating captions and audio description.

**Cost for 100 percent captioning of free-to-air television**

Able gave us information about costings for the additional budget that would be needed for increased captioning for New Zealand free-to-air television.

Able stated that the cost to increase captioning coverage to 100 percent across TVNZ 1, TVNZ 2, Three and Prime is approximately $6 million a year. This is in addition to the $2.8 million it receives annually from NZ On Air for its services. It also told us that the cost to provide 100 percent captioning for any channel not currently captioned is approximately $3.5 million per year, per channel.

Able added that:

- these costs are estimates only
- it would expect costs to reduce by 25 percent in subsequent years
- these costs do not include capital expenditure: approximately $100,000 would be needed to establish live links between Able and broadcasters
- these costs take into account infomercials, but not regular television commercials
- these estimates do not include a commercial mark-up
- as automated captioning technology improves, costs will continue to reduce, but this is unlikely in the first five years.

**Legislation requiring captioning**

Internationally, a common captioning funding model is that broadcasters are legally required to fund the delivery of broadcast media. Broadcasters ensure the provision of free-to-air and commercial television programmes, movies, videos, live and pre-recorded sports, and other events, through their profits.

The Captioning Working Group believes that non-taxpayer funded captioning is feasible in New Zealand and could become an integrated expense, absorbed by advertisers and broadcasters. The Captioning Working Group notes that there are clearly defined exemptions to captioning requirements in models such as that of the United Kingdom.
We also heard proposals similar to those used in some overseas models, involving the setting of captioning targets. For example, the Office of the Ombudsman recommended that legislation require all news and current affairs programmes to be captioned by January 2018. In addition, an increasing annual target would be imposed on other programmes to achieve a goal of 80 percent of all programmes captioned by 2020. Overseas jurisdictions often set targets with timeframes of between 5 and 10 years, allowing enough time for broadcasters to scale up their captioning services and absorb implementation costs incrementally.

As an alternative, Able is of the view that it would be reasonable to consider a mix of NZ On Air funding and broadcaster-funded services because New Zealand is a small market.
5 International comparisons of captioning access

Australia

Legislation requiring captioning

On 20 March 2015, the Broadcasting and Other Legislation Amendment (Deregulation) Bill 2015 was enacted and amendments to captioning provisions in the Broadcasting Services Act 1992 came into effect.

Regulation authority

The Australian Communications and Media Authority (ACMA) regulates television captioning in Australia. Captions must comply with requirements set out in legislation, industry codes of practice and the television captioning quality standard.

Degree of captioning on main channels

Free-to-air television broadcasters must caption all content from 6am to midnight. All news and current affairs programmes broadcast on their main channels must be captioned.

Subscription television licensees have annual targets for the proportion of programmes that must be captioned. These targets increase yearly until they reach 100 percent in a 24-hour period.

Both free-to-air and subscription television broadcasters are obliged to caption repeat programmes.

Exemptions to captioning requirements

Non-English programming, music-only programming, and community broadcasters are exempt. New subscription television services are exempt from the annual captioning targets for one or two years depending on the commencement date of services.

Subscription television licensees may also apply to the ACMA for particular services to be exempt.

Emergency warnings

If a broadcaster or subscription television licensee transmits an emergency warning at the request of an emergency service agency on any of its television broadcasting services, the broadcaster must transmit the whole emergency warning in text and speech, and caption the warning where practical.

Annual reporting and record-keeping requirements

National and commercial television broadcasters must give annual compliance reports to the ACMA.

Breaches

Provision is made for certain captioning breaches to be disregarded if they were caused by significant, unforeseen technical or engineering difficulties.
Television Captioning Quality Standard

The Broadcasting Services (Television Captioning) Standard 2013 requires broadcasters to ensure that captions are readable, comprehensive, and accurate, so that they are meaningful to viewers.

Video on demand

There is no legislative requirement for video on demand services to be captioned. Media Access reports that captions are available on three catch-up television services: ABC’s iview, SBS on demand, and Plus7. Also, the on-demand platforms iTunes and Foxtel caption a substantial amount of content.

United Kingdom

Legislation

Under the Communications Act 2003, television broadcasters are required to deliver a certain proportion of their programmes with subtitles, signing, and audio description to ensure that people with hearing or visual impairments can understand and enjoy television programmes. It also requires Ofcom (the UK media and communications regulator) to review the Television Services Code relating to provision for the deaf and visually impaired.

Regulation authority

Ofcom is required to set 10 year targets for captioning. By a broadcaster’s tenth year of service, it must caption 80 percent of its content. Ofcom reports on the provision of television access services by broadcasters twice a year.

Degree of captioning on main channels

In 2016, 83 domestic channels were required to provide broadcast access. This accounts for more than 90 percent of the audience share for UK television.

Exemptions to captioning requirements

In deciding which programmes and services to exclude, Ofcom may consider: the extent of the benefit, the size of the intended audience, the technical difficulty of providing the assistance, and the cost.

Video on demand

The Digital Economy Act, passed in April 2017, will extend captioning requirements to on-demand content.

United States of America

Legislation

The Americans with Disabilities Act 1990 requires places of public accommodation (such as state offices, libraries, theatres, museums, education facilities, hotels, hospitals, restaurants, shops, train stations, and airports) to display all video with captions.

The Twenty First Century Communications and Video Accessibility Act 2010 requires all online video previously aired on US television to be closed captioned. It also extended captioning requirements to television programmes delivered over the internet, and reinstated requirements for audio description. However, this applies only to content that is distributed on the internet, not online-only content.
**Regulation Authority**

The Federal Communications Commission (FCC) regulates interstate and international communication via television, radio, and internet. The FCC sets strict guidelines for closed captioning television programmes and live broadcasts, with specific standards for caption accuracy, timing, and placement.

The FCC rules apply to all television programming with captions, requiring that captions are accurate, synchronous, complete, and properly placed. The rules recognise the greater difficulty in live captioning as opposed to captioning of pre-recorded content.

**Degree of captioning on main channels**

All content from 6am to 2am must be captioned.

**Exemptions to captioning requirements**

There are two categories of exemptions from the closed captioning rules: self-implementing and economically burdensome. Some examples are non-English programming, programming that is already mostly text, and public service announcements.

Channels are also exempt from captioning where costs exceed 2 percent of gross revenue for the year, or where the channel produces revenues of less than $3 million. New networks are exempt for four years after operations begin.

**Summary**

We note that in some overseas cases, legislation requiring captioning sets out a general intent to make content more accessible to deaf and hard of hearing people, and appoints a communications regulatory body to set specific regulations and targets. In many jurisdictions, captioning goals are set for specific time periods, such as 5 to 10 years. This allows broadcasters to scale up their captioning services and absorb implementation costs incrementally.

It is difficult to obtain information about the implementation costs of captioning in these overseas models, as it is the broadcaster’s responsibility.

**Potential need for captioning watchdog**

As we have discussed, many jurisdictions have a monitoring agency to oversee caption quality and standards, commonly referred to as a “captioning watchdog”. Problems commonly arising include:

- grammatical mistakes
- time delays or “lag” between audio and caption display
- time delays between the visual and caption display
- awkward placement of captions on the screen (e.g. covering actors’ faces or mouths)
- miscuing
- captions that are difficult to read due to font or colour.

Many submitters mentioned the captioning watchdogs in international jurisdictions, and believed it would be valuable to establish a similar agency in New Zealand. It was suggested that a captioning watchdog could be appointed alongside the current New Zealand relay service. This is a national relay service for the New Zealand Deaf, deaf-blind, hearing
impaired and speech impaired communities. A model particularly favoured by submitters is that of Ofcom in the United Kingdom, which applies the watchdog role to the Broadcasting Act.

Submitters also commented that a captioning watchdog is important in ensuring that captioning keeps pace with new technology, including online platforms.

In its submission, The Captioning Working Group noted two examples of inconsistent accessibility measures. The first is typed transcripts being used in place of video captioning. The second is the absence of captioning as a means of facilitating communication at a public meeting. The Captioning Working Group feel that these examples reinforce the need for a captioning watchdog in New Zealand.
6 Intellectual property issues with imported films and television content

Purchased files

One of Able’s methods for captioning television content is to purchase a file of the text. Able acknowledges that this can raise questions about the intellectual property and ownership of captioning.

Able said that it sources caption files for internationally produced programming from the original production company. Purchasing a caption file and obtaining the rights to broadcast it in New Zealand costs approximately $300 per television hour. Able must then edit the caption file to match the video content supplied by the New Zealand broadcaster. We were told that this process is more efficient than creating captions from scratch.

We heard that people often believe, incorrectly, that captions “come with” a programme. They think that if a programme is broadcast with captions in its country of origin, it will also have captions in New Zealand. Generally, the rights must be purchased separately from the original captioning production company, because they were produced independently of the distributor or producer. Able buys and sells caption files with many captioning companies worldwide, which is common practice.

The Captioning Working Group understands that visual and captioning files of movies and programmes are separated when sold to international markets. This means that royalties are payable on both files.
7 Captioning of advertising

Several submitters noted the lack of captioned advertising in New Zealand. We heard concerns that deaf or hard of hearing people are often late to learn of new products and services. They can also miss out on information conveyed in important public service announcements.

A prime example of this was given by the Captioning Working Group. In 2007, a television advertising campaign was broadcast asking for people to advise their power company if a family member was dependent on life-preserving technology, powered by electricity. This message was not originally captioned. Similarly, serious consequences might arise if advertisements such as those promoting health screening programmes are not captioned.

The Captioning Working Group also pointed out that advertisements and marketing may not reach the deaf and hard of hearing population. It explained that advertisers should have an incentive to extend their audience reach. This, in turn, could help broadcasters to recover some costs. We also heard from other submitters that deaf and hard of hearing people need access to be able to make informed choices as consumers.

Able told us that it provides captioning for television commercials broadcast on TVNZ 1, TVNZ 2 and Three. Advertisers are charged $200 plus GST per commercial for this service, which is not covered under the NZ On Air funding that Able receives. Viewers indicated they were particularly interested in public service commercials from government advertisers. Able said there is currently nothing to require government advertisers to provide captioning on their commercials. We also heard that local councils and local government would benefit from captioning video content that is posted online or broadcast on television.

We were told that commercials are often only captioned as a result of an advertiser receiving a complaint.
Public education and attitudes towards captioning

Lack of captioning of movies
We were told that cinema captioning is available in major New Zealand cities for a small number of movies via special one-off screenings of open-captioned films or via the Captiview system, used by Hoyts cinemas.

Able said that New Zealand-produced films are often captioned when the film is sold to overseas markets or shown at international film festivals, because this is a requirement. However, this often happens only after a film has been released in New Zealand, or New Zealand cinemas do not have the capacity to enable the captions.

Hunt for the Wilderpeople is an example of a successful, recent New Zealand film that was distributed in New Zealand without captions.

Closed captioning allows the choice of turning captions on or off. As awareness grows as to why captions are needed and how they operate, there will be more widespread acceptance. Submitters expressed the importance of New Zealand films having a caption file available on release, so that there is access available to captions at an open screening or on a closed captions device.

Benefits of universal design
The Disabled Persons’ Assembly NZ told us about the benefits of universal design in relation to captioning. The concept of universal design is that things should be usable to as many people as possible, regardless of their age, ability, or status in life.

Other users of captioning
Older people can use captions to compensate for age-related hearing loss. According to a recent study, the number of New Zealanders aged 70 years and older suffering from hearing loss is expected to double in the next 50 years.8

People for whom English is not a first language can use captions to keep up with the speed of dialogue and to help understand accents. It is significant that a study on viewership indicated that Asian New Zealanders are 37 percent more likely than the general population to use captioning when watching television.9

Lastly, research in 2006 by the UK’s Ofcom found that about 7.5 million people had used subtitles while watching television, but only 1.5 million of them identified as deaf or hard of hearing. This indicates that a large proportion of people are using subtitles for various reasons.

8 http://www.hear-it.org/new-zealand-number-seniors-hearing-loss-expected-double
Literacy support

Captioning may assist children in reading comprehension when they are learning to read, a point raised by several submitters. The Captioning Working Group highlighted two articles that discuss the positive associations of closed captions or subtitles with reading and literacy rates.

Representatives from the van Asch Deaf Education Centre told us that many deaf and hard of hearing students miss out on incidental learning gained through overhearing. Captions allow these students to participate more fully in the school learning environment and community. The centre’s submission detailed the educational benefits of captioning that it has seen in practice.

We were told that captioning can also support students with some types of developmental and cognitive delays.
9 Captioning of online content

Increasingly, content is moving to online platforms. We discussed issues involving the captioning of online content at length during our inquiry. The Disabled Persons Association considers that this is an important area for focus, predicting that, by 2020, people will view about 80 percent of content online. This reiterates the substantial increase in the “access gap”.

New Zealand-based online platforms include Lightbox, Quickflix, WatchMe, SkyGo, TVNZ OnDemand and 3Now (MediaWorks’ online platform). As noted, none currently provides captions. There is no requirement for online video content to be captioned in New Zealand.

We heard from Able that TVNZ OnDemand and 3Now offer several programmes that have broadcast on television with captions. We asked Able to explain its approach to captioning for these particular platforms. It said that it is willing to absorb the costs of reformatting the captions that were originally created for television. It believes that this would maximise the initial investment in producing the captions.

Sky and TVNZ explained that a major challenge of captioning online content is that there are different requirements for different devices because of variations in screen resolution and dimensions. Similarly, specifications may need to be adjusted to cater to a range of internet speeds. It is clear that the primary barrier is the capital cost to acquire the technical capability to provide captions online.

TVNZ is of the view that, in a market where advertising revenue is declining, it is not commercially viable to support this extension to its services. It is prepared to extend captioning to its OnDemand service where:

- extension is to suitable devices
- funding is available for the technology required
- captions already exist for the programme (that is, not all programmes will necessarily be captioned)
- adding captions does not create undue complexity or add ongoing maintenance costs to technology supporting online services.

We heard that NZ On Air granted $1.3 million for the production of the children’s drama programme “Terry Teo”. A number of submitters expressed their disappointment to us that these episodes did not screen on television, and instead were only shown on TVNZ OnDemand. This denied access for deaf and hard of hearing young New Zealanders.
10 Other related matters

Audio description

The scope of our inquiry is broad, and we agree with the Association of Blind Citizens of New Zealand that it is also important to consider the related matter of audio description. Able mentioned that, internationally, it is common for audio description to feature in the same “media accessibility” legislation as captioning.

Audio description is a commentary on visual activities that occur on screen. For the blind, deaf-blind, vision impaired, and people with low vision, it is equivalent to captioning for the deaf and hard of hearing. The audio information is provided through an alternative channel, so it does not interfere with standard television listening and viewing.

Audio description commenced in New Zealand in 2011, and has since increased from 2 hours a week to more than 40. However, it is only available on two channels (TVNZ 1 and TVNZ 2).

Blind Citizens of NZ considers that the current availability of audio description does not meet the diverse needs of blind viewers. Among other recommendations, it suggests that films and DVDs produced in New Zealand should be audio described. Additionally, cinemas should screen movies with audio description, as the necessary technology exists. Blind Citizens of NZ also proposes that Freeview and other broadcasters adopt a common way to identify that a programme has accompanying audio description. These are just a few measures that would help to better meet the needs of blind and vision impaired people.

Able told us that the audio description service that it provides has been developing slowly and steadily, but that it now struggles to meet the growing demand. We were pleased to hear that New Zealand’s blind viewers praise the quality of audio-described content produced by Able.

Both Able and Blind Citizens of NZ think that the current funding approach must be reviewed to achieve higher rates of audio description in New Zealand.

Captioning during civil defence emergencies

Some submitters expressed concern about the inconsistent captioning of broadcast media during civil defence emergencies. The Captioning Working Group believes this needs to be addressed urgently, because it is a safety matter. However, it praised the New Zealand Police for introducing “111 TXT”—an emergency text message service that people with hearing or speech difficulties can register to use.

Able provided some clarification about agreements in place for civil defence emergencies. Able provides live captioning for TVNZ’s news bulletins. It does not caption MediaWorks or Prime bulletins, because they are not functionally supported to provide live captioning, nor is Able funded to provide it. Able does not receive funding or compensation for captioning civil defence messages and coverage. Able said that it understands the importance of captioning during civil defence events so it provides captioning in those circumstances wherever possible. However, it believes that a collaborative approach is needed to ensure that responsibility is shared among the relevant parties.
Petition 2014/63 of Louise Carroll

We received a petition from Louise Carroll on behalf of the New Zealand Captioning Working Group. It requests:

That the House note that 2,370 people signed an online petition calling to legislate to ensure accessibility via closed captioning for Deaf, Hard of Hearing and other New Zealanders who need it, to access all broadcast, online and video mediums.

The petition was referred to us on 19 May 2016, and we initiated this inquiry on 1 June 2016. We agreed with the petitioner that the issues raised by her petition would be considered as part of our inquiry.

Party views

National Party members of the committee would prefer improvement of captioning access to be made by encouragement and policy change. Whereas, Labour Party and Green Party members of the committee believe that a legislative approach to improving captioning access in New Zealand is now required.
Appendix

Committee procedure
We met between 1 June 2016 and 9 August 2017 to consider the inquiry. We called for public submissions with a closing date of 28 July 2016. We received submissions from 92 organisations and individuals, and heard oral evidence from 25 submitters. We heard evidence in Auckland and Wellington. The documents that we received as advice and evidence for this inquiry are available on the Parliament website, www.parliament.nz.

Committee members
Hon Ruth Dyson (Chairperson)
Paul Foster-Bell (Deputy Chairperson)
Barry Coates
Matt Doocy
Hon Nanaia Mahuta
Hon Scott Simpson

Mojo Mathers replaced Barry Coates for this item of business.
Clare Curran and Poto Williams participated in some consideration of this item of business.
Petition 2014/18 of Hon Maryan Street and 8,974 others

Report of the Health Committee

Fifty-first Parliament
Simon O'Connor, Chairperson
August 2017

Presented to the House of Representatives
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1 Introduction

Recommendation

The Health Committee has considered Petition 2014/18 of Hon Maryan Street and 8,974 others and recommends that the House take note of its report.

This report gives us the opportunity to summarise, for the benefit of the House and the public, what we heard and considered during our review of more than 21,000 submissions from the petitioner and others. This issue is clearly very complicated, very divisive, and extremely contentious. We therefore encourage everyone with an interest in the subject to read the report in full, and to draw their own conclusions based on the evidence presented in it.

Background

On 23 June 2015, we received Petition 2014/18 of Hon Maryan Street and 8,974 others requesting:

That the House of Representatives investigate fully public attitudes towards the introduction of legislation which would permit medically-assisted dying in the event of a terminal illness or an irreversible condition which makes life unbearable.

The petitioner, Hon Maryan Street, was a member of Parliament between 2005 and 2014. While a member, she sought to introduce the End of Life Options Bill as a member’s bill.1 The purpose of this bill was to provide individuals with a choice about how they end their life and allow them to receive assistance from a medical practitioner to die under certain circumstances. The petition originated with the Voluntary Euthanasia Society of New Zealand (VES) before being adopted formally by Hon Maryan Street. Since leaving Parliament, Ms Street has become the President of VES.

There have been two first reading debates in Parliament on similar bills. Both were unsuccessful. In 1995, members voted 61 to 29 against Michael Laws’ Death with Dignity Bill. In 2003, members voted 60 to 58 against Peter Brown’s Death with Dignity Bill.

The petitioner’s bill was formally removed from the members’ bill ballot in December 2014.

Submission process and terms of reference

To fully investigate public attitudes, we agreed to seek submissions from the public. Submissions were open between 27 August 2015 and 1 February 2016. The long submission period allowed time for anyone with an interest in the subject, in New Zealand or overseas, to make a submission.

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1 Members’ bills are introduced by members who are not Ministers. There must be at least eight members’ bills awaiting first reading on the Order Paper each Members’ Day (every second Wednesday). Members’ bills are drawn by ballot. Members enter bills in the ballot by lodging notices of proposal with the Table Office and providing a copy of the proposed bill. Further information is available at https://www.parliament.nz/en/pb/bills-and-laws/proposed-members-bills/
To help our consideration of the petition, we formulated our own terms of reference. The terms of reference for considering the petition were:

The petition asks for a change to existing law. Therefore the committee will undertake an investigation into ending one’s life in New Zealand. In order to fully understand public attitudes the committee will consider all the various aspects of the issue, including the social, legal, medical, cultural, financial, ethical, and philosophical implications. The committee will investigate:

1. The factors that contribute to the desire to end one’s life.
2. The effectiveness of services and support available to those who desire to end their own lives.
3. The attitudes of New Zealanders towards the ending of one’s life and the current legal situation.
4. International experiences.

The committee will seek to hear from all interested groups and individuals.

We received more than 21,000 unique written submissions from individuals and organisations. Copies of these submissions can be found on the Parliament website www.parliament.nz.

We heard from the petitioner on 14 October 2015.

We agreed to hear from the more than 1,800 submitters who had initially indicated that they wished to appear before the committee. These submitters were invited to meetings in Wellington, Christchurch, and Auckland. Submitters who were unable to make it to these locations were heard by teleconference. A number of submitters were not available for a variety of reasons, often due to scheduling conflicts, and some submitters declined to appear once invited. We eventually heard from 944 submitters over 108 hours of hearings. We began hearing from submitters on 24 August 2016 and concluded our oral hearings on 5 April 2017.

Structure of this report

We have structured the chapters of our report in the following way:

- An overview of what New Zealand’s legislation does and does not allow in relation to assisted dying.
- The petitioner’s submission.
- Attitudes to assisted dying raised by submitters during the submission process.
- An overview of legislation in international jurisdictions that allow assisted dying and/or euthanasia.
- Information about jurisdictions that have voted against euthanasia in recent years.
- Individual chapters about health professionals and assisted dying, proposed safeguards, palliative care, and suicide. These matters were raised by submitters throughout the submission process. We have given them separate chapters because these topics covered several issues.
- Our concluding remarks.
Petition vs legislation

Because of the amount of public attention around the issue, there was a need to differentiate this process from a separate process which was David Seymour of the ACT Party’s End of Life Choice Bill. This bill was entered into the ballot in October 2015 and was drawn from the ballot on 8 June 2017. At the time of this report, the bill had not had its first reading. We were therefore not considering any legislation throughout this process.

Terms used in this report

Submitters held different views on the language used for the subject of assisted dying. Throughout this report, we have used the terms that the petitioner used in her submission.

**Assisted dying** refers to a patient receiving lethal drugs at their request, which they take by themselves.

**Euthanasia** refers to a patient being administered a lethal drug. This can be voluntary or involuntary.

Submitters used a variety of terms. They included suicide; assisted suicide; euthanasia; voluntary euthanasia; physician-assisted suicide; medically assisted dying; and medical aid in dying.

As can be seen, there was a wide range of terms used within this debate—from the technical to the colloquial. Medical professionals, lawyers, and ethicists preferred the technical terms such as physician-assisted suicide and euthanasia.

The public’s terminology was much more varied. This frequently depended on the submitter’s position. Submitters wanting a law change used terms such as medically assisted dying. Those opposed tended to use the technical terms including suicide, assisted suicide, and euthanasia.

We noted that palliative care professionals were very reluctant to use terms such as “assisted dying” because they view their current work as already assisting people to die without it being euthanasia or physician-assisted suicide. For those arguing for euthanasia, there was concern around the use of the technical terms of suicide and assisted suicide because they did not consider the actions equivalent.
2 What does New Zealand legislation allow?

What is not considered euthanasia or assisted dying?

There is general consensus that it is ethically and legally permissible to withdraw treatment at a patient’s request or because treatment is not working. This is not euthanasia and section 11 of the New Zealand Bill of Rights Act 1990 provides that everyone has the right to refuse to undergo any medical treatment.

Some submitters believe that euthanasia is commonly practised in New Zealand. This stems from the idea that dying patients are given increased amounts of morphine, which results in their deaths. However, we heard from palliative care physicians and the New Zealand Medical Association (NZMA) that this view is inaccurate. They said that opioids delivered in the appropriate concentration are unlikely to hasten a patient’s death. Doses of opioids may increase over time as needed by the patient to manage pain.

It was acknowledged that opioids could have the side effect of hastening death. This is because opioids are powerful drugs, which have risks like any other medicine. However, there is an important distinction between giving pain relief that may shorten a person’s life and deliberately causing death.

Advance directives

An advance directive is a written or oral directive by which a person makes choices about future health care procedures. The Code of Health and Disability Services Consumers’ Rights allows health consumers to use an advance directive.

Advance directives give individuals the chance to state what they would like to happen if their mental capacity becomes impaired. They are used when a person is no longer mentally competent, is unconscious, or is no longer able to communicate.

Individuals cannot ask for anything in an advance directive that they cannot ask for while conscious or mentally competent. This means that patients cannot request euthanasia or assisted dying in an advance directive.

Crimes Act 1961

It is an offence under section 179 of the Crimes Act (Aiding or abetting suicide) for a person to incite, counsel, or procure any person to commit suicide, if that person commits or attempts to commit suicide as a result, or to aid or abet any person in the commission of suicide. Any person convicted of this offence is liable to a prison term not exceeding 14 years.

Section 63 of the Crimes Act (Consent to death) provides that a person cannot consent to have death inflicted upon themselves. If a person is killed, their consent shall not affect the criminal responsibility of any person who was party to the killing.

Section 160(2)(a) of the Crimes Act (Culpable homicide) states that homicide is culpable when it consists in the killing of any person by an unlawful act. Section 160(3) states that culpable homicide is either murder or manslaughter.
Section 164 (Acceleration of death) provides

that everyone who by an act of omission causes the death of another person kills that person, although the effect of the bodily injury caused to that person was merely to hasten his death while labouring under some disorder or disease arising from some other cause.

The Crimes Act 1961 repealed the previous offence of attempting suicide. However, the offence had been largely superseded by changes in practice formalised by the Health Amendment Act 1960. This Act provided for courts to refer attempted suicides to treatment services.

**Prosecutions for assisted dying under the Crimes Act**

There have been several high profile cases in New Zealand involving prosecutions for assisted dying and euthanasia. The current law provides for the investigation of these incidents and permits discretion in sentencing. In 2004, Lesley Martin, a former intensive care nurse, was convicted of attempting to murder her mother, Joy Martin. This was done by administering a 60 milligram dose of morphine in 1999. She was released from prison in December 2004 after serving half her 15 month term.

In 2011 Sean Davison was convicted for assisting his 85 year old mother, Pat Davison, to end her life. His mother, who was terminally ill with cancer, was on her 33rd day of a hunger strike. Mr Davison was sentenced to five months’ home detention.

In 2012, Evan James Mott was discharged without conviction. He had pleaded guilty to assisting his wife, Rosemary Mott, to commit suicide. Ms Mott was in pain, losing the ability to walk and take care of herself, hated the perceived indignity of her condition, and made the decision to end her life.

**Seales v Attorney-General [2015] NZHC 1239**

In 2015, a 42 year old Wellington woman, Lecretia Seales, sought declarations that sections 179 and 160 of the Crimes Act (the offence provisions) were inconsistent with sections 8 and 9 of the Bill of Rights Act.

Section 8 (Right not to be deprived of life) states that no one shall be deprived of life, except on such grounds as are established by law and are consistent with the principles of fundamental justice. Section 9 (Right not to be subjected to torture or cruel treatment) states that everyone has the right not to be subjected to torture or to cruel, degrading, or disproportionately severe treatment, or punishment.

Ms Seales was dying from a brain tumour and wanted the legal ability to end her life. Her doctor was willing to administer or provide a lethal drug to Ms Seales to enable her to end her life by herself. However, her doctor was unwilling to do so unless she could be assured that she was not breaching either:

- section 160(2)(a) and (3) (Culpable homicide) of the Crimes Act, if she administered medication to Ms Seales that caused her death, or
- section 179(b) (Aiding and abetting suicide) of the Crimes Act, by giving Ms Seales medication that Ms Seales could take to cause her own death.

Justice Collins did not issue the requested declarations. This was because the changes to the law sought by Ms Seales could only be made by Parliament. Justice Collins stated, “I would be trespassing on the role of Parliament and departing from the constitutional role of
Judges in New Zealand if I were to issue the criminal law declarations sought by Ms Seales’.

In his judgment, Justice Collins analysed the offence provisions of the Crimes Act. These were:

- section 160(2)(a) (Culpable homicide)
- section 179(b) (Aiding and abetting suicide)
- section 63 (Consent to death)
- section 164 (Acceleration of death).

Justice Collins concluded that:

- Ms Seales’ consent would not provide a lawful excuse to Ms Seales’ doctor if she administered aid in dying to Ms Seales (Section 63 of the Crimes Act).
- If Ms Seales’ doctor were to administer a lethal dose of pain relief to Ms Seales, this may not be an unlawful act within the meaning of Section 160(2)(a) of the Crimes Act if the doctor intended to provide Ms Seales with palliative relief. This would be on the condition that what was done was reasonable and proper for that purpose even though Ms Seales’ life would be shortened as an indirect but foreseeable consequence (Section 164 of the Crimes Act).
- If Ms Seales’ doctor were to administer a fatal drug to Ms Seales with the intention of terminating her life, two offences may be committed. By administering a lethal drug, Ms Seales’ doctor would intentionally apply force to Ms Seales by the lethal drug being inserted into Ms Seales or through the pharmacological effects of the lethal drug on Ms Seales’ body. This could be considered committing an assault, which is an offence under Section 196 of the Crimes Act. In this circumstance, Ms Seales’ doctor would also likely have breached Section 200 of the Crimes Act. This makes it an offence to administer a poison or other noxious substance to another person intending to cause him or her grievous bodily harm (Section 160(2)(a) and (3) of the Crimes Act).
- Ms Seales would die by suicide if she took a fatal drug supplied to her by her doctor and died from that drug. This was because Ms Seales would intend to bring about her own death, would be acting voluntarily, not altruistically or subject to coercion, and the immediate cause of her death would be the fatal drug, not natural causes. Therefore Ms Seales’ doctor would be exposed to prosecution under Section 179 of the Crimes Act if she supplied Ms Seales with a fatal drug knowing that Ms Seales would use that drug to take her own life, and Ms Seales did so.

Ms Seales then asked for a declaration that sections 160 and 179 of the Crimes Act interfered with section 8 of the Bill of Rights Act. Ms Seales believed that the offence provisions in the Crimes Act, under which her doctor could be charged, meant that she would be forced to take her own life prematurely before her condition deteriorated to the extent that she was no longer able to do so.

Justice Collins’ starting point was that section 8 of the Bill of Rights Act does not guarantee that a State will never deprive a person of life. A State will do so only on grounds established by law and where it is consistent with principles of fundamental justice.
Justice Collins found that the offence provisions in the Crimes Act constituted grounds established by law because they were enacted by Parliament.

Justice Collins found that the phrase “consistent with the principles of fundamental justice” had not been determined in New Zealand. Therefore, he relied on Canadian case law, which identified the following three tests in considering whether the principles of fundamental justice were breached:

- The law must not be arbitrary (there must be a rational connection between the objective and the law).
- The law must not be overly broad (it must not go further than necessary to achieve the objective).
- The impact of the law on an individual’s life must not be grossly disproportionate to the relevant objective (protection of human life).

Justice Collins ruled that the offence provisions were not arbitrary, overly broad, or grossly disproportionate to the relevant objective.

Ms Seales also argued that her right under section 9 of the Bill of Rights Act was engaged—not subjecting her to torture or cruel treatment—because:

- Her suffering was preventable.
- The State (through the offence provisions) was depriving her of an opportunity to end her suffering.

To reach his decision, Justice Collins reviewed Canadian and United Kingdom case law which dealt with similar arguments. He concluded that Ms Seales’ right under section 9 of the Bill of Rights Act was not engaged because:

- Ms Seales’ distressing circumstances were a direct consequence of her tumour, not her treatment.
- Ms Seales’ treatment was designed to alleviate, to the extent that it was possible, the worst effects of her tumour.
- The State’s obligation under section 9 of the Bill of Rights Act was a positive obligation. That positive obligation was not engaged when the criminal law prevents culpable homicide.
3 Submission from the petitioner

The petition originated from the Voluntary Euthanasia Society of New Zealand but was subsequently adopted in the name of Hon Maryan Street and supported by the Voluntary Euthanasia Society of New Zealand. The petitioner told us that the petition was worded to encourage us to consider more than our own views about the subject and to investigate how New Zealanders, regardless of their background, feel about the right to determine their own end-of-life choices.

Factors contributing to a desire to end one’s life

In her work as an MP the petitioner stated that she regularly spoke about physician-assisted dying to audiences of 300 to 400 in urban settings and between 50 and 150 in provincial and rural settings. These audiences often consisted of older people.

The petitioner told us that the primary reason people she spoke to gave for supporting assisted dying is a desire for autonomy. Having considered themselves autonomous, self-determining adults throughout their life, supporters believe that they should continue to be autonomous, self-determining adults at the end. The petitioner supports physician-assisted dying when a mentally competent person has one, or both, of the following:

- a terminal illness which is likely to end their life within the next six months
- constant and unbearable physical or psychological suffering which cannot be relieved in a manner that the patient deems tolerable.

The petitioner believes that a mentally competent person should be allowed to make an end of life directive to carry out their wishes should they subsequently become mentally incompetent. End of life directives would be refreshed every five years and could be cancelled or changed at any time. A person registering an end of life directive could appoint one or more persons to advocate for them, should they become mentally incompetent.

The petitioner stated that supporters of assisted dying also cite the fear of dementia and attempting to take their own life unsuccessfully as reasons for their views. The petitioner does not believe that these people are suicidal in the clinically understood use of the word, or suffering from depression that can be treated.

The petitioner told us that these people have decided that they wish to die before they become a different person in the eyes of themselves or their loved ones, or become violent, unpredictable, or a danger to themselves because of dementia. These people wish to die free from pain, surrounded by their loved ones, and without their loved ones breaking any law by assisting them in their death.

Safeguards

The petitioner stressed that safeguards are essential in any assisted-dying legislation. Suggested safeguards include that an individual:

- is a New Zealand resident or citizen
- is aged 18 years or over
• has had two medical practitioners assess that they are mentally competent to decide to end their life and that they fully understand the implications of the decision
• has not been coerced
• has been given 7 days to reflect before taking any drug that will end their life
• has been offered, but not compelled, to have counselling
• has been encouraged, but not compelled, to talk with their family and loved ones
• has not had another person prevent their explicit end-of-life wishes.

Effect of assisted dying on suicide rates
The petitioner told us that people are often concerned that assisted-dying legislation will encourage suicide by others who do not meet the criteria for assisted dying. She noted that people claim that rates of youth suicide in Oregon, where physician-assisted dying is legal, have increased. The petitioner encouraged us to scrutinise these assertions in our consideration of this petition.

Living wills
The petitioner stated that the idea of a living will is a good one and an important part of her draft bill. The petitioner’s contention is that a living will should be allowed to incorporate an end of life directive; that is, that the person should have an assisted death given certain pre-agreed conditions, triggered by a nominated person. An end of life directive should not be stopped by someone else at a person’s death bed.

Definition of suffering
One of the criteria the petitioner suggests for assisted dying is constant and unbearable physical or psychological suffering which cannot be relieved in a manner that the patient deems tolerable. We asked the petitioner how suffering and tolerability should be defined. The petitioner told us that legislators need to introduce safeguards that provide assurance that people are making their own choices and that choices are not being made for them by other people. The petitioner believes that people need to establish their own threshold of what suffering and dignity are when establishing end of life directives. She said that there should be a protected provision for the person’s own definition in any legislation.

We were interested in the situation of people with life-limiting or life-threatening diseases, where death may be more than six months away. We asked about people choosing assisted dying because their quality of life had diminished. The petitioner agreed that, in her proposal, an individual could choose assisted dying if they considered their quality of life had slipped below the level that they could tolerate with dignity or without pain.

New Zealand Bill of Rights Act 1990
The petitioner is concerned that New Zealand’s legislative framework does not criminalise suicide but does prohibit assisted suicide. The Bill of Rights Act explicitly allows people to refuse medical intervention. The petitioner told us that she believes people with unbearable suffering often opt to refuse food and water. This can be distressing for the individual and their loved ones. The petitioner believes that it usually takes between 17 and 19 days for an unwell person to die of malnutrition and dehydration.
The petitioner asserted that there are no safeguards when a person exercises their right to refuse medical intervention, food, or water. A person does not have to be assessed by two physicians for mental competence, have any period of reflection, talk to family or loved ones, or seek counselling.

The petitioner emphasised that legislation to allow assisted dying would not directly compel anyone who disagrees with it to choose assisted dying. However, it would make assisted dying available, in certain circumstances and under certain conditions, to those who wish to lawfully choose to end their life.

**Effect on palliative care of allowing assisted dying**

The petitioner said that opponents of assisted dying have expressed concern that any legislation would compromise and undermine palliative care in New Zealand. She does not view assisted dying as a replacement for palliative care. However, she told us that palliative care is not universally accessible across New Zealand and is not consistent in quality. The petitioner supports additional funding for palliative care and hospices.

**Public views**

In 2012, when developing her original bill in consultation with the Voluntary Euthanasia Society, the petitioner was contacted by Horizon Research Ltd. It asked for a copy of the bill to conduct a detailed survey on its contents. Horizon sampled 2,969 people online, weighted by age, gender, income, ethnicity, and region to reflect the population. It also weighted by party vote at the 2011 General Election.

The survey found that:

- 62.9 percent of people supported or strongly supported the availability of medical assistance to end one’s life in specific medical circumstances
- 12.3 percent of people were opposed or strongly opposed
- 15.8 percent of people were neutral
- 9 percent of people were unsure
- men and women were equally likely to support it (62.6 percent of men and 63.1 percent of women)
- 65 percent of Europeans and Māori, 61.5 percent of Pasifika peoples, 55.3 percent of Asians, and 65 percent of Indians supported it
- slightly fewer Māori (10.2 percent) opposed it
- slightly more Pasifika peoples than average (13.9 percent) opposed it
- support was high amongst the 45 to 54 age group, at 71.6 percent.

We asked about those who are worried about the “slippery slope” argument. Those arguing a “slippery slope” are concerned that any initial restrictions around assisted dying will gradually be removed or abused and an ever-increasing number of people will seek to end their life. The petitioner told us that those who are concerned about widening the scope of assisted dying tend to be more in the middle (that is, not strongly committed to one side of the debate or the other) and need some reassurance about the safeguards.
4 Public attitudes towards assisted dying

Public attitudes towards assisted dying

There are many ways of measuring public attitudes towards assisted dying. One of these is by surveying randomly selected samples of the population (polls). Several recent polls of New Zealanders have shown high levels of support for euthanasia.

Curia Market Research poll

A Curia Market Research poll conducted during the period 14 to 30 June and 7 September to 6 October 2015 stated that “some people believe that the law should be changed to allow doctors to assist in ending the life of a person with an incurable illness, if the patient requests it” and asked, “what is your view on whether voluntary euthanasia should be legal – strongly oppose, somewhat oppose, somewhat favour, strongly favour?”

There were 2,800 responses. The poll found that:

- 66 percent of respondents supported a law change to allow euthanasia
- 20 percent were opposed
- 10 percent were neutral
- 2 percent were unsure.

TV3 news/Reid Research poll

A July 2015 Reid Research poll conducted for TV3 news asked “should law be changed to allow ‘assisted dying’ or euthanasia?” A total of 71 percent of respondents said yes, 24 percent said no, and 5 percent were undecided.

One News/Colmar Brunton poll

A July 2015 Colmar Brunton poll conducted for TVNZ’s One News asked 1,000 people “should a patient be able to request a doctor’s assistance to end their life?” A total of 75 percent of respondents said yes, 21 percent said no, and 5 percent were unsure.

These polls were taken around the time of Lecretia Seales’ case.2

Submitters’ attitudes towards assisted dying

Another way to measure public opinion on assisted dying and euthanasia is to analyse the submissions made to this committee in response to this petition. These submissions provided not only a numerical indication of submitters’ sentiments, but also allowed them to explain their position in more detail than could be provided in response to a simple question in a poll.

The majority of submitters were opposed to legislation that would allow assisted dying in New Zealand. Advisers reported that 80 percent of submitters opposed any change to assisted dying legislation, while 20 percent favoured a law change to permit assisted dying.

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2 Seales v Attorney-General [2015] NZHC 1239
We heard from a wide variety of submitters. They included many individuals speaking from personal experience. In some instances it was their own pain or experience of health issues, but more often they recounted the experience of a family member, friend, or loved one. We heard from a range of academics, including lawyers, ethicists, and bioethicists. We also heard from a significant number of medical and health professionals—doctors, nurses, palliative care experts, psychologists and psychiatrists, hospice workers, carers, youth workers, grief counsellors, and social workers. Submitters included representatives from various organisations, including cultural, religious, and professional bodies, as well as advocacy groups from both sides, disability groups, and suicide prevention organisations.

We also took the opportunity to speak with numerous people overseas, often those leading calls for, or opposition to, change in their respective jurisdictions. In respecting the petitioner’s request to “investigate fully public attitudes”, we were pleased to hear from such a wide cross section of New Zealand society.

A statistical analysis of all submissions was undertaken by one submitter. According to that report, the majority of those writing in support of a law change did so for reasons of choice—both individual freedom and that the law should enable such choices to be made (74 percent of those in favour). The majority of those writing to oppose a law change did so on the basis that human life has an innate value that should be upheld in law (40 percent of those opposed).

Other arguments that predominated among those supporting a law change included the desire to not lose their abilities or a sense of self (41 percent of those in favour), and the desire to not suffer (41 percent of those in favour). Key arguments from those against included the dangers to vulnerable people (38 percent of those opposed) and that modern palliative care is sufficient to treat suffering (31 percent of those opposed).

Another common message in support of a law change was the desire to save families from watching a family member suffer. For those against a law change, a further common issue was concern about sending mixed messages about suicide.

**Dignity and independence**

Both supporters and opponents of assisted dying raised the idea of dignity. Proponents often defined dignity on the basis of maintaining independence, and physical and mental capacity. There was a clear desire to maintain bodily functions and not become reliant on others. Submitters often spoke of not wishing to be a burden, either to family or society, and commented that to be a burden would lessen their own self-worth. Submitters would often refer to specific circumstances that, for them, would be undignified and unbearable. They described such limitations as making their life not worth living. Some limitations that were frequently mentioned included requiring a wheelchair, needing assistance with toileting, being unable to fully communicate, and developing dementia. Many often spoke of not wishing to spend their last weeks on large doses of painkillers. While not wishing to experience pain, the concern was that drugs might impair their mental faculties and therefore their dignity. Dignity was acknowledged as being specific to each person, so it was up to each individual to define what dignity meant for them.

Opponents argued that this perspective undermines the idea of human dignity by equating an individual’s worth with their ability to contribute to society. Several submitters said that this was a very utilitarian perspective and was a threat to the elderly, disabled, and minorities. Dangers could arise if some lives are considered by others to be not worth
living. We heard that assisted-dying legislation would be particularly concerning for disabled people because people could see their lives as being of less value. The view of some supporters of assisted-dying legislation—that needing support to carry out everyday tasks results in a lack of dignity—was seen as inaccurate and demeaning for disabled people. They maintain that, although advocates argue that they are concerned only with perceptions of their own dignity, it would be impossible for their actions not to make an implicit statement about the value of others in similar circumstances.

Some submitters were concerned that disabled people would be pressured to choose assisted dying. However, several submitters who identified as disabled rejected this view, and argued that they should have the right to make end-of-life choices.

Submitters were particularly concerned about dementia, or the loss of independence through another age-related degenerative condition. Several advocates of assisted dying and euthanasia felt that these options should be available to dementia patients, while other advocates felt that such processes should be reserved for those of sound mind. Both groups expressed the belief that the onset of dementia would impinge on their perceptions of dignity. We also heard from many submitters who had cared for parents with dementia and felt that such challenges had enriched their lives. They were concerned that advocating the ending of someone’s life is not an appropriate response to serious mental health issues.

The fear of becoming a burden on friends and families—losing one’s independence—was also cited as a reason for wanting the option of assisted dying.

Opponents were concerned that the mere perception of being a burden, however that might be defined by individuals, could induce people to end their life. We noted that some submitters spoke of the burden that an ill relative was placing on them and their family. These burdens included physical, mental, and emotional exhaustion, and they commented that they felt relief once that relative had passed.

We also heard from numerous submitters who were concerned that their health issues would place an undue burden on the health system. They often spoke of ending their life so as to free resources for those more in need or younger. An organisation of health professionals spoke in support of euthanasia as an alternative to an increase in funding. It argued that, in the absence of increased funding, assisted dying and euthanasia could play a role in sustaining the health system.

**Pain and suffering**

Pain and suffering were common reasons for submitters wanting assisted-dying legislation.

Many submitters recounted stories of family and friends who had died in pain over extended periods of time in hospital. They expressed regret about the suffering and felt that this should not have happened and could have been avoided through assisted-dying laws. Many submitters questioned why anyone would let a loved one suffer a prolonged and undignified death when they would not allow the same for a family pet.

Many others feared that they might experience pain and suffering in the future. To avoid this, they would like to have the option of assisted dying. They viewed pain and suffering as “worse than death” and something to be avoided. Submitters were clear that pain and suffering are subjective, noting that what might be unbearable for one person may not be for another. Some submitters thought that pain and suffering should not be confined to physical pain but also include mental and emotional suffering. Submitters noted that in
some jurisdictions, such as Belgium, the suffering necessary to warrant assisted dying was determined by the sufferer alone. There were also submitters who felt that assisted dying and euthanasia should not be limited to those suffering in any particular way but should be available to anyone for any reason. Reasons given included old age and the general “burden of living”.

Medical and health practitioners stated that no one should be dying in pain in New Zealand in the 21st century. Instances of this indicated a failure in care and a deviation from the norm. It was also stated that many people misunderstand serious health issues and frequently misinterpret symptoms as indications of pain.

We heard that there have been great advances in pain management, and most pain can be effectively managed. However, some palliative-care clinicians acknowledged that there are some, rare, instances where pain cannot be alleviated. Submitters demonstrated that the public is not clear on whether pain can always be effectively relieved. Members of the public spoke of relatives dying in extreme pain because the pain relief was not working, while many medical professionals stated that such tragedies almost never occur. We found it difficult to reconcile these perspectives and suspect that greater communication between health professionals and the general public is required to explain the dying process and alleviate fear. For example, we heard from several submitters whose dying relatives had stopped eating and drinking in what they perceived to be an attempt to hasten death. We heard from doctors and nurses that this is actually a normal symptom of the dying process rather than a cause. They say that it is not uncommon for people who are extremely ill to lose their appetite and reduce fluid intake.

Several hospices made submissions on the nature of pain and suffering. They pointed out that not all pain is physical, and that in addition to treating physical discomfort, they also pursue the treatment of emotional, social, and spiritual suffering. They argued that the very nature of hospice care and the underlying philosophy of neither hastening death nor prolonging life, precludes the use of assisted dying or euthanasia. While some submitters felt that these options were a perfectly acceptable extension to palliative care, the hospice submitters were unambiguous in their assertions that palliative care and assisted dying are incompatible.

There was some discussion around palliative sedation, the process of inducing varying degrees of unconsciousness in extreme cases in which patients’ pain cannot be managed. Some submitters found this practice a perfectly reasonable solution in such cases. Others, however, found it to be an unacceptable treatment, undignified, and one which merely prolonged suffering.

**Autonomy**

Supporters of assisted dying seek autonomy to make decisions about their end-of-life choices. They said that an essential part of life in a liberal democracy and of medical ethics is individual autonomy: the right to make decisions about the course of one’s life. Many submitters felt that current laws circumscribe their right to make decisions about how and when to end their life. They placed a high value on their own autonomy and desired the right to end their life at the time of their choosing.

Other submitters argued that in a society, individual autonomy is frequently limited for the good of other members of that society. They illustrated their point by highlighting the need for traffic speed limits, and controls on guns and tobacco. Public safety was frequently
cited by submitters as a reason why assisted dying could not be legalised. They believed that the individual's right to autonomy must be balanced against the effect that assisted dying could have on others, such as patients’ families and vulnerable members of society.

Many submitters felt it was inappropriate to completely remove an individual's right to choose because of the potential risks others may face. The principle of individual freedom is applied widely throughout New Zealand and should not be abridged on this important issue. Many supporters argued that the ability to choose the manner of one's death is a fundamental human right. Supporters expressed certainty that legislators could devise a system which permitted individual autonomy while preserving general public safety, because safeguards would be an essential part of any legislation on this matter. A variety of safeguards were proposed, including age limitations, medical certification, and review panels.

Whether the right to die is a human right was a source of much discussion and debate. Some submitters argued that if there is a right to life there must be a concomitant right to death. Others queried how such a human right could be limited to only certain groups, such as those who are terminally ill or have an intolerable condition. Any human right would have to be applicable to all humans, and to deny it to any group would be discriminatory.

Submitters also raised concerns about an individual’s ability to make a truly autonomous decision. Many factors were raised which may influence someone’s decision-making process, such as family pressures, financial considerations, social expectations, and frame of mind at a given time. Submissions from several psychiatrists and psychologists, as well as doctors and counsellors, noted that depression and feelings of hopelessness are common responses to terminal diagnoses or chronic pain and suffering. Health professionals expressed concern that an individual’s decision-making abilities could be compromised under such circumstances. The belief that one could make a decision to end one’s life without being affected by many surrounding factors was highly contentious.

Advocates of assisted dying and euthanasia suggested that any concerns around an individual’s ability to make an autonomous decision could be mitigated in various ways. Proposals included assessment by counsellors, a close relationship with a medical practitioner, and the use of advance directives. Others stated that these requirements actually limited or removed personal autonomy. They noted that any requirement to seek the permission of others, such as a counsellor or medical practitioner, was inherently an infringement on their autonomy. This would also apply in the case of advance directives in which someone other than the patient is required to make the decision on their behalf.

Advance directives in particular were seen as a concern by some palliative care specialists because they are written by individuals for circumstances they are not currently experiencing. Health practitioners frequently stated that terminal illnesses and disability are often feared more by those anticipating them than those living with them.

Supporters of assisted dying wished for autonomy to make decisions about their end-of-life choices. Others believed that the right to autonomy needs to be balanced against the effect that assisted dying could have on others, such as patients’ families and vulnerable members of society. Several submitters asked why legislation could allow autonomy for one group—those who are terminally ill or have an intolerable condition—but not allow another person the right to autonomy; for example, somebody with depression.
Effect on families

Some submitters were concerned that if there were a change of legislation, some people might request assisted dying and euthanasia only because it was convenient for the remaining family members. They would not want to see people choosing to end their own life because they felt that they were a burden. There is also a risk that some families may pressure a relative to end his or her own life.

Submitters told us about the effect that illness can have on the family members of the dying person. We heard personal stories from many submitters about the trauma of watching family members suffer through what they considered to be a bad death. Palliative care clinicians acknowledged that the dying process can be more traumatic for families to witness than it is for the individual who is dying.

On the other hand, we heard that the end of life can be a chance for families to spend time together and reconcile any past grievances. Submitters were concerned that this special time at the end of life would be lost if assisted dying was legalised.

We heard from some submitters that the current legislation can actually result in less time with loved ones. This is because family members might choose to suicide while they are still able to do so. These submitters pointed to evidence from proceedings in the Seales v Attorney-General case\(^3\) that, were assisted dying legal, their loved ones would not have to choose to end their life at that time and on their own. Many submitters advocated assisted dying and euthanasia as a way to prevent people suiciding on their own using unreliable methods.

Numerous submitters conveyed to us tremendous feelings of guilt from being unable to mitigate the suffering of a dying family member. On the other hand, some submitters expressed sadness at the premature deaths of their family members due to suicide. Others were concerned that if, in the future, they were asked to help a family member to die, they might be happy to do so at the time but could later feel guilty.

Grief counsellors and some medical professionals explained the effects of a suicide in the family and expressed concerns about the intergenerational impact. It was stated that families that experience a suicide are at greater risk of further suicides. It was suggested that this could also apply to assisted dying and euthanasia.

Effect on vulnerable populations

Opponents of a law change argued that vulnerable populations, such as the elderly and the disabled, would be adversely affected by assisted-dying legislation. The Ministry of Health could find no evidence of adverse effects on ethnic minorities or the economically disadvantaged in jurisdictions where assisted dying is permitted. In Oregon, for example, 95 percent of individuals accessing assisted dying are white, and more than half have at least a bachelor’s degree.

Some submitters pointed out that those groups traditionally considered disadvantaged are not necessarily those most vulnerable on this issue. When it comes to making end of life decisions, these submitters contend that more appropriate markers of vulnerability include difficulties communicating, having a distressing medical condition or unrelieved symptoms, or being socially marginalised.

\(^3\) Seales v Attorney-General [2015] NZHC 1239
We heard many different cultural, ethnic, and gender perspectives from groups and individuals. Some raised concerns that women are over-represented in cases of assisted dying around the world. Others expressed concern about the further marginalisation of members of communities that already suffer disproportionately high suicide rates, such as the LGBTIQ* community, where legally assisted dying might be seen as incongruous with anti-suicide campaigns. Cultural reservations were raised as to how assisted dying could be incorporated into cultures that have high regard for the elderly, or traditions that include multi-generational care. Others questioned how legalising assisted dying would affect the already high levels of elder abuse in New Zealand.

While some acknowledged the concerns of these groups, many submitters felt that it was unnecessary to limit the individual choices of some in deference to these groups. They also stressed that they were advocating a voluntary approach to euthanasia and assisted dying, which no individual or group would be compelled to endorse. They further expressed certainty that safeguards could be developed to mitigate any concerns that vulnerable groups may have.

**Risk of coercion**

Submitters were concerned that individuals could be coerced into assisted dying. Submitters also argued that people with life-limiting illnesses are vulnerable, even if they are well educated and have family support.

Several submitters spoke about the fear that family members would put subtle pressure on individuals because they wanted to inherit, or to avoid spending money on care. Many submitters expressed fear that if assisted dying or euthanasia were institutionalised, the disabled, the elderly, and the ill could experience greater social prejudice. We heard various stories from overseas in which members of these groups felt societal pressure to end their life. Submitters were also concerned that the option could evolve into an expectation, and that the right to die would soon be seen as a duty to die.

Other submitters rejected this view, believing that adequate safeguards would prevent coercion. Some submitters suggested that overseas stories had been exaggerated.

**Discretion within sentencing**

While many submitters considered it inappropriate for anyone to assist in ending someone’s life, some submitters believed that in some cases people could be considered to have acted reasonably in assisting a death, so punishment would be inappropriate. These submitters said people should not fear being punished for helping their loved ones. Others argued in response that the current law adequately addresses the few hard cases in which assisted dying might be appropriate, because the courts have discretion in sentencing.

**Widening of scope: the slippery slope**

Submitters, regardless of their views, were concerned about the “slippery slope” effect—a tendency for assisted-dying laws to widen beyond the initial intentions. Submitters cited the Netherlands and Belgium as examples of jurisdictions where the scope of legislation to assist dying has widened since it was introduced. Their laws were initially intended only for the terminally ill, but some submitters now point to evidence of assisted dying or euthanasia being used in cases of psychiatric conditions, dementia, depression, and old age.

In Belgium the initial law, passed in 2002, restricted euthanasia to those over the age of 18. However, in 2014 the scope was extended to people under the age of 18 in highly specific
circumstances, including having a terminal condition and where a psychiatrist has deemed them competent.

Some submitters expressed concern that the expansion of scope for assisted dying has seen the number of people ending their life increase. One of the more extreme examples offered by submitters was the increase that occurred in Belgium between 2002 and 2015. The number of people euthanised annually rose from 24 to 2,021. Other submitters argued that changes in scope are part of the democratic process, and that an increase in such deaths only demonstrates public awareness and acceptance over time.

Submitters also expressed concern about the increasing number of people ending their life in jurisdictions where the scope of assisted dying has not changed over time. For example, submitters cited Oregon where the number of people accessing assisted dying had expanded over time. In 1998, when assisted dying was legalised, 16 people took lethal drugs. In 2016, 133 people did so, representing 37.2 per 10,000 total deaths.\(^4\)

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The following graphs show the long term trends in Oregon, the Netherlands, and Belgium.

**Oregon**

**The Netherlands**

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Adverse events

There is an assumption among some supporters of assisted dying that a lethal injection is painless and uncomplicated. We asked for statistics about adverse events associated with assisted dying. The Ministry of Health told us that a study in the Netherlands in the 1990s found that technical problems occurred in 35 cases (5 percent), complications in 24 cases (4 percent), and problems with completion in 44 cases (7 percent). Complications were less frequent when the drug was delivered by specialists (only 2 percent of cases).\(^7\)

Data from the Oregon Health Authority is incomplete because it does not require a doctor or other official to be present at ingestion. It shows complications in 3 percent of cases, which are almost always vomiting because the drug can only take by oral ingestion.\(^8\) There was also a highly publicised case in 2005 involving an individual who regained consciousness 65 hours after ingesting lethal drugs.

Other matters

Cultural, religious, and ethnic community views

We heard submitters from a wide range of cultural communities and ethnic groups, and with various religious beliefs, who spoke on behalf of their groups in opposition to a legislative change. For example, many submitters said that their culture’s beliefs about death mean that hastening it would be unacceptable to members of that culture. Similarly, people of faith told us that assisted dying was incompatible with their beliefs. Cultural and

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religious groups are not homogenous, however we also heard from some members who were in favour of a law change.

**Insurance implications**

We heard that assisted dying legislation could have insurance implications relating to how a death is reported, the validity of insurance policies, and inheritances. Specifically, that a deliberate action to cause death would invalidate the policy.

Proponents suggested explicit exceptions be made in cases of assisted dying and euthanasia to allow insurance claims to be made. Others suggested that death certificates should make no reference to assisted dying but instead state the underlying condition believed to be likely to cause death. Others believed that this would be falsifying records.
5  Jurisdictions that have voted for assisted dying and euthanasia

Switzerland

Article 115 of the Swiss Federal Criminal Code provides that it is not a crime to assist another person to commit suicide, as long as there are no selfish motives. Euthanasia is not permitted under Article 114 of the Code.

Competent adults can request assistance to commit suicide. There are no medical criteria and doctors do not have to be involved. Swiss law does not require that a person be terminally ill but only that the motive of the assistant is not selfish.

Since the 1990s, Switzerland has had four private right-to-die organisations assisting people to die. These organisations provide patients with counselling and lethal drugs. Swiss citizens and foreigners can seek assistance from these organisations, although not all accept non-residents.

The organisations notify the police and coroner when they assist a person to die. The police and coroner determine whether any crime has taken place. This includes whether there are any selfish motives, the competence of the deceased, and the autonomy of their choice. If they find no evidence of wrongdoing, the death is reported as a suicide. If the suicide does not comply with the law, the case is referred to the public prosecutor.

There are no regulations or official statistics about the number of such deaths in Switzerland because assisted suicides are not recorded centrally by a national body. The lack of regulations appears to stem from the belief that the right to make an end-of-life decision is personal and individual, and the State should not interfere.

Oregon

Oregon’s Death with Dignity Act was passed in 1997. Competent adults with a terminal diagnosis can legally be prescribed and self-administer drugs from a doctor if they are a resident of the state. They must have a terminal diagnosis, with a life expectancy of less than six months. A person must make three separate requests (two oral and one written) to access medication. Each request must be separated by a minimum of 15 days. An individual’s suffering does not have to be intolerable. Euthanasia is not permitted.

Patients who are approved for assisted dying most commonly ingest a lethal drug, without the presence of their healthcare provider. We heard that those accessing the drugs were meant to have six months to live, but some took them years later. This appears to be supported by an Oregon Government report which notes that in 2007 up to 698 days passed between the prescribing and taking of the lethal drug.10

Several procedural requirements must be satisfied. Deaths must be reported to the state health department which monitors compliance and issues statistical reports.

Netherlands

In 2002, the Netherlands passed the Termination of Life on Request and Assisted Suicide Act. It specifies criteria that give doctors an exception to Article 293–294 of the Penal Code, which makes euthanasia a form of murder.

In Dutch law and society, there is generally considered no distinction between euthanasia and assisted dying. The Act applies to both under the term “euthanasia”. The Act codified the practice of euthanasia that had developed through judicial decisions and professional guidelines over the previous several decades. From 1973 onwards, Dutch courts recognised the defence of necessity. This involved a physician assisting an individual to die as the only way to end that individual’s unbearable and irremediable suffering.

Patients must be suffering unbearably and have no prospect of improvement to request euthanasia. The law does not require the patient to have a terminal condition but at the time of adoption it was assumed that most patients’ unbearable suffering would be due to a terminal condition. This law has not changed, but the interpretation of what constitutes sufficient suffering has broadened. Individuals can now make a request on the grounds of mental suffering.

There must be a close physician–patient relationship for assisted dying. This means that non-residents cannot seek assisted dying in the Netherlands.\textsuperscript{11}

Several procedural requirements must be satisfied. Deaths must be reported to a Regional Review Committee which evaluates all cases to ensure that the requirements are met. The committee assesses whether the physician acted in accordance with the criteria set out in the Act. The committees contain, at a minimum, a medical doctor, an ethicist, and a legal expert. Publicly available statistics are collated by the regional review committees in an annual report.

Minors can request euthanasia from the age of 12. Sick children require parental consent if they are aged between 12 and 16. Youths aged 16 or 17 do not require parental consent but their parents should be involved in the decision-making process. Parental involvement is not required from the age of 18 onwards.

We heard from a submitter about elderly people in the Netherlands wearing “do not euthanize me” bracelets. This is in case they are unexpectedly admitted to hospital or if they are unable to speak for themselves. The Ministry of Health found no evidence of these bracelets. However, a disability rights organisation, the Dutch Patients’ Association, has developed wallet-size cards which state that if the signer is admitted to hospital “no treatment be administered with the intention to terminate life”. These cards are not commonly used because individuals in the Netherlands generally use living wills to state their choices about euthanasia.

Groningen Protocol

The Groningen Protocol was developed by a team at Groningen University Hospital in 2005. It outlines the conditions under which the Government of the Netherlands considers it permissible for doctors to euthanise infants. The protocol requires that:

- the child’s suffering must be unbearable, with no chance of improvement

\textsuperscript{11} Netherlands Ministry of Foreign Affairs. Euthanasia: A guide to the Dutch Termination of Life on Request and Assisted Suicide (Review Procedures Act).
there must be no doubt about the child’s diagnosis and prognosis
the physician and the child’s parents must be convinced that there is no reasonable
alternative given the child’s condition
the parents must consent to the termination of the child’s life
the parents must be fully informed about the child’s diagnosis and prognosis
an independent physician must have examined the child and agreed in writing that
the criteria of the protocol have been met
the termination must be performed with due care.

Belgium
In May 2002, Belgium passed the Belgian Act on Euthanasia. It was designed to stop the
practice of physicians administering life-ending drugs without an explicit request from a
patient. This practice was known as LAWER and had been happening in some regions of
Belgium.

The Act states that competent patients can request euthanasia from doctors if they have
continuous and unbearable physical and mental suffering that cannot be alleviated. The
suffering does not have to be physical, but it should result from a medical condition.

The law was expanded in 2014 to include children. However, there are narrower criteria
and stricter safeguards. These include being in constant and unbearable physical pain, being
likely to die in the short term, and having parental permission. Psychological pain is not
considered a criterion for children.

Several procedural requirements must be satisfied for euthanasia deaths. They are more
rigorous if a patient is not terminally ill. Deaths must be reported to the Federal Control
and Evaluation Commission (FCEC) following the death of an individual. It verifies that
the correct procedures were followed and provides statistical reports to the legislature every
two years. If two-thirds of the commissioners or more believe that the statutory conditions
have not been met, the individual’s file is sent to the local state prosecutor. A 2010 study
found that in the Flanders region, just under half of all cases were not reported as legally
required. However, the study found that the main cause of the under-reporting was that
physicians did not perceive the act to be euthanasia.12

The Belgian Euthanasia Review Committee collates yearly reports. The Euthanasia Control
and Evaluation Commission, which consists of 16 lawyers and doctors, meets monthly in
Brussels to review physicians’ reports.

The Belgian Act does not mention assisted dying. However, the FCEC has since clarified
that the Act includes cases of suicide where a physician has assisted by prescribing or
supplying the drugs.

Luxembourg
In 2009, Luxembourg passed the Law on Euthanasia and Assisted Suicide. Competent
adult patients suffering from constant and unbearable physical or mental suffering, without
any hope of recovery, can ask for euthanasia or assisted dying from a doctor.

practice in Flanders, Belgium: cross sectional analysis of reported and unreported cases. BMJ; 2010;341:c5174.
The patient must make a written request to a doctor. The doctor must then inform the patient about his or her health condition, life expectancy, and about the possible therapeutic and palliative options and their consequences. The doctor must then consult a second physician about the serious and incurable nature of the disorder. The second physician must be independent of the patient and the attending doctor, be competent to give an opinion about the patient’s disorder, and examine the patient and report on the findings.

Doctors who perform an act of euthanasia must submit a declaration document within four days to the National Commission for Control and Assessment. The commission consists of nine members and monitors compliance. The doctors must also submit documentation which is reviewed for compliance. A 2015 report found that all cases had been carried out within the legal framework.  

**United States of America other than Oregon**

The following states also allow assisted dying. Their Acts are all modelled on Oregon’s:

- Vermont: the Patient Choice and Control at End of Life Act was passed in 2013.
- California: the End of Life Option Act was passed in 2015.
- Colorado: the Colorado End-of-Life Options Act was passed in 2016.
- District of Columbia: the Death with Dignity Act was passed in 2016.

In 2009, a Montana Supreme Court ruling removed legal obstacles to assisted dying. There is no legislative or regulatory framework, and there are no limits or restrictions on the use of assisted dying. There is no reporting mechanism and no statistics are collected or published.

**Colombia**

In 2014, a Constitutional Court ruling in Colombia reaffirmed that ending a life was not a crime when it was requested by a terminally ill patient. This followed an initial ruling in 1997. In 2015 the Government published Resolution 2016, which provided a detailed federal policy. This allows adults who are expected to die soon because of a progressive and irreversible serious condition to request euthanasia from a doctor.

**Canada**

In 2015, the Supreme Court found that the prohibition on euthanasia and assisted dying violated section 7 of the Canadian Charter of Rights and Freedoms. The Court’s declaration was suspended to allow the Government to amend legislation.

In June 2016, the Medical Assistance in Dying Act (Bill C-14) received Royal assent. It allows competent adults to request medical assistance in dying if they have a grievous and irremediable medical condition. This covers both assisted dying and voluntary euthanasia. An individual must meet the following criteria:

- They have a serious and incurable illness, disease, or disability.

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• They are in an advanced state of irreversible decline in capability.
• The illness, disease, or disability or the state of decline causes them enduring physical or psychological suffering that is intolerable to them and that cannot be relieved under conditions that they consider acceptable.
• Their natural death has become reasonably foreseeable, taking into account all of their medical circumstances, without a prognosis necessarily having been made as to the specific length of time that they have remaining.

Individuals who are ineligible for government-funded healthcare and foreign visitors to Canada cannot currently access medically-assisted dying.

The Act provides the following safeguards which must be ensured by the practitioner administering the assisted death:
• The patient must meet all of the eligibility criteria.
• The patient must submit a written request stating that they want to have a medically-assisted death.
• The written request must be signed and dated before two independent witnesses who must also sign and date the request.
• The patient’s physician or nurse practitioner must ensure that the patient is eligible for medical assistance in dying according to all of the listed criteria.
• A second independent practitioner must confirm the patient’s eligibility.
• The patient must be informed that they have the right to withdraw the request at any time.
• Ten days must elapse between the time the patient signs the written request and assisted dying is administered.

The legislation requires that the Minister of Health make regulations to collect information and publicly report on medical assistance in dying in Canada. Consultation with stakeholders and the public is taking place in 2017 to ensure that the regulations are appropriate. The monitoring system, including data collection and reporting activities, will begin in 2018. A year after introducing the legislation, the Canadian Government is consulting on whether to allow additional categories of people, such as mature minors and those with mental illness, to access assisted dying.
6 Jurisdictions that have voted against assisted dying and euthanasia in recent years

United Kingdom

In England and Wales, section 2(1) of the Suicide Act 1961 states that a “person who aids, abets, counsels, or procures the suicide of another, or an attempt by another to commit suicide, shall be liable on conviction on indictment to imprisonment for a term not exceeding fourteen years.”

The Act was primarily designed to decriminalise suicide. In doing so, the crime of assisting suicide was created. The Act indicates that no prosecution should take place without the agreement of the Director of Public Prosecutions.

In Scotland, suicide has never been a crime and no specific crime of assisting suicide exists. However, assisting a suicide is likely to fall under the law of murder or culpable homicide, which is the Scottish equivalent of manslaughter.

Euthanasia is prohibited in the United Kingdom by common law, rather than statute. The common law makes it clear that, except in cases of rape where consent is central to the offence, consent is no defence against criminal charges. Therefore in Scotland, where there is no crime of assisting suicide, a person who kills another can be prosecuted for the crime of murder. Despite the lack of Scottish cases, it can be concluded that although a murder charge is possible, it would be unlikely when the individual was motivated by compassion. The most likely charge would be culpable homicide.

Assisted Dying Bill [HL] 2014-15

The Assisted Dying Bill [HL] 2014-15 was a private member’s bill. It started in the House of Lords and was sponsored by Lord Falconer of Thoroton. The bill aimed to “enable competent adults who are terminally ill to be provided at their request with specified assistance to end their own life; and for connected purposes”.

The bill reached the second day of committee stage on 16 January 2015. Line by line examination of the bill took place during this stage.

The 2014/15 session of Parliament was prorogued and the bill made no further progress. It was reported that Lord Falconer considered that such a bill would be best placed in the House of Commons.

Assisted Dying (No 2) Bill 2015

The Assisted Dying (No 2) Bill 2015, a private member’s bill, was tabled by Rob Marris MP after he was drawn first in the ballot in the 2015/16 Parliament. It aimed to “enable competent adults who are terminally ill to choose to be provided with medically supervised assistance to end their own life; and for connected purposes”.

14 In the House of Commons and the House of Lords, bills are not referred to a select committee. The committee stage involves line-by-line examination of the separate parts of a bill. Any member of the House of Lords can take part. It usually starts about two weeks after the second reading debate.

15 This is when a session of a Parliament or legislative assembly is discontinued without dissolving it.
The bill was presented to Parliament through the ballot procedure on 24 June 2015. In the United Kingdom, this is known as the first reading. No debate takes place at this stage. The bill did not pass its second reading debate on 11 September 2015 and made no further progress. It was defeated by 330 votes to 118.

**Assisted Suicide (Scotland) Bill**

In the Scottish Parliament in 2013, Margo MacDonald MSP introduced a member’s bill. It was sponsored by Patrick Harvie MSP following Ms MacDonald’s death in 2014. The bill aimed to legalise assisted suicide for individuals who met all of the following conditions:

- had been diagnosed with a terminal or life-shortening illness or progressive condition
- had concluded that their quality of life was unacceptable and that there was no prospect of improvement
- were aged 16 or over
- were registered with a Scottish medical practice
- had the legal capacity to make the decision.

The Health and Sport Committee was designated the lead committee to look at the bill. The Justice Committee was designated the secondary committee.

In its report published in April 2015, the Health and Sport Committee concluded that the bill contained significant flaws, which presented major challenges to the bill being progressed. The majority of the committee did not support the general principles of the bill but made no formal recommendation to Parliament on the bill. This was because the issue of assisted suicide is a matter of conscience.

At the Stage 1 debate in May 2015, which asked whether the general principles of the Assisted Suicide (Scotland) Bill were agreed to, the bill was defeated by 82 votes to 36.

**Australia**

**South Australia**

In November 2016 the South Australian Parliament rejected the Death with Dignity Bill proposed by Liberal MP Duncan McFetridge. The bill passed the second reading stage with a vote of 27 to 19. However, when it was examined clause by clause, the conscience vote was tied at 23. The Speaker Michael Atkinson used his casting vote against the bill. The bill would have legalised voluntary euthanasia.

**Tasmania**

In May 2017 the Voluntary Assisted Dying Bill, co-sponsored by Labor MP Lara Giddings and Greens leader Cassy O’Connor, was defeated in the Tasmanian Parliament by 16 votes to 8 at the first reading stage. This followed unsuccessful votes at the second reading stage in 2009 for the Dying with Dignity Bill (15 against and 7 in favour) and 2013 for the Voluntary Assisted Dying Bill (13 against and 11 in favour).

**United States of America**

In the last 10 years, multiple pieces of assisted dying legislation have been introduced in 34 states. The majority have been defeated, withdrawn, or discontinued in committee. It is common in the United States for unsupported bills to not be referred back from
committees, rather than for there to be a vote. States which have voted against assisted
dying legislation in the recent years are:

- Massachusetts: the Death with Dignity Initiative was defeated in 2012 with 51
  percent against and 49 percent in favour.

- New Mexico: In 2017 Senate Bill 252, which would have legalised assisted dying for
  terminally ill patients, was defeated by 22 votes to 20.

- Maine: In 2017 Bill LD 347, which would allow doctors to prescribe life-ending
  drugs to those with less than six months to live, was defeated in the Maine House of
  Representatives by 85 votes to 61.
7 Health professionals and assisted dying

Any discussion about assisted dying or euthanasia almost always involves the role of medical practitioners. Many submitters queried whether assisted dying is compatible with medical ethics and whether it would conflict with the very nature of medicine and other health professions.

**Medical ethics**

There are four generally accepted principles of medical ethics:

- respect for patient autonomy
- beneficence (doing the best for the patient)
- non-maleficence (doing no harm)
- distributive justice (fairly allocating scarce medical resources).

It is possible to construct ethical arguments both for and against assisted dying, depending on the understanding of and weighting given to each principle.

We heard from the New Zealand Medical Association that, although patients have a right to autonomy in their health care choices, ethical and societal considerations inherently limit personal autonomy. It also pointed out that assisted dying or euthanasia does not only involve a patient’s own personal autonomy, it also necessarily requires the involvement of a health practitioner. The New Zealand Medical Association believes that assisting dying is incompatible with medical ethics. The World Medical Association holds the same view. However, we note there are other jurisdictions, such as Belgium, where medical associations support or are neutral towards assisted dying or euthanasia.

We heard from some individual doctors who support assisted dying in specific circumstances. Some submitters noted that Lecretia Seales’ doctor was willing to assist her to die. This was only on the condition that the law would allow it and her doctor would not be charged under the Crimes Act.

**Other health professionals**

Whether doctors would have to be involved in assisted dying was not an area widely covered by submitters. However, if the involvement of health practitioners is required, this does not necessarily need to be restricted to doctors. In New Zealand, an increasing number of other practitioners are able to prescribe medication.

When the New Zealand Nurses Organisation (NZNO) appeared before the committee, it told us that most of the 145 nurse practitioners in New Zealand could prescribe medication. The NZNO told us that nurses have mixed views. However, in the event of assisted dying legislation being passed, it supports individual nurses being able to choose whether to take part in the practice or not.
**Would assisted dying affect the public’s confidence in doctors?**

We were interested in whether assisted dying would adversely affect public confidence in doctors.

Medical practitioners who addressed the committee, as well as other submitters, noted several concerns about doctors’ involvement in assisted dying and euthanasia. These included the effect it may have on doctor–patient relations, the effect on the public’s confidence in doctors, and the effect on doctors themselves.

Several doctors described the special relationship doctors have with their patients, especially when those patients are seriously or terminally ill. Due to the complicated nature of many treatments and conditions, doctors tend to have considerable power, responsibility, and trust placed with them. Many doctors were worried that their patients’ trust in them might be eroded if assisted dying or euthanasia became a legal option.

On a societal level, several doctors were concerned that the legalisation of assisted dying and euthanasia could have an adverse effect on public confidence in doctors. We sought advice from the Ministry of Health about jurisdictions where assisted dying or euthanasia is legal.

The International Social Survey Programme collected data between 2011 and 2013. It found that public trust in doctors was the highest in Switzerland. A total of 83 percent of respondents agreed or strongly agreed with the statement “All things considered, doctors in [our country] can be trusted”. In the Netherlands, the figure was 78 percent, while in Belgium it was 74 percent. In the United Kingdom and France, where assisted dying is not permitted, the figures were 76 percent and 75 percent respectively.16

A 2005 US survey of a random sample of 1,117 adults found that, for the majority of respondents, trust in doctors would not reduce if euthanasia were legal. Respondents were asked about the level of agreement with the statement “that they would trust their doctors less if euthanasia were legal and doctors were allowed to help patients die”. Only 20 percent of participants agreed with this statement, while 58 percent of participants disagreed, and the remainder were neutral.17

Many health professionals talked to the committee about the effect that legalising assisted dying and euthanasia may have on their own conscience, mental health, and their understanding of their profession. Several doctors said that they entered medicine to heal people, not to kill them. They cited studies from jurisdictions where assisted dying is legal demonstrating the negative impact the procedure had on the health professionals involved. They also worried that the right to refuse to participate in such a procedure might not be permanently protected and that an expectation might develop that doctors unwilling to participate would be obligated to refer their patients to someone who would. Some stated that they would not be able to remain in the field of medicine if such concerns eventuated.

**Euthanasia and veterinarians**

Several submitters suggested that research shows veterinarians to be under worse stress than other professions. The Ministry of Health told us they could not find any research

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that directly compared veterinarians’ stress levels with other professions. It told us that
some research suggests that veterinarians may have higher levels of stress than the general
public. The major causes appeared to be client grief and financial stresses. Euthanasia was
considered a further contributing factor. A systematic review of 36 studies found that veterinarians are highly satisfied with their
work. There appears to be little evidence to suggest that they have poor levels of mental
health. However, suicide rates among veterinarians are much higher than for other
professionals and the general public.

In 2013, researchers investigated why the rates of suicide were high when veterinarians do
not have high levels of stress or mental illness. They concluded that although veterinarians
had similar levels of stress and mental illness to the public, individuals with repeated
experience of euthanasia were less fearful about their own death.

We invited veterinarians from the Massey Veterinary School, the New Zealand Veterinary
Association, and the Veterinary Council to appear before us to discuss their experiences of
euthanasia. They told us that their primary focus is on animal welfare and they consider
euthanasia absolutely justified to ease animal suffering. The veterinarians said it was
common when euthanising pets for an owner to comment that they wished that they had
been able to do this for a relative.

Veterinarians also euthanise dangerous dogs and animals for which they are unable to find
a home. They said that some veterinarians refuse to euthanise healthy animals. However,
they noted that this was not a comparable situation for humans, because it is unlikely that
healthy humans would be euthanised.

We asked whether animals ever experience any adverse reactions to the lethal drugs. We
heard that, provided the drug is injected correctly into the vein, it is usually very peaceful.
However, people are often unaware that death entails several normal physiological
responses, such as releasing the bladder and gasping for breath in older animals.

veterinary surgeons. Occupational medicine, 60(6), 436-446.
veterinary surgeons: a systematic review. Social psychiatry and psychiatric epidemiology, 47(2), 223-240.
about death in veterinary students. Suicide and Life-Threatening Behavior, 43(2), 125-138.
22 Ibid.
Opponents and supporters of a law change both identified effective safeguards as an important part of any assisted dying legislation. Many of the safeguards proposed were actually eligibility criteria. These criteria and safeguards were discussed by various submitters, though many frequently disagreed on the specifics.

Criteria that may be considered for assisted dying and euthanasia:

- age
- the nature and particulars of a person’s condition(s)
- mental competency
- residency status.

Considerations that may regulate assisted dying and euthanasia:

- how many medical practitioners’ assessments are required, if any
- the nature of the medical practitioner–patient relationship
- conscience rights of medical practitioners
- availability of appropriate lethal drugs and ancillary equipment
- the need for counselling
- a stand-down period
- family involvement.

Who should be responsible for approving an application for assisted dying and euthanasia:

- the patient alone
- health or medical practitioner(s)
- lawyers
- a committee that might include health practitioners, lawyers, ethicists, cultural advisors, lay people, and others
- a Family Court judge
- a Registrar, assigned by the Director-General of Health, to co-sign for lethal drugs.
9 Palliative care

What is palliative care?

The World Health Organization (WHO) describes palliative care in the following way:

An approach that improves the quality of life of patients and their families facing the problem associated with life-threatening illness, through the prevention and relief of suffering by means of early identification and impeccable assessment and treatment of pain and other problems, physical, psychosocial, and spiritual. Palliative care:

- provides relief from pain and other distressing symptoms
- affirms life and regards dying as a normal process
- intends neither to hasten or postpone death
- integrates the psychological and spiritual aspects of patient care
- offers a support system to help the family cope during the patients’ illness and in their own bereavement
- uses a team approach to address the needs of patients and their families, including bereavement counselling, if indicated
- will enhance quality of life, and may also positively influence the course of illness
- is applicable early in the course of illness, in conjunction with other therapies that are intended to prolong life, such as chemotherapy or radiation therapy, and includes those investigations needed to better understand and manage distressing clinical complications.

Palliative care in New Zealand

Palliative care is provided to people of all ages with a life-limiting or life-threatening condition. It aims to enhance a person’s quality of life until death by addressing their physical, psychosocial, spiritual, and cultural needs. It also provides bereavement support to a person’s family, whānau, or caregiver.

In New Zealand, palliative care services are delivered in the community, including in private homes and residential aged care facilities, hospitals, and hospices.

Primary palliative care is provided by health care professionals as part of standard clinical practice. Individuals are assessed by providers and referred to specialist palliative care services when their needs extend beyond the scope of primary palliative care services.

Palliative care was introduced as a medical speciality in New Zealand in 2001. Specialist palliative care is provided by people who have had specific training or are accredited in palliative care or palliative care medicine. The training includes both an understanding of pharmacology (particularly in relation to pain management) and an appreciation of a

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23 World Health Organization (2017). "WHO Definition of Palliative Care"
person’s emotional and psychological needs. This also includes working with families and their needs as they support a dying loved one.

**Funding for palliative care**

District health boards (DHBs) fund some palliative care services. These include assessment, care coordination, clinical care, and some support services, including grief and loss support services to family and whānau of people receiving specialist palliative care.

Most DHBs do not fund hospital specialist palliative care as a separate service. This is because many elements of palliative care are similar to non-palliative care. Therefore, the services are often integrated with other parts of service delivery and coding, such as long-term conditions.

Additional services to non-clinical patients and family support services are also provided. These are usually provided by volunteers and are funded through community fundraising.

Budget 2015 delivered an additional $76.1 million of funding for hospice services. This included $24.1 million over four years to support new palliative care services and innovation in aged residential care, primary care, and community settings. Forty new palliative care positions have been established across 15 DHBs.

**Review of adult palliative care services**

Between October 2015 and September 2016, the Ministry of Health reviewed adult palliative care services in New Zealand. The purpose of the review was to identify priorities to ensure that New Zealand adults continue to receive high-quality palliative care services when needed.

**Increased demand for palliative care services**

Demand for palliative care services is expected to increase by 51 percent between 2016 and 2038. This equates to an increase from 24,680 individuals in 2016 to 37,286 in 2038. Based on historic patterns of places of death, by 2038 the need for palliative care is expected to increase:

- by 37.5 percent in public hospitals
- by 84.2 percent in aged residential care
- by 51.8 percent under hospice care. This includes those in hospice services in aged residential care facilities and in the community.

**Shortage of palliative care specialists**

Some parts of New Zealand are experiencing shortages in palliative medicine specialists. DHBs are also having difficulties recruiting and retaining palliative medicine specialists in some places, particularly rural areas. This creates inequities in access to palliative care.

The sustainability of the palliative medicine specialist and nursing workforce is also a concern. This is because the workforce is ageing. Although this trend affects the whole health workforce, it is particularly relevant to palliative medicine specialists. By 2020, 56 percent of the palliative medicine workforce will be over the age of 65.

An ageing population means that demand for palliative care services will increase. This, combined with the ageing palliative care workforce, means a declining ratio of palliative medicine specialists to people aged 60 years and over.
Palliative care action plan

On 30 March 2017, the Minister of Health launched the Adult Palliative Care Services in New Zealand – Review and Action Plan. The review identified five priority areas to improve services over the next three to five years, while addressing the increased demand for palliative care services over the next 10 to 20 years. The priorities are to:

- improve the emphasis on primary palliative care
- improve the quality of palliative care in all settings
- grow the capability of informal carers in communities
- respond to the voices of people with palliative care needs and their families and whānau
- ensure strong strategic connections.

The action plan supports the review and provides a roadmap to address the five priority areas.

Submitters’ views on palliative care

Palliative care services were a common focus in the submissions process. Submitters noted that New Zealand has a high-quality palliative care system, and generally agreed that palliative care is a valuable aid at the end of life. Submitters had different views on whether palliative care was sufficient in New Zealand. Regardless of whether they thought palliative care services are adequate, submitters agreed that palliative care in New Zealand needs more resources. Submitters generally agreed that, in most cases, good palliative care services are available and adequately relieve pain at the end of life. A few submitters suggested that assisted dying and euthanasia could be a further option within the palliative care space. We heard from a significant number of palliative care specialists, doctors, nurses, and support workers. Almost all stated that assisted dying or euthanasia was incompatible with the principles of palliative care.

Some submitters believed that palliative care does not always relieve pain and suffering. Specialists acknowledged that such rare cases do exist, but said they are always due to issues of access, delivery, and misperceptions. We heard that access to palliative care services is not uniform throughout New Zealand, particularly in rural and provincial areas. Late referral to palliative care services and other delays could also potentially diminish the efficacy of the care. Some medical practitioners noted that access to palliative drugs was also restricted by regulations. In these cases, an attending doctor would require the approval of a separate authority. This sometimes leads to the drugs not being used, or a delay in their use.

Some submitters noted that as palliative care has become a very specialised service, more training is needed for doctors and nurses who are not palliative care specialists to better understand what palliative medicine consists of. Further, more needs to be done to encourage new practitioners to enter the field to meet the increasing demand for these services.

These matters may affect the quality of palliative care, but are not a reflection of the efficacy of the service so much as a need to ensure better access to, and application of, the existing services.
Some submitters argued that even if access was uniformly available, there are examples in which palliative care has failed to relieve loved ones’ pain and suffering.

When we put these examples to palliative care specialists, nurses, and others working in the field, they stressed that such instances were anomalies. Such cases indicated errors in the delivery of palliative care services, not in the nature of the services themselves. They also noted in these cases that family members frequently misunderstand what is happening to their loved one and this creates a perception that palliative care was ineffective. It is clear that better communication is needed by some palliative care workers to ensure that not only the patients, but family and friends, fully appreciate what is happening.

Specialists stressed that pain is always manageable within palliative care. However, they noted that it is important to acknowledge that life-limiting conditions frequently involve more than just physical pain. In addition to physical discomfort, such conditions often include elements of psychological and emotional pain. These can include anxiety, depression, and feelings of hopelessness. Some medical specialists, including psychologists and psychiatrists, reported that terminal diagnoses were often accompanied, initially, by severe depression, though this often abates with time. Treatment for such pain is an important part of palliative care. People suffering from depression and suicidal thoughts are treated in the same way regardless of whether their underlying condition is terminal or not. A few specialists, and several disabilities advocates, expressed serious concern that terminal patients might seek assisted dying and euthanasia while suffering from the depression related to their diagnosis. Such depression almost always passes if given time and treatment. Concerns about making it easier to end one’s life during such episodes were also echoed by suicide prevention groups.

In contrast, some submitters referred to the Oregon model. About a third of individuals in Oregon who have a prescription for lethal medicine filled do not take it. Submitters argued that having options can have a palliative effect. Others expressed serious concern that this phenomenon indicates that a large quantity of lethal prescription drugs is circulating unsupervised throughout the state.

Some submitters were concerned that any change to legislation would lead to reduced support for palliative care services. However, the only study on this issue, conducted in 2015, did not support this assertion. (It compared the development of palliative care services in three countries where assisted dying is allowed with four countries where it is not.) In fact, the legislation may have promoted the expansion of palliative care in Belgium.  

We were concerned to hear that Pasifika peoples and members of other ethnic communities are less likely to access palliative care. We heard that this maybe because the individuals are cared for by families in their own homes. One submitter suggested Pasifika people were not accessing palliative care because they were unaware of its benefits, rather than because they did not want it.

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Our response

We note that there appears to be a lack of understanding from the general public and some submitters about what palliative services can do. We urge the Government to invest in a campaign to better communicate the role of palliative care services in New Zealand, with particular emphasis given to communities that do not generally access the services.

We considered whether hospices should be funded as a core health service, rather than as a service that relies on some community fundraising. However, we note that hospices appreciate the way fundraising allows engagement with the community. Smaller hospices in particular value the contributions that families and the wider community make, and families that have used hospice services appreciate being able to give back.

We recognise that a fully funded model could undermine community engagement. We believe that the Government should investigate palliative care funding and consider whether palliative care should be funded and coded as a separate service. This would ensure that hospices receive a consistent and certain amount of funding each year.

We were concerned to hear that access to palliative care may be uneven around New Zealand, particularly in rural communities and some ethnic communities. We suggest that the Government investigate how it can promptly reduce the inequities in palliative care across the country.

We were concerned to hear that some areas have difficulties in recruiting palliative care specialists and that the sustainability of the workforce is uncertain. We are interested in how the Government plans to address the shortages in the palliative care workforce.

Some doctors expressed concern that it is difficult for primary care doctors to prescribe palliative care drugs, such as dexamethasone. This can create unnecessary delays for patients requiring these drugs. We encourage the Government to improve primary care access to palliative care pharmaceuticals.
10 Suicide

Assisted dying, euthanasia, and ending one’s life

New Zealand has a high suicide rate. About 500 people die each year by suicide. Almost three-quarters of those are male. A further 20,000 people attempt suicide. Suicide disproportionately affects Māori, Pasifika peoples, and youth.

The relationship between assisted dying and suicide was a common theme for submitters. Many referred to the definition of suicide and highlighted the parallels to the definition of assisted dying. The World Health Organization acknowledges significant definitional difficulties in its most recent publication on the issue. In its 2014 report, “Preventing Suicide: A global imperative”, it defines suicide as the act of deliberately killing oneself.

Some submitters were concerned that changing the law would be seen as normalising suicide. They felt that it was not possible to make a distinction between a suicide undertaken by someone with a terminal condition and one undertaken by someone without such a condition. Most advocates of assisted dying argued that suicide and assisted dying should not be conflated. They often made a distinction between some forms of suicide and others, suggesting that they can be categorised as either “rational” or “irrational”. This distinction was not supported by any submitters working in the field of suicide prevention or grief counselling. On the contrary, we heard from youth counsellors and suicide prevention organisations that suicide is always undertaken in response to some form of suffering, whether that is physical, emotional, or mental. All forms are deliberate and intentional. It was pointed out by a few submitters that when the media cover assisted dying stories, they always accompany the story with suicide prevention contact details.

Many submitters were concerned that if assisted dying was legalised, people would see death as an acceptable response to suffering. It would be difficult to say that some situations warranted ending one’s life while others do not. These submitters were concerned that while terminal illnesses would initially be the only scenario in which ending one’s life would be considered acceptable, this would quickly widen to include any degree of physical pain, then to include mental pain, and then in response to many other situations that arise throughout life. They pointed to several overseas jurisdictions where they believe this happened, such as Belgium and the Netherlands.

Submitters told us about their experiences of depression and suicidal thoughts. Several submitters suggested that, during their worst periods of depression, they would have opted for euthanasia had it been available in New Zealand.

A submitter suggested that about 5 to 8 percent of suicides are undertaken by sick people. Submitters therefore argued that assisted dying would make suicide less likely. There was some debate as to whether in these cases, “assisted dying” was merely reclassifying those suicides. We heard it argued that when assisted dying is not available, some people intent on ending their lives will do so while they are still physically capable, in a method that they

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26 World Health Organization (2014). Preventing suicide: A global imperative
considered less dignified than assisted dying. These individuals might choose to do this earlier than they might have otherwise done, if assisted dying was available.

**Rates of suicide where assisted dying is legal**

Some submitters suggested that suicide rates are higher in jurisdictions where assisted dying is legal. We sought advice about this claim. The Ministry of Health told us that there does not appear to be any connection between assisted dying or euthanasia and rates of suicide. We heard that because causes of suicide are complex, increases in suicide rates are unlikely to be caused by one single factor, so certainty in this area is very difficult.

Oregon was often cited as an example of a jurisdiction that saw suicide rates increase when assisted dying was made available. While suicide rates in Oregon are significantly higher than the national average, they have been high for the last 30 years. Assisted dying was legalised in Oregon in 1998. Although the rate of suicide declined in 1999, it has grown since then. This follows the United States national trend.

In 2002, the law change in the Netherlands codified accepted practice of doctors not being prosecuted for assisting a patient to die. Suicide rates in the Netherlands had declined between 1987 and 2007. However, they have increased since 2007.

**Suicide prevention support services**

Submitters highlighted the lack of support services and counselling for families bereaved by suicide. A submitter also suggested that suicide prevention is underfunded.

We asked the Ministry of Health about suicide prevention support services and funding for counselling services. The Ministry of Health told us that the Government is committed to investing in suicide prevention and postvention. It defines suicide as “a death where evidence shows that the person deliberately brought about their own death”. In New Zealand a coronial ruling decides whether a death is classified as suicide.

The New Zealand Suicide Prevention Strategy 2006–2016 provided a framework for suicide prevention efforts. The New Zealand Suicide Prevention Action Plan 2013–16 was a cross-government plan to reduce the risk of suicide, involving eight government agencies. A draft revision of the strategy, “A Strategy to Prevent Suicide in New Zealand”, was released for consultation in April 2017, led by the Ministry of Health. It includes new research and evidence about changes in society. The draft strategy does not deal with assisted dying or euthanasia because the Ministry of Health considers that there are separate legal, ethical, and practical issues to consider.

Other initiatives include “Rising to the Challenge”, which is a five-year service development plan for mental health and addiction services, the rural mental health initiative in partnership with the Ministry for Primary Industries, and the Prime Minister’s Youth Mental Health Project, which takes a cross-agency approach.

All DHBs have suicide prevention action plans for their areas. They include providing suicide awareness and prevention training for influential people in the community, such as teachers and ministers. DHBs also target support to local priority areas, including rural communities, schools, and workplaces.

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27 Postvention is an intervention conducted after a suicide. It primarily involves providing support for the bereaved, who may themselves be at increased risk of suicide.

The Ministry of Health also funds the following:

- Waka Houra, a national programme which supports Māori whānau, hapū, iwi, and Pasifika families and communities. Annual funding is $2 million.

- The Kia Piki te Ora Māori suicide prevention service, which operates in eight DHBs, with a long term goal of reducing suicides and harm associated with suicidal behaviour in Māori communities. Current funding is $1.5 million a year, excluding GST.

- The national suicide prevention training programme. The aim of the training programme is to create a supportive environment or safety net for those at risk of suicide by increasing the number of people aged 18 years and over who are able to identify individuals at risk of suicide in their communities and refer them to agencies and services that can help. The training will increase participants’ understanding of suicide risk factors in New Zealand, help them identify signs that an individual may be at risk of suicide, and teach them the skills to intervene safely and constructively. The annual cost is $530,775.

- The Family/Whānau Suicide Prevention Information Service, which develops and provides resources and information for those bereaved by suicide. Total funding for the current financial year is $404,000.

- A support service for peer support groups for those bereaved by suicide. Funding for the current financial year is $120,000.

- A service that works with media to promote safe reporting on suicide, suicide recovery stories, and information on suicide prevention. Funding for the current financial year is $125,000.

- Training for the facilitators of the WAVES suicide bereavement programme. Funding for the current financial year is $50,000.

- The Initial Response Service, which supports family, whānau, and friends in the aftermath of a suicide. This is provided by volunteers managed by Victim Support. Funding for the current financial year is $785,000.

- Expert advice and support for communities experiencing “suicide clusters or contagion”, to help them develop an appropriate response. Current funding for this is $443,000.

- A coronial data-sharing service that promptly exchanges information about suspected suicides with DHBs. This allows them to deliver better postvention responses in the community. Funding for the current financial year is $84,455.

- MH101 mental health and addictions literacy training, which provides training for “those in front-line positions who in their day to day work or life come into contact with people experiencing mental distress, so that they can recognise, relate to, and respond appropriately to that distress”. Funding for the current financial year is $394,506.

**Our response**

We acknowledge that the Government, through the Ministry of Health and other government agencies, has done significant work on suicide prevention programmes and
providing support services for families bereaved by suicide. However, we were concerned to hear that some people affected by suicide do not feel that they are getting adequate support services and counselling. We encourage the Government to continue to improve access to, and funding for, suicide prevention services and wellbeing education, particularly for young people. We also urge the Government to consider the effectiveness of its bereavement programmes for families, friends, and communities affected by suicide, and consider changes to these programmes to ensure that those affected are able to access grief counselling.
11 Conclusion

We thank the petitioner for bringing this petition before the committee and encouraging us to ascertain the views of New Zealanders on ending one’s life in this country. We appreciate that people come from a range of backgrounds and that this is a subject on which people hold strong views. We believe that the written submission and oral hearing process has provided a platform for people to share these views and discuss the issues with us. This report gives us an opportunity to summarise what we heard for the benefit of the House and the public.

Eighty percent of submitters were opposed to a change in legislation that would allow assisted dying and euthanasia. Submitters primarily argued that the public would be endangered. They cited concern for vulnerable people, such as the elderly and the disabled, those with mental illnesses, and those susceptible to coercion. Others argued that life has an innate value and that introducing assisted dying and euthanasia would explicitly undermine that idea. To do so would suggest that some lives are worth more than others. There were also concerns that, once introduced, eligibility for assisted dying would rapidly expand well beyond what was first intended.

Supporters of assisted dying feared their loss of dignity, independence, and physical and mental capacity. Submitters also spoke about the fear of pain and of having to watch loved ones suffer from a painful death. Supporters stressed their personal autonomy and that they should have the choice as to when to end their life.

Many submitters discussed their experiences of palliative care. We commend the service given by palliative care providers and hospices. However, we were concerned to hear that there is a lack of awareness about the role of palliative care, that access to it is unequal, and that there are concerns about the sustainability of the workforce. We urge the Government to consider ways in which it can better communicate the excellent services that palliative carers provide, address the unequal access, consider how palliative care is funded, and address the workforce shortages.

The relationship between assisted dying and suicide was a common concern for submitters. Some believe that assisted dying should not be considered until New Zealand’s high suicide rate is reduced. Others believe that the lack of assisted dying legislation means that people are more likely to suicide.

We recognise that a lot of work and investment has gone into suicide prevention programmes and support services. However, we were concerned to hear that people feel that there is a lack of grief counselling. We therefore encourage the Government to investigate improving access to these services.

We have not made any recommendations about introducing assisted dying legislation. We understand that decisions on issues like this are generally a conscience vote.

The petitioner asked us to investigate attitudes towards the introduction of legislation that would permit assisted dying in the event of a terminal illness or an irreversible condition which makes life unbearable. However, some submitters thought that the criteria would or should be broader than terminal illness or an irreversible condition. This has made it
difficult for us to consider what the safeguards should be. We were particularly concerned about protecting vulnerable people, such as individuals with dementia or reduced capacity. Some of us remain unconvinced that the models seen overseas provide adequate protection for vulnerable people.

We would like to thank all of the submitters for sharing their stories with us and for the respect submitters showed for opposing views when they appeared before the committee. This issue is clearly very complicated, very divisive, and extremely contentious. We therefore encourage everyone with an interest in the subject to read the report in full and to draw their own conclusions based on the evidence we have presented.

**New Zealand First minority view**

New Zealand First congratulates the petitioner for bringing this issue before the Select Committee. Medically-assisted dying is a serious matter and is so serious that it is not one that should be taken by temporarily empowered politicians. New Zealand First cannot support such a fundamental change without a clear sign that this is the will of most New Zealanders. That would be achieved by either a binding Citizens’ Initiated Referendum, or a Government Initiated Referendum held with a future General Election thus allowing for a period of informed debate.
Committee procedure

Petition 2014/18 of Hon Maryan Street and 8,974 others was referred to the committee on 23 June 2015. We received written submissions from 21,891 individuals and organisations. This total includes supplementary submissions from some submitters. We heard oral evidence from the petitioner and the 944 individuals who wished to appear before us. We received advice from the Ministry of Health.

Committee members

Simon O’Connor (Chairperson)
Dr David Clark
Sarah Dowie
Julie Anne Genter
Barbara Kuriger
Melissa Lee
Dr Shane Reti
Barbara Stewart
Poto Williams

Ria Bond replaced Barbara Stewart for some of the consideration for this item of business.

David Seymour was a non-voting member for this item of business.

We would also like to acknowledge Hon Jacqui Dean, Kevin Hague, Hon Annette King, and Hon Scott Simpson who were committee members during our consideration and hearings of evidence for this petition.
Inquiry into the 2014 general election

Report of the Justice and Electoral Committee

Fifty-first Parliament
(Jacqui Dean, Chairperson)
April 2016

Presented to the House of Representatives
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Summary of recommendations

The Justice and Electoral Committee recommends to the Government that it consider the following:

The Electoral Commission

Updating the Electoral Act 1993 and Regulations to remove references in the Act to the historical separation of services between the Chief Electoral Office, the Electoral Enrolment Centre, and the Electoral Commission.

Participation and turnout

Exploring the further development and coordination of ongoing, independent, civics education.

Amending the Electoral Act 1993 and Regulations to only prescribe the data and purpose of the electoral forms (but with the exception of ballot papers which should remain prescribed), to provide the Electoral Commission with discretion and flexibility to better meet the needs and circumstances of electors.

Enabling the Electoral Commission, where appropriate, to use new methods of providing information to electors, in addition to post.

Enrolment

Enabling the Electoral Commission, where an elector has informed them of a change of residence to a different electorate, to allow enrolment which will take effect after one calendar month from the moving date.

Promoting voter enrolment as a whole-of-government priority with government agencies working together to facilitate enrolment.

Considering conducting a review of roll access in consultation with the Privacy Commissioner, given that the information included on the roll and the availability of the roll do present privacy concerns.

Enabling electoral officials to use an online enrolment checking function in voting places to enable real-time checking of voters’ enrolment status in polling places.

Voting and election day processes

Improving accessibility to advance voting places by increasing their numbers and opening hours, and providing greater consistency, as far as is practical, between advance voting places and voting places on election day. Provided that improved accessibility is achieved, we recommend considering a 12-day advance voting period.

Allowing the Electoral Commission to investigate a new approach to advance vote counting, including bringing forward the start time for the counting of advance votes from 2.00 pm to 9.00 am on election day, the location of the count, and the use of technology, given the increasing number of advance votes.
Amending Regulation 36 of the Electoral Regulations to remove reference to “endorsement” in order to facilitate a fully electronic process for special vote declaration processing.

Enabling the Electoral Commission to make the minor improvements which it has identified that will clarify address details that overseas voters need to provide on the declaration form prescribed in the Electoral Regulations 1996.

Changing regulations relating to dictation voting for remote overseas voters to allow for applications until 4.00 pm on the Thursday before election day, and for dictation votes to be cast until the close of polling at 7.00 pm on election day.

Enabling voters on vessels and offshore installations, and on remote islands administered by the Department of Conservation, to receive and return voting papers electronically or by phone dictation.

Enabling electors of Māori descent to change roll type once each electoral cycle with the Māori Electoral Option (MEO) period taking place every three years.

Considering “decoupling” the electorate boundary review process from the census, in light of possible future changes to the census.

Reviewing whether the emergency provisions as specified in section 195 of the Electoral Act 1993 are adequate and fit for purpose.

**Broadcasting and election advertising**

Considering greater flexibility for opening and closing addresses and give parties choice around how they want to use their allocation to buy broadcasting time and money, on the condition that broadcasting time is able to be purchased in primetime slots to ensure maximum reach to electors.

Reviewing specific provisions in relation to the Electoral Commission’s power to vary broadcasting allocations to ensure greater clarity.

Considering providing clarification or exemptions to the restrictions on broadcasting election programmes to address satirical, humorous, and creative programmes.

Considering aligning the statutory tests of “election programme” in the Broadcasting Act 1989 with “election advertising” in the Electoral Act 1993, but suggest that this alignment take into account the current work by the Ministry of Culture and Heritage on broadcasting and digital media convergence.

Aligning liability for breaching Part 6 of the Broadcasting Act to apply to the broadcaster and any person who arranged for the broadcast of an election programme, whether within or outside an election period.

Prohibiting campaigning and the display of campaign material within, and in the immediate vicinity of, advance voting places.

Considering extending the current exemption from electioneering on election day for party headquarters signage to any members’ fixed parliamentary signage on electorate offices.

That the date from which hoardings can be erected should be “Saturday-ised” to provide clarity.


**Regulatory framework**

Considering making the deadlines for both the party list and bulk nominations noon on the day before nomination day.

Providing for, that when a party secretary ceases to hold office, the party appoint a default or acting secretary within five days, until a new party secretary is elected.

Enabling all submissions regarding objections to proposed electoral boundaries, to be made available online, instead of the current requirement to produce a summary of all submissions.
1 Introduction

On 30 October 2014, we resolved to conduct an inquiry into the 2014 general election. By convention, after a general election, a select committee inquiry is conducted into the legal and administrative aspects of that election. This process provides a multi-party approach to reviewing and any reform of the law and administration for any subsequent parliamentary elections.

Terms of reference
The terms of reference for the inquiry are “To examine the law and administrative procedures for the conduct of Parliamentary elections in light of the 2014 general election.”

Themes in submissions
We appointed the Ministry of Justice as advisers to this inquiry. We received 211 submissions from a variety of individuals and organisations, and heard oral submissions from 32 submitters.

The following areas attracted detailed comment in submissions:

- Advance voting, with electors being able to cast their vote during the advance voting period (17 days before election day) at 295 accessible and visible locations throughout the country. The number of advance voters has doubled from 14.7 percent in 2011 to 29.3 percent in 2014. Submitters are interested in how the increase in advance voting might affect other aspects of the election, such as enrolment or advertising.

- Turnout, which remains a concern for many submitters. Turnout in 2014 was 72.1 percent of those eligible to enrol, a small increase from the record low turnout in 2011 of 69.6 percent. Submitters suggest a range of measures to improve voter participation, especially youth participation. These include developing online voting, lowering the voting age, and introducing compulsory voting.

- Advertising rules, with submitters interested in the increasing use and variety of social media and the inconsistency between advertising rules during the advance voting period and on election day.

- The Broadcasting Act 1989, with submitters commenting on the effectiveness of opening and closing addresses; time and funding allocations; newer media, such as on-demand services; and issues with the definitions of election programmes and advertising.
### 2014 key election dates

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>10 March</td>
<td>Announcement by PM</td>
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<tr>
<td>20 June</td>
<td>Start of regulated period for election expenses</td>
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<tr>
<td>23 June</td>
<td>Launch of Enrolment Update Campaign</td>
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<td>14 August</td>
<td>Dissolution of Parliament</td>
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<td>20 August</td>
<td>Writ Day</td>
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<tr>
<td>26 August</td>
<td>Nomination Day</td>
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<tr>
<td>3 September</td>
<td>Advance and overseas voting commences</td>
</tr>
<tr>
<td>20 September</td>
<td>Election Day and preliminary results</td>
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<tr>
<td>4 October</td>
<td>Official Results</td>
</tr>
<tr>
<td>9 October</td>
<td>Due date for return of writ (was delayed until 10 October due to judicial recount)</td>
</tr>
<tr>
<td>10 October</td>
<td>Return of writ and declaration of election of list members</td>
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</tbody>
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2 The Electoral Commission

A programme of reforms to establish a single electoral agency responsible for all aspects of parliamentary electoral administration began after the 2008 general election and was completed in July 2012.

Before the reforms, electoral functions and responsibilities were spread between three electoral agencies: the Chief Electoral Office, the Electoral Enrolment Centre, and the Electoral Commission (the commission). The commission was responsible for providing public education on the electoral system, and administering the electoral laws for political parties (registering parties and their logos, allocating broadcasting time and funding, and supervising election programme broadcasting). Amalgamating the three agencies allows for a more effective and integrated approach to electoral administration.

The 2014 general election, held on 20 September, was the first election held after the three agencies had been completely amalgamated. Although amendments were made to the Electoral Act 1993 (the Act) to provide for a single agency, delivering an election has highlighted that many aspects of the legislation still reflect the historical separation of services. For example, voters expected that they would be able to enrol and vote at an advance voting place, but were instead directed to lodge an enrolment application elsewhere.

Recommendation

We recommend that the Government update the Electoral Act 1993 and Regulations to remove references in the Act to the historical separation of services between the Chief Electoral Office, the Electoral Enrolment Centre, and the Electoral Commission.

The new Electoral Commission is responsible for the entire administration of parliamentary elections and referendums. This includes

- enrolling electors
- allocating time and money for broadcasting election programmes
- servicing the work of the Representation Commission (which determines electorate boundaries)
- providing advice, reports, and public education on electoral matters
- administering electoral laws for candidates.

The commission is an independent Crown entity. It is accountable to the Minister of Justice and monitored on behalf of the Minister by the Ministry of Justice. However, the commission must act independently and is not subject to ministerial direction when performing its electoral functions.

Section 4C of the Act sets out the commission’s objective:

“to administer the electoral system impartially, effectively, efficiently, and in a way that—
(a) facilitates participation in parliamentary democracy; and
(b) promotes understanding of the electoral system and associated matters; and
(c) maintains confidence in the administration of the electoral system.”
3 Participation and turnout

Declining voter participation

Voter turnout has been declining in most developed democracies during the last 30 years. However, New Zealand’s decline has been particularly consistent.

Voter turnout, as a percentage of those eligible to enrol, dropped to 69.6 percent in the 2011 general election, the lowest recorded at a New Zealand parliamentary election since universal suffrage was adopted in 1893.\(^2\) Although the 2014 general election saw a small increase in voter turnout, it remains the second-lowest recorded result at 72.1 percent.

Voter turnout (percent) in parliamentary elections on average by decade since 1945\(^3\)

The turnout of enrolled electors in the Māori electorates also saw a slight increase from 58.2 percent in 2011 to 65.1 percent in 2014. However, the participation rates of electors who identify as Māori are lower than those who identify as non-Māori, and also lower for those enrolled in Māori electorates than for those enrolled in general electorates.

We are concerned to see that voter participation is falling for all age groups. The greatest drop is in the 25–29-year-old age group and the lowest rate of voter participation is for 18–24 year olds.\(^4\) Falling rates of voter participation appear to show that enrolment and voting is a habit that is formed early and persists as one ages.

\(^3\) Report of the Electoral Commission on the 2014 general election, p. 2. Source: Data from International IDEA database.
Post-election surveys indicate that the main reasons non-voters gave for not voting were:

- lack of interest in voting (27 percent)
- other personal reasons, such as health and religious reasons or being away from home (22 percent)
- "didn’t know who to vote for" (11 percent)
- “other commitments” (10 percent).

Only three percent of people did not vote because they did not know how or where, and only two percent said it was because a voting place was too far away.

The reasons non-voters gave for not voting appear to demonstrate that declining voter participation is less about institutional barriers and more about a lack of interest and motivation.

**Initiatives for improving voter participation in the 2014 general election**

The commission described the turnout result for the 2011 general election as a turning point. Previously, the commission had focused on making voting as accessible as possible, but, after 2011, it determined that it needed to champion participation.

The commission’s strategy for promoting participation in the 2014 general election focused on three areas. The following are some of its main initiatives:

1. **Starting a national discussion on the implications of declining voter participation.**

   In May 2014, the commission convened a Valuing our Vote conference and Rock the Vote workshops. The conference aimed to encourage discussion about declining voter participation and set the foundation for a long-term strategy that would involve the Government, academics, media, public sector agencies, and social leaders.

2. **Providing public information and education resources that facilitate participation.**

   The commission has worked to increase voter participation through its public information resources. As well as producing the traditional enrolling and voting messages, the

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commission targeted motivational messages at hard-to-reach voters and developed resources to reduce barriers to participation for those with disabilities or literacy challenges. Youth voters were targeted through Facebook advertising and radio messaging.

The commission piloted a community engagement programme to engage with under-represented groups, particularly Māori, Pasifika, and ethnic communities. The programme aimed to increase voter participation by connecting with community leaders and “influencers”.

The commission continues to support early engagement with the electoral process by developing resources and through its Kids Voting programme in schools. In 2014, the Kids Voting programme saw more than 78,000 Year 9 and 10 students take part in an authentic election experience, using real ballot papers, parties, and candidates from the election.

3 Research on what affects participation.

In August 2013, the commission hosted a one-day workshop, attended by leading academics, researchers, and interested government agencies, on voter participation and electoral research in New Zealand. In 2013, the commission also established scholarships for students completing post-graduate research in voter participation.

Improving voter participation for the future

We recognise the commission’s efforts to increase voter participation from 2011 to 2014. However, much more needs to be done to reverse the trend of declining voter participation. Although the commission could lead this work, it would require dedicated input from a wide range of stakeholders.

Civics education

Declining turnout, particularly among younger people, was of concern to submitters. Many propose that better civics education in schools could help remedy the trend.

We acknowledge the commission’s work in developing teaching units and in running the Kids Voting programme. However, the Constitutional Advisory Panel noted that, although schools have access to a wide range of educational resources, these units do not form a coherent and connected approach to civics education. We agree with submitters and the panel, and would like to see civics education strengthened in the New Zealand school curriculum, increasing in complexity as young people approach voting age.

Some of us suggested that members of Parliament are already involved in civic engagement by visiting schools. While acknowledging the risk that this might be perceived as “electioneering”, some of us felt that this could be mitigated by having the commission run a programme with a focus on information and civic participation.

Recommendation

We recommend that the Government explore the further development and coordination of ongoing, independent, civics education.

Third party voter participation campaigns

We note the work of voter engagement and participation campaigns, such as RockEnrol, Ask Away, and On the Fence, in engaging voters with the electoral process. Some of us considered that third-party voter participation campaigns were more effective in engaging
demographics that the commission was not reaching, such as youth voters. For this reason, some of us felt that these campaigns could be better funded and supported in their work. However, some of us observe that third-party voter participation campaigners can have conscious or unconscious political bias that could influence the votes of people in their target demographics. There are also risks that third-party campaigners might misrepresent parties’ policies, and unduly influence voters, hence it is inappropriate for public funding to go towards them. On balance, the majority of us consider that the focus of the commission should be on much earlier enrolment, and not on engagement through analysis of parties’ policies.

### Lowering the voting age

Many submitters support lowering the voting age to 16. They argue that 16 and 17 year olds would have a better understanding of their rights and responsibilities as citizens through civics education at school, from which political engagement and voting habits could be developed and sustained.

Submitters who oppose lowering the voting age believe that 16 and 17 year olds could be too easily influenced by their parents or mainstream media.

The commission said that it would support consideration and public consultation on lowering the voting age to 16, noting that overseas evidence indicates that it may be easier to engage 16 year olds in the democratic process than 18 year olds.

In 2007, Austria became the first member of the European Union to adopt a voting age of 16 (except at European Parliament elections, for which the voting age is 18). Electoral data shows that the turnout rates of 16 and 17 year olds were comparable to those of the wider electorate.

In September 2014, Scotland allowed 16 and 17 year olds to vote in the Scottish Independence Referendum. About 75 percent of 16 and 17 year olds are reported to have voted, higher than 18–24 year olds (54 percent) and 25–34 year olds (72 percent). After the referendum, the British and Scottish parliaments agreed to reduce the voting age to 16 for parliamentary elections and local government elections in Scotland.

We recognise that lowering the voting age would be a major change to the electoral system, requiring broad public consultation and a high level of political consensus. Provisions about the voting age in the Act are entrenched, and amending these would require a majority in a referendum or a 75 percent majority in Parliament. While the majority of the committee does not support lowering the voting age, some of the committee feel that this should be debated and considered further.

### Compulsory voting

Of the 76 submitters who commented on compulsory voting, 68 provided unconditional or qualified support. Many submitters argue that compulsory voting would lift voter participation and encourage people to become more aware of political issues and policies. Some argue that voting should be compulsory because voting is part of a person’s civic duty. Others noted that compulsory voting appears to work well in Australia.

The commission, with some other submitters, does not support the introduction of compulsory voting. It believes that concerns about voter turnout should be rectified through the active engagement of the public, rather than compelling the public to vote.
Making voting compulsory would be a major constitutional change. Therefore, we consider that, if such a move were contemplated, the public must be consulted and a high level of political consensus achieved before any such change is implemented.

**De-prescribing forms**

The commission submits that the complexity of many electoral forms is a barrier to participation. However, many forms are prescribed in either the Act or Electoral Regulations and can be changed only by legislative amendment or Order in Council. The commission argues that, generally, the Act and Regulations should prescribe what data is collected and the purpose for which it is used, but that how that data is collected and the forms to be used should be determined by the commission.

The commission is seeking to improve participation and electoral accessibility by making the forms more user-friendly—for example, by providing a form in various languages. This will enable the commission to target and encourage the participation of more diverse communities.

**Recommendation**

We recommend that the Government amend the Electoral Act 1993 and Regulations to only prescribe the data and purpose of the electoral forms (but with the exception of ballot papers which should remain prescribed), to provide the Electoral Commission with discretion and flexibility to better meet the needs and circumstances of electors.

**Communicating with electors**

The commission is required to communicate with electors at several specified points during the electoral process. For example, it conducts an enrolment update campaign about twice every three years, and it also provides information to voters about candidates and parties, voting places, and the voting process before the election takes place.

Currently, the Act requires the commission to post information to the elector’s address. For the enrolment update campaign, the commission reports that many people no longer respond to this information because they see it as a passive exercise to which no response is required.

For information posted to voters before the election, concern was raised about the length of time it took for the information to get to voters, particularly for the beginning of the advance voting period. It is also expected that changes to New Zealand Post services will mean that postal delivery times will be longer at the next election.

We recognise that legislative changes should be made to allow for more effective alternative methods of communicating with voters, whether it be to prompt voters to update their enrolment details or to provide them with information about an upcoming election. The commission suggests that one alternative method could be digital channels, such as communicating by email.

**Recommendation**

We recommend that the Government enable the Electoral Commission, where appropriate, to use new methods of providing information to electors, in addition to post.
4 Enrolment

An enrolment inquiry began on 23 June 2014, when a personalised enrolment update pack was posted to all registered electors. Any packs that were returned as undeliverable because the elector did not reside at the specified address resulted in the elector being removed from the main roll to the dormant roll.

Registrars of Electors and their staff also carried out enrolment outreach work from the beginning of the enrolment campaign until the day before election day. Through door-knocking and face-to-face interactions, such as in shopping malls, they obtained an additional 65,827 valid enrolment applications.

The rolls used on election day closed for printing on 20 August 2014 and were put on display from 5 September 2014 to allow members of the public to check the status of their enrolment. The roll contained 3,060,957 electors. This was 90.3 percent of the estimated eligible voting-age population, a small drop from the previous three elections.

People were still able to enrol after the rolls closed for printing. Between writ day\(^6\) and election day, Registrars of Electors processed an extra 166,740 enrolment applications. We are aware that enrolment application data shows that more people are leaving enrolling to the last minute.

**Enrolment comparisons as at writ day\(^7\)**

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<td>Estimated eligible voting age population</td>
<td>3,391,100</td>
<td>3,276,000</td>
<td>3,138,000</td>
<td>2,990,300</td>
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<td>Enrolled electors</td>
<td>3,060,957</td>
<td>3,013,651</td>
<td>2,935,537</td>
<td>2,812,033</td>
</tr>
<tr>
<td>% enrolled</td>
<td>90.3%</td>
<td>92.0%</td>
<td>93.6%</td>
<td>94.0%</td>
</tr>
</tbody>
</table>

About 3.013 million EasyVote information packs were posted to registered electors in New Zealand who had enrolled by writ day. The packs contained the voter’s personalised EasyVote card, information on electorate candidates and voting places, party lists, and a flyer on the mixed member proportional (MMP) voting system. An additional 77,300 packs were posted to electors who enrolled after writ day.

**The one-month rule**

Currently, the Act specifies that, if an elector changes their place of residence to a different electorate, they must update their enrolment details after living at that new residence for a period of one month. So, in current practice, if an elector moves to a different electorate, and immediately applies to update their address details, the application has to be returned and a new application has to be completed once the elector has lived at the address for one month.

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\(^6\) Writ day is the day on which the Governor-General issues a writ to the Chief Electoral Officer. The writ specifies the dates of nomination day, election day, and the latest day for the return of the writ.

\(^7\) Report of the Electoral Commission on the 2014 general election, p.75.
month. This is inefficient, confusing, and frustrating for electors who try to do the right thing by updating their enrolment details as soon as possible.

The commission submits that legislative changes should be made so that, should they receive an application to update an elector’s details before the one-month threshold, the commission will update the elector’s details on the basis of their declaration that they will continue to be at the address in one month. Confirmation can be sent to the elector at the point of enrolment to confirm that they are still at that address.

**Recommendation**

We recommend that the Government enable the Electoral Commission, where an elector has informed them of a change of residence to a different electorate, to allow enrolment which will take effect after one calendar month from the moving date.

**Accuracy and completeness of the roll, and automatic enrolment**

The accuracy and completeness of the electoral rolls are important components of electoral integrity. The commission reports that a recent independent survey of the accuracy of the rolls confirmed that they were 96.9 percent accurate as at writ day.

Some submitters suggest that electors should be automatically enrolled, using information supplied from other government data. They argue that automatic enrolment would increase the completeness of the rolls and would also be useful in reversing declining voter turnout because it would capture those missing from the rolls, a target population of concern.

In overseas jurisdictions where there is automatic enrolment, generally one of two different models are used. Many European countries, such as Denmark and Germany, have adopted a civil registry model. Under this model, the Government maintains a register of the population, including basic data such as age, residence, citizenship, and identification numbers. New Zealand does not have such a register.

Other countries, such as Canada and Australia, use a government data-sharing model in which the country’s electoral authority collects electoral information from other government agencies. New Zealand does use data-sharing partnerships to identify and contact individuals who are not enrolled or have potentially out-of-date information. However, registration is not automatic and requires direct contact with the elector. The response rate is quite low, at about 20.5 percent.

Automatic enrolment presents several challenges, including the concern of citizens and privacy advocates about data-sharing between government institutions, preserving the accuracy of the rolls, and (specifically in the New Zealand context) how to reconcile automatic enrolment with the Māori Electoral Option (MEO). The commission also notes that it has higher standards of address verification than other government departments. The commission has information-matching agreements with the Ministry of Business, Innovation and Employment, the Ministry of Social Development, the Registrar of Motor Vehicles, the New Zealand Transport Agency, and the Department of Internal Affairs. The commission works with these agencies, as they interact with their service users, to identify individuals who are not enrolled and follow up with them. We consider that there is room for more government agencies to work with the commission to encourage enrolment by integrating prompts to enrol within the services they provide.
Recommendation

We recommend that the Government make promoting voter enrolment a whole-of-government priority with government agencies working together to facilitate enrolment.

Special vote declaration as an application to enrol

Special votes are cast in instances where the voter is casting a vote from overseas, outside their electorate, or away from the supervision of an electoral officer (such as a dictation vote). A voter must also cast a special vote if they are not on the printed roll. Special voters must complete a statutory declaration at the time they vote.

During the advance voting period, anyone who is not enrolled as an elector (or is unsure about the status of their enrolment) can enrol at any point during the period with the prescribed form, and can then immediately cast their vote in the form of a special vote, except on election day.

For various reasons, an elector may choose to complete a special vote, which involves submitting their details and signing a statutory declaration in front of a witness, unaware that they are not enrolled to vote. In this case, the elector will receive a letter from the commission advising them that their vote did not count and requesting that they now enrol by submitting the same details they provided when they cast their special vote. Not only has their vote been disallowed but an opportunity to engage the elector in the political process has been lost. The elector must also duplicate the paperwork for their enrolment.

There were 328,029 special votes cast in 2014. Of these, 38,031 had only their party votes allowed because they had voted in the wrong electorate and 27,447 disallowed special votes were disallowed because the voter was not enrolled at all.

An analysis of the Te Tai Tokerau judicial recount indicated that some voters whose votes had been disallowed because they were not enrolled had completed special vote declarations at previous elections. The commission surmises that these voters thought that completing a special vote declaration would enrol them.

With both enrolment and voting now being delivered by a single agency and because both forms require similar details from the elector, the commission suggests legislative change that would enable a special vote declaration form to be treated as an application to enrol or update details. This would also serve to streamline the enrolment and voting process during the advance voting period. A minority of us support the proposal that if the special vote is cast during the advanced voting period then the vote would count for that election, and if the special vote were cast on election day, the special vote declaration form would be treated as an application to enrol or update details for the next election.

Election day enrolment

To cast a valid ballot, voters must be enrolled before election day. This means that, although advance voters can enrol and vote at the same time, those voting on election day cannot. Some submitters suggest that voters should be able to enrol and vote on election day; this would reconcile the incongruity between voters being able to enrol and vote on the same day during the advance voting period but not on election day, and would enhance the convenience for voters.

We heard that the ability to enrol on election day may also go some way to minimising disallowed special votes. During the 2014 general election, 27,467 special votes were
rejected because those casting them were not properly enrolled to vote. The commission observes that a growing number of electors find the enrolment system complex and have failed to realise that they are not currently enrolled.

One submitter notes that disallowed votes are unevenly distributed between electorates, with the highest numbers found in the Māori electorates and those South Auckland seats with a large proportion of Māori or Pasifika voters. The number of disallowed special votes represent 0.98 percent of all votes cast in general electorates and 3.15 percent of all votes cast in Māori electorates.

The ability to enrol and vote on election day presents certain challenges. Some submitters argue that many voters would leave enrolment until election day, which could result in resourcing issues on the day. We note that the trend in advance voting uptake could mitigate these resourcing issues, as fewer people choose to vote on election day. We will monitor these trends in the 2017 general election with interest.

The commission advised us that because of the numbers potentially involved, it would not be confident it could validate election day special vote enrolment applications with integrity without delaying the official count. The commission instead recommended that the question of whether election day special vote enrolment applications could be included in the official count should be reconsidered for the 2020 election in light of lessons learnt in 2017.

A minority of us believe that the ability to enrol and vote should be available on election day to prevent the currently high rate of disallowed votes.

However, the majority of us consider that the focus of the commission should be to enrol electors earlier, rather than later, to protect the integrity of the roll by allowing time for it to be scrutinised. We are not pursuing the ability of electors to enrol and vote on election day for the 2017 general election.

**Availability of the roll**

The public availability of the roll is important to ensure its integrity. Political parties, candidates, and special interest groups also use the roll to promote and mobilise turnout. However, the public availability of the roll also raises some privacy concerns, because rolls are more commonly being purchased for commercial purposes, such as debt collection, marketing, and other non-electoral purposes.

Submitters have mixed reactions about how to balance maintaining the integrity of the roll, the scrutiny of the roll, encouraging enrolment, promoting turnout, and protecting electors’ privacy. Some submitters argue that the roll should be provided only to parties and candidates. Others submit that voter participation and engagement groups should also have access to the roll to promote voter turnout, but only if they register to use the roll solely for civic purposes. The commission supports the public availability of the roll, but with certain restrictions to protect electors’ privacy, such as removing the roll from general sale and removing specific information from the roll.

**Recommendation**

We recommend to the Government that it consider conducting a review of roll access in consultation with the Privacy Commissioner, given that the information included on the roll and the availability of the roll do present privacy concerns.
**Electronic roll look-up and roll mark-off**

The commission submits that legislative change would allow it to electronically look up and mark off the roll. The commission hopes that this technology would bring about greater efficiencies in the voting process, and would like to trial the use of this technology in some advance voting places. The commission notes that this technology has been used successfully in other international jurisdictions.

**Recommendation**

We recommend that the Government enable electoral officials to use an online enrolment checking function in voting places to enable real-time checking of voters’ enrolment status in polling places.

**Closing the roll**

Some submitters argue that, although the roll has traditionally closed before voting, the advance voting period means that it is now possible to enrol at the same time as voting. They question whether this process is robust enough, and suggest an earlier closing of the roll, or a separate closing of the roll for advance voting, to ensure adequate scrutiny of the roll.

The commission observes that closing the rolls earlier would be impractical for advance voting places, because officials would be unable to tell whether a person who was not on the printed roll in the voting place was nonetheless still enrolled. We observe that more people than ever are choosing to enrol later and suggest that the commission put a strong focus on earlier enrolment. However, some of us agree with the commission that an earlier closing of the rolls could disenfranchise a significant number of people.
5 Voting and election day processes

Voter survey results showed that 92 percent of voters were satisfied or very satisfied with their voting experience, and we were pleased that satisfaction with the entire voting process improved from the 2011 general election.

Advance voting

Advance voting began on 3 September 2014. This was 17 days before election day. The number of advance votes doubled from the 2011 election, with 717,549 (29.3 percent) advance votes in 2014 compared with 334,558 (14.7 percent) in 2011. More people voted in the last three days of advance voting than in the entire advance voting period in 2011.

Most submitters who commented on advance voting support it, describing the service as “really useful”, “convenient”, “welcome”, and “brilliant”.

The commission noted that many voters chose to vote in advance for reasons of convenience. Voters found it easy to vote in one of the 295 advance voting places (compared with 254 in 2011) in highly visible and high-traffic areas throughout the country. University students away from home could vote at advance voting stations on campus, and advance voting services at airports catered to voters who were travelling during the holiday period. The commission suggests that advance voting also increased in popularity because the service gained more media coverage in 2014 than in previous elections.

Advance voting statistics from the 2014 general election

![Graph showing advance voting statistics]

Resourcing advance voting services

With advance voting increasing in popularity, the commission is reviewing its staffing and resourcing requirements, including the number and location of advance voting places.

The commission is considering a shorter, more concentrated advance voting period to allow for a more cost-effective use of its staff and resources. The commission suggests that

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in order to provide a better, more consistent service the advance voting period be concentrated in the 12 days before election day, when most advance votes are cast.

By shortening the advanced voting period, the commission also hopes that it would be able to send out EasyVote packs before the beginning of the advanced voting period. During the election, 24 percent of advance votes had already been cast before the EasyVote pack had been delivered. Although some submitters suggested sending out the EasyVote packs earlier, the commission notes that the timely delivery of the packs depended on nomination day, which was close to election day.

We would like to see an increase in the number of advance voting places, with increased opening hours, and greater consistency of opening hours between advanced voting places for the 2017 general election. We would also like to see better promotion of the availability of advance voting places. Some of us do not believe that this should be at the cost of a shorter advanced voting period, but the majority agreed that to free up resourcing to effect our recommendation, the advance voting period could be shortened to two weeks before election day.

**Recommendation**

We recommend that the Government improve accessibility to advance voting places by increasing their numbers and opening hours, and providing greater consistency, as far as is practical, between advance voting places and voting places on election day. Provided that improved accessibility is achieved, we recommend considering a 12-day advance voting period.

**Counting advance votes**

The Act enables Returning Officers to do a preliminary count of ordinary advance votes at their electorate headquarters before the poll closes. In 2014, the preliminary count of advance votes began at 2.00 pm on election day. Because of the popularity of advance voting, the average electorate had to count about 10,000 voting papers, compared with an average of 4,000 voting papers in 2011.

The commission commends the work of Returning Officers, who were able to complete counting the unexpected volume of advance votes within their target times. Ninety-eight percent of all advance votes were reported by 8.30 pm.

For the 2017 general election, the commission aims to release the results of the advance ordinary votes by 8.30 pm. However, because advance voting is expected to rise again, counting the votes to meet this target will become increasingly difficult.

The commission submits for legislative change that would allow the preliminary count of advance votes to begin earlier on election day. However, given the logistical challenges of getting advance votes back to headquarters in large rural electorates, simply allowing the count to start earlier may not be an adequate solution and a new approach may be required.

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9 Nomination day: the date specified in the writ for a general election or by-election on which all nominations for electorate candidates must be made to a Returning Officer, and in the case of a general election, by which all party lists must be submitted to the Chief Electoral Officer.
**Recommendation**

We recommend that the Government allow the Electoral Commission to investigate a new approach to advance vote counting, including bringing forward the start time for the counting of advance votes from 2.00 pm to 9.00 am on election day, the location of the count, and the use of technology, given the increasing number of advance votes.

**Preliminary count**

The growth in advance voting meant that a larger proportion of the votes were counted earlier than in previous elections. Ninety-eight percent of all advance votes were counted by 8.30 pm on election day, and 99.8 percent of all voting places reported by 11.30 pm. In total, electoral officials counted 2,112,522 votes as part of the preliminary count on election day.

Candidate scrutineers present at the official count or any judicial recount are required to sign a secrecy declaration. Scrutineers are there to observe the process and to update the candidate, who is not allowed to be present. The presence of scrutineers is an important way of ensuring the integrity of the electoral process. However, it undermines the public trust and confidence in the system if candidates or other persons were to leak the result before the official results are declared. This was an issue at the Waitakere recount in 2011 and at the official count in Hutt South in 2014.

We endorse the commission’s intention to strengthen its messaging to scrutineers and candidates about the importance of observing the correct protocols during the official count and any recount, and maintaining the confidentiality of results until they are officially released.

**Voter identification**

Several submissions call for more robust identification requirements when voters present to cast their ballot, to prevent fraud and personation. Some submitters suggest that photographic identification be required, and others suggest that postal voting be strictly limited.

We observe that fraud and personation countermeasures are in place: dual votes are extracted through the scrutiny process and not included in the official count, and cases of personation are referred to the police. The number of dual votes is very low, between 0.002 and 0.004 percent of registered voters. The pattern of dual voting between electorates does not show any attempt by an individual or group to affect the outcome of the election.

There has been an increase in referrals for personation, from 63 in 2011 to 126 in 2014. The increase in referrals may reflect a number of significant changes in the 2014 general election voting processes. In previous years, the roll was scrutinised manually. However, in 2014, the rolls were scrutinised using optical scanning technology, which is a more accurate detection system. The increasing popularity of advance voting may have also contributed to the increase in referrals, with 70 percent of the referrals involving a person who had voted during the advance voting period and then again on election day.

We note that submitters regularly raise issues of voter identification and voter fraud. Because there is no evidence of widespread fraud or personation, we do not consider it

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10 Personation: where an individual votes in an election pretending to be a different elector, or votes again after having already cast their vote.
necessary to introduce additional identification requirements when voting. We also note that requiring photographic identification from voters might result in some voters being turned away from voting, impose additional costs on voters, and ultimately further reduce turnout.

**Requirement for voter to verbally confirm their name**

For the 2014 general election, Parliament enacted a new requirement for voters to verbally confirm their name before being issued with a voting paper. This process provided for additional confirmation from the voter about their identity as well as ensuring the accuracy of the marking of the roll. We would like to see the commission ensure that this requirement is being consistently followed by issuing officers at future elections.

If it was not possible for a voter to verbally confirm their name because of disability or language difficulties, they could confirm their name by writing it or by affirming with gestures that their name as presented on the EasyVote card was correct.

**Special vote processing**

Regulation 36 of the Electoral Regulations requires Registrars of Electors to endorse the words (qualified, party vote qualified, or not qualified) on the special vote declaration. Currently, Registrars of Electors affix a label showing the voter’s enrolment status to the declaration and then endorse it by placing their initial next to it.

The commission argues that this manual process is time consuming and should be done electronically.

**Recommendation**

We recommend that the Government amend Regulation 36 of the Electoral Regulations to remove reference to “endorsement” in order to facilitate a fully electronic process for special vote declaration processing.

**Overseas voting**

The commission sent a personalised letter to all electors with an overseas postal address, informing them how, when, and where to vote. About 40 percent of the 52,226 enrolled voters with an overseas address voted. Most overseas votes came from Australia, the United Kingdom, the United States of America, and Canada.

In the 2011 general election, overseas voting fell by 35 percent from the previous election. Many overseas voters struggled to return their voting papers because they did not have access to a fax machine. The commission determined to make voting more accessible for overseas voters in future elections.

For the 2014 election, overseas voters could download their voting papers from the commission’s website, apply to the commission to have voting papers sent to them, or vote in person at an overseas post. Overseas voters could then return their votes by fax, post, an overseas post, or, for the first time, scanning and uploading them directly to the commission’s website. Although some submitters are concerned about the security of the upload process, the commission reported that an independent security review did not identify any security breaches throughout the voting process.

In 2014, there were 40,132 overseas votes, an 86.7 percent increase from 2011’s 21,496 votes. The commission suggests that the number of overseas votes increased because the
The commission has identified some minor improvements that it could make to clarify the address details that overseas voters need to provide on the declaration form.

**Recommendation**

We recommend that the Government enable the Electoral Commission to make the minor improvements which it has identified that will clarify address details that overseas voters need to provide on the declaration form prescribed in the Electoral Regulations 1996.

**Dictation voting**

**Dictation voting for remote overseas voters**

For remote overseas voters who choose to use the dictation voting service, regulations specify that dictation votes must be cast by 4.00 pm on the Thursday before election day. We agree with the commission that this deadline is unnecessarily restrictive and may present a barrier for some overseas voters. We consider that dictation votes from overseas voters should be able to be cast until the close of polling on election day.

**Recommendation**

We recommend to the Government that regulations relating to dictation voting for remote overseas voters be changed to allow for applications until 4.00 pm on the Thursday before election day, and for dictation votes to be cast until the close of polling at 7.00 pm on election day.

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Dictation voting for voters with disabilities

The 2014 general election was the first time when voters with a disability who typically need assistance with marking their ballot paper could use a telephone dictation service to cast their vote. The Association of Blind Citizens awarded the commission with the Extra Touch Award in recognition of its successful implementation of dictation voting and its success for blind and vision-impaired people.

Electors could use the service by making an initial call to register for the service, from the day after writ day until two days before election day. As part of their registration, the elector was given a unique six-digit registration number and provided with a personal question to verify their identity for when they next used the service.

From the beginning of the advance voting period until the close of voting on election day, electors could make a second call to cast their vote. One operator would read and mark the ballot options, and another operator would confirm how the ballot had been marked.

Overall, 753 people registered to use the dictation service, and 714 used it to record their vote. Ninety-five percent of dictation voters cast their vote during the advance voting period.

We are pleased with the success of the commission’s efforts to make voting more accessible to electors and that dictation voting will now be provided as a core voting service at future elections, by-elections, and referendums.

Online voting

Of the 211 submissions we received, 70 support the introduction of online voting. Submitters point out that, in this “digital age”, many government services are delivered online and that online voting would align with people’s expectations better than traditional voting. Many submitters feel that online voting would be an easier, more accessible method of voting, especially for young voters and voters with disabilities.

Some submitters oppose the introduction of online voting. Arguments against online voting include the cost to establish and maintain an online voting system, the risk of security breaches, doubt about whether a more accessible system of voting necessarily encourages voter engagement, and that New Zealand’s voting system is already one of the most accessible and trusted systems in the world.

We note the proposed online voting trials for the 2016 local government elections and will monitor these with interest. However, we recognise that there are substantial differences in systems, context, and legislative frameworks between local and national elections. We consider that, in comparable international jurisdictions, online voting has not necessarily increased voter turnout. Although we watch the progress of online voting in these jurisdictions with interest, we do not consider online voting to be a priority for the 2017 general election in light of other, more pressing concerns outlined in this report.

Services to voters

Voters in remote locations in New Zealand

For 2014, provision was made for overseas voters and voters on fishing vessels to be able to receive and return their voting papers electronically. The commission submits that there are voters in other types of remote locations in New Zealand who would also benefit from accessing these alternative voting services.
Recommendation

We recommend that the Government enable voters on vessels and offshore installations, and on remote islands administered by the Department of Conservation, to receive and return voting papers electronically or by phone dictation.

Voters in prisons

Prisoners on remand are the only prisoners eligible to enrol and vote. Before the election, Registrars of Electors visited or contacted managers of all prisons holding remand prisoners, to make sure that electors were given information about the election and the opportunity to enrol.

Returning Officers liaised with prison managers to collect prisoner votes during the advance voting period. On election day, Returning Officers visited police stations to give remand prisoners held in police cells the opportunity to vote.

Some of us consider that voting rights should be reinstated for prisoners serving a custodial sentence of three years or less, as was the case previously. We also note the recent High Court declaration that current prisoner voting restrictions are inconsistent with the New Zealand Bill of Rights Act 1990. Some of us also argue that the prohibition on prisoner voting hinders rehabilitation and disproportionately affects Māori. Having considered this issue, the majority of the committee recommends that the status quo should be maintained.

Services to voters with disabilities

We were pleased that 88 percent of voters with a disability reported that they were “happy” or “very happy” with the overall voting process and that satisfaction levels of voters with a disability had improved since 2011. Ninety-four percent of voters with a disability said that they had a good or excellent understanding of voting processes.

Some submitters appreciate the commission’s efforts to make the electoral process more accessible for voters with disabilities. Others suggest ways that the electoral experience could be improved—for example, by providing online voting or a fully automated telephone voting service so that voters with disabilities could cast their votes unassisted.

A strong theme in the submissions relating to voters with disabilities was about media coverage around the election. Submitters call for a greater use of captioning on political media coverage and more media content aimed at voters with disabilities. Some submitters argue that interpretation, captioning, and election advertising targeted at voters with disabilities should be publicly funded or not count towards electoral expenditure limits.

The cost of captioning an election advertisement or providing translation into New Zealand Sign Language is not exempt from the meaning of election expenses as specified by the Act. However, other services for voters with disabilities fall outside of what constitutes an electoral expense—for example, providing a New Zealand Sign Language interpreter at a campaign meeting cannot be deemed an electoral expense. We consider that it is important that parties be allowed to continue using their funding allocation for state-funded political broadcasts for captioning.

We are pleased at the commission’s efforts to improve the voting process for voters with disabilities, particularly by providing a telephone dictation service. We encourage the

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commission to continue to develop and improve services for these voters and to provide them with the information and services that they need to fully participate. At this time, we do not recommend online voting as a method of voting, as we have discussed previously in our report.

**Services to Māori voters**

Elector on the Māori roll were able to vote at all voting places. Eighty-six percent of Māori voters reported a high level of satisfaction with voting processes, and Māori voters reported a higher level of understanding than other voters about how and where they could vote.

For the 2014 general election, the commission took greater steps in engaging Māori electors in Te Reo Māori than in previous elections. Some bilingual voting place signage was introduced, and the commission appointed 650 Te Reo Māori speakers as staff. We are pleased by the commission’s plans to improve Māori engagement and participation by increasing the number of staff who can speak Te Reo Māori and continuing to use outreach activities targeted at Māori voters.

**Māori Electoral Option**

During the Māori Electoral Option (MEO) period, electors of Māori descent can choose whether they want to be enrolled in the general or Māori roll. The MEO period is a four month period that takes place about every five years, depending on the timings of the census and general elections.

In the run-up to an election, some Māori electors assume that they can change their roll type as part of the general enrolment or update process but are disappointed to learn that they must wait until the next MEO.

The Māori Party member of the committee recommended that those who identify as Māori in the census should be automatically enrolled on to the Māori roll, with the option to “opt off” in each election cycle.

We are concerned that such a large delay between each MEO period could confuse Māori voters and frustrate their ability to participate meaningfully in the electoral process. We agree with the commission that Māori voters should be allowed to change roll types once each electoral cycle and that this should be communicated in the commission’s enrolment update campaigns. We recognise that this change would need to be carefully communicated, so that Māori electors would be fully aware of the consequences of this when voting in local government elections.

**Recommendation**

We recommend that the Government enable electors of Māori descent to change roll type once each electoral cycle with the Māori Electoral Option (MEO) period taking place every three years.

We also note that the census is the timing “trigger” for the MEO period and is also the data source for setting the number of electorates and electorate boundaries. Statistics New Zealand is currently reviewing the census model, and we consider that any consideration of changes to the MEO period and/or setting of electorate boundaries should take this work into account. At this stage, the most practical options in these areas would be to decouple the MEO period and any review of electorate boundaries from the timing of the census,
and use an alternative data source such as Statistic New Zealand’s Estimated Resident Population.\(^{13}\)

**Recommendation**

We recommend that the Government consider “decoupling” the electorate boundary review process from the census, in light of possible future changes to the census.

**Services to diverse voters**

Although Asian, Pasifika, and young voters reported a high level of overall satisfaction with voting processes (96 percent, 98 percent, and 90 percent respectively), these demographics were more likely than other voters to report having a poor or very poor understanding of the electoral process. We are pleased that the commission will look at ways to improve outreach and information for diverse voters, and will monitor this with interest.

**Administrative and operational matters**

**Adjournment of polling in an emergency**

Section 195 of the Act provides for the commission to adjourn voting at a polling place if voting cannot proceed because of an emergency. The commission observes that this provision has significant constitutional and political implications: under MMP, if voting has to be adjourned in a voting place, the election of all members of Parliament and the formation of the Government is delayed for the period of the adjournment.

After the 2011 general election, the commission recommended further consideration of whether the current emergency provisions are adequate. The current emergency provisions do not allow nationwide adjournment and do not deal with the effect of adjournment in one area on the release of results elsewhere.

**Recommendation**

We recommend that the Government review whether the emergency provisions as specified in section 195 of the Electoral Act 1993 are adequate and fit for purpose.

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\(^{13}\) The Estimated Resident Population (ERP) is an official population measure. It is an estimate of all people who usually live in New Zealand at a given date. The ERP is produced annually and is therefore more frequently available than a 10-year census.
6 Broadcasting and election advertising

Parliament appropriated $3,283,250 to enable political parties to fund their broadcasting of election programmes for the 2014 general election, the same amount as was available in the 2005, 2008, and 2011 general elections. The commission notes that, although the amount of funding has remained the same, its purchasing power has decreased significantly over time.

The broadcasting regime

Opening and closing addresses

The broadcasting allocation and the restrictions on broadcasting election programmes continue to be a regular topic of submissions for general election inquiries. Some submitters argue that public funding for political advertising is inappropriate. Others propose that parties should be given flexibility in determining how they spend their broadcasting allocation.

Other submissions suggest that the current provisions of Part 6 of the Broadcasting Act 1989 are outdated. For example, they argue that public funding for political advertising should be extended beyond broadcasting to include other forms of increasingly popular media, such as social media or on-demand services. Submitters argue that there are much more effective means of engaging with voters than broadcasted opening and closing addresses, noting that the opening addresses attracted 146,000 fewer viewers than Channel ONE usually averages in this time slot.

Television New Zealand (TVNZ) submits that it no longer sees itself as a public national broadcaster. It said that it has moved to being a commercial operator and should not be obliged to provide free time for broadcasting. It suggests that Parliament TV would be a more appropriate channel to host the opening and closing addresses. We disagree.

Part 6 of the Broadcasting Act 1989 obliges TVNZ and Radio New Zealand to provide some time, free of charge, for broadcasting opening and closing addresses for each general election. The commission decides the amount of time each party should be given and the order of the addresses.

The provisions of Part 6 of the Broadcasting Act 1989 encourage party participation by providing that all eligible parties have a means of election advertising. This limits the advantages of the better-resourced parties by restricting their ability to conduct extensive broadcast advertising, while allowing access to broadcast advertising for parties that ordinarily would not be able to afford it.

However, Part 6 places strict restrictions on the broadcast of election programmes because broadcasting media is viewed as more influential and powerful than other types of media. It also limits parties’ abilities to choose how they will advertise or target specific demographics, and it restricts freedom of speech, particularly for parties who get small allocations. We consider that parties should be given greater flexibility about how they use their broadcasting allocation while ensuring maximum reach to electors.
**Recommendation**

We recommend that the Government consider greater flexibility for opening and closing addresses and give parties choice around how they want to use their allocation to buy broadcasting time and money, on the condition that broadcasting time is able to be purchased in primetime slots to ensure maximum reach to electors.

Section 75(2) of the Broadcasting Act 1989 requires the commission to, when allocating broadcasting time to parties, consider specific matters such as the number of MPs in the party and its polling results, as well as give broader consideration to “fairness”. Because parties have different perspectives about what is “fair”, the commission feels that allocating broadcasting time is difficult, and its allocation is almost always universally unpopular. The commission submits that the provisions that determine how it allocates broadcasting time be reviewed.

The commission also notes that a situation arose just before the 2014 general election that required the commission to vary its broadcasting allocations. The situation brought to light some deficiencies with the commission’s power to vary broadcasting allocations, and the commission submits that these powers be reviewed. In the commission’s view, the following matters require legislative review:

- the distinction between ceasing to be registered and failing to achieve registration
- eligibility to apply for allocations against final eligibility for allocations
- the scheme anticipates variation by way of reallocation yet prohibits variation in circumstances in which a party or parties have given effect to an allocation in whole or in part, but what “giving effect to” amounts to is unclear
- distinctions between criteria for the allocations and the criteria that trigger a power to vary
- what circumstances constitute a change in relationships between political parties “to a significant extent”
- whether the power to vary includes a power to reduce allocations in circumstances not covered in section 76A(4) of the Act.

**Recommendation**

We recommend that the Government review specific provisions in relation to the Electoral Commission’s power to vary broadcasting allocations to ensure greater clarity.

**Entertainment**

Important public interest exemptions for news, comment, and current affairs, protect media freedom from the restrictions in Part 6. However, there is no express exemption for satirical, humorous, and creative programmes broadcast by third parties. We agree that this is an area that either needs clarification or an exemption.

**Recommendation**

We recommend that the Government consider providing clarification or exemptions to the restrictions on broadcasting election programmes to address satirical, humorous, and creative programmes.
“Election programme” and “election advertisement”

Several submitters noted that the responsibilities of the commission overlap with those of the Broadcasting Standards Authority (BSA). The Broadcasting Act 1989 prescribes a statutory test of “election programme” and the Electoral Act prescribes a statutory test for “election advertisement”. The application of the contrasting statutory tests, or of either test by two different bodies to the same programme can produce different results.

In addition, some submitters feel that the rules that apply to election programmes are unnecessarily restrictive and curtail freedom of expression, and called for a review of the restrictions on the broadcasting of election programmes.

The commission suggests that a review of the broadcasting regime encompass the differences between the statutory tests of “election programme” in the Broadcasting Act and “election advertising” in the Electoral Act. We agree that a review would be timely, but consider that any review should consider the current work by the Ministry of Culture and Heritage on broadcasting and digital media convergence.

Recommendation

We recommend that the Government consider aligning the statutory tests of “election programme” in the Broadcasting Act 1989 with “election advertising” in the Electoral Act 1993, but suggest that this alignment take into account the current work by the Ministry of Culture and Heritage on broadcasting and digital media convergence.

At the moment, outside the election period, only the broadcaster is liable for breaching Part 6 of the Broadcasting Act. We also recommend aligning the liability for breaching Part 6 of the Broadcasting Act so that provisions would apply to the broadcaster and any person who arranged for the broadcast of an election programme in contravention of the Electoral Act, whether within or outside an election period.

Recommendation

We recommend that the Government align liability for breaching Part 6 of the Broadcasting Act to apply to the broadcaster and any person who arranged for the broadcast of an election programme, whether within or outside an election period.

Restrictions on campaigning: advance voting and election day

The advance voting period, the 17 days before election day, is a critical time for the election campaign. The prohibitions on campaigning that apply on election day do not apply during this time. However, with more people voting in advance, some submitters question the inconsistency between the lack of restrictions on campaigning in and around advance voting places and the prohibition on campaigning on election day.

Submitters who observe this inconsistency generally fall into one of the following three groups:

- Those who feel that the status quo should remain, arguing that voters could choose whether they wanted to vote during the advance voting period or vote on election day as a “special day”, without the interference of campaigning.
Those who feel that election day campaigning restrictions should be relaxed, especially given the increase in voting before election day. Some submitters argue that there should be consistent freedom to campaign and advertise throughout the voting period. A submitter also argues that the advance voting period has demonstrated that people can vote without being unduly influenced by political campaigning and advertising.

Those who feel that some or all election day campaigning restrictions should be extended to cover the advance voting period. Many submitters call for a “zone” around advanced voting places where campaigning and advertising would be banned.

The commission recorded complaints from the public or candidates and parties about campaign activity near advance voting places, or election advertising worn by scrutineers inside advance voting places. Although Returning Officers and their staff urged campaigners to exercise restraint, some members of the public still felt intimidated when they went to cast their vote.

We agree that the immediate confines of voting places need to be free of campaign material throughout the voting period.

**Recommendation**

We recommend that the Government prohibit campaigning and the display of campaign material within, and in the immediate vicinity of, advance voting places.

**Parliamentary signage**

We observed that the current rules exempt the signage around a political party’s headquarters from the definition of “electioneering” on election day. We consider that this exemption should be extended to include members’ parliamentary office signage and other fixed signage not intended to be an election advertisement.

**Recommendation**

We recommend that the Government consider extending the current exemption from electioneering on election day for party headquarters signage to any members’ fixed parliamentary signage on electorate offices.

**Hoardings**

We observed that the current rules about when political hoardings can be erected are sometimes in conflict with local by-laws causing confusion and complaints.

Apart from the two months before an election only local council rules and bylaws apply to electoral billboards. However, in the lead up to an election the relevant provisions of the Act and the Electoral (Advertisements of a Specified Kind) Regulations 2005 (which provide election signs up to $3\text{m}^2$ to be erected) apply. These generally override any council rules; however, some local rules (such as where signs can be erected) still apply.

The start of this period is two months before election day, which means that it can fall on days other than a Saturday. One submitter suggested to us that the date from which hoardings can be erected should be “Saturday-ised”. We agree with this.
Recommendation

We recommend to the Government that the date from which hoardings can be erected should be “Saturday-ised” to provide clarity.

Social media and election day

Social media continues to present several challenges to regulating the election day advertising rules.

Currently, the election day rules prohibit any statement published or distributed that may influence how voters may vote. Although these prohibitions were enacted before the use of social media, they include statements published or shared on social media. Some submitters feel that these rules do not reflect the expectation of voters about what they can post online and unduly criminalise behaviour that should not be restricted.

Social media presents other challenges. Social media users might post election material before election day, in line with current rules. However, if that material is shared or re-posted on election day, either intentionally or not, the user who shared that content would be in breach of the rules. Also, if social media users publish election material before election day, but then leave the content up on election day, they would not be in breach of the regulations, but would be contravening the spirit of the Act’s prohibition on election day electioneering.

During the advance voting period, some candidates and voters took pictures of themselves in voting places and posted them online. Not only did this raise concerns about congestion and disturbance in voting places but the commission also observes that any person who shared or posted these images on election day would breach the election day rules. The rules that protect the secrecy of the ballot are not only there to protect the voters’ privacy but are also there to protect the integrity of the vote by ensuring that the voter can never prove how they voted, to prevent intimidation.

Submitters have mixed reactions as to how to address the challenges presented by social media. Some submitters argue that there should be an exemption for personal expression of political views on social media. However, some submitters point out that high-profile personalities using this exemption might still influence voters. Additionally, it would be difficult to regulate this exemption as it applied to parties and candidates.

There is no simple solution to these issues, and, on balance, we consider that lifting the restrictions on statements on election day could be exploited. We consider that the status quo restrictions should remain but encourage a proportionate approach to infractions and the provision of further information and guidance on complying with the law.
7 Regulatory framework

MMP
After the 2011 general election, the commission conducted an extensive public consultation and review of the MMP electoral system. The commission’s recommendations are yet to be considered by Parliament.

Nominations
In the 2014 general election, 15 parties contested the party vote, and 483 electorate candidates and 440 list candidates were nominated.

General nomination statistics\(^{14}\)

<table>
<thead>
<tr>
<th>Category</th>
<th>2014</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parties contesting party vote</td>
<td>15</td>
<td>13</td>
</tr>
<tr>
<td>Male candidates</td>
<td>390 (70%)</td>
<td>397 (73%)</td>
</tr>
<tr>
<td>Female candidates</td>
<td>164 (30%)</td>
<td>147 (27%)</td>
</tr>
<tr>
<td>Total number of candidates</td>
<td>554</td>
<td>544</td>
</tr>
<tr>
<td>List only candidates</td>
<td>71</td>
<td>91</td>
</tr>
<tr>
<td>Electorate only candidates</td>
<td>114</td>
<td>73</td>
</tr>
<tr>
<td>Dual candidates</td>
<td>369</td>
<td>380</td>
</tr>
<tr>
<td>Average number of electorate candidates per electorate</td>
<td>6.8</td>
<td>6.5</td>
</tr>
</tbody>
</table>

A party’s secretary is required to provide the nominations of their electorate and list candidates to the commission. The commission provided training on how to use its secure online nominations system, and 15 parties opted to bulk nominate their electorate candidates and pay their nomination deposits using the commission’s online facility.

The deadline for the bulk nominations was at noon on 25 August 2014, while individual nominations and party list candidates closed at noon on 26 August 2014. The commission observes that the different deadlines are confusing, especially because most parties have dual candidates contesting both the party vote and an electorate. The commission submits that the process would be much simpler if parties were required to submit their party list and bulk nomination together.

Inquiry Into the 2014 General Election

Recommendation

We recommend that the Government consider making the deadlines for both the party list and bulk nominations noon on the day before nomination day.

Electoral finance

Expenditure limits and donation caps

Most submissions about electoral finance comment on campaign expenditure limits and donation caps or bans.

Some submitters suggest that the expenditure limit be the same for all parties, to provide a level playing field. Some submitters also argue that caps should be placed on the size of donations. We recognise that the current rules that govern expenditure limits and donations seek to balance various competing factors, such as

- the need to allow equitable opportunity for different political perspectives to be expressed and the need to manage perceptions of the influence of expenditure on the elections, weighed against the need for restrictions on freedom of expression to be well justified
- the need for rules to be efficient and practical for candidates, parties, promoters, and the commission.

Party secretaries

Any party applying to be registered as a political party must have a party secretary. The party secretary is responsible for discharging the party’s legal obligations under the Act.

One submitter observes that, in some cases, it would be more appropriate for political parties to be charged with offences, rather than the party secretary. The submitter argues that some party secretaries are volunteers and that it would be unfair to attribute all responsibility to them.

We note, with the commission, that enforcing compliance with a party’s legal obligations is difficult if the party does not have a party secretary for an extended period. The commission suggests that provision be made in the Act so that, if a party secretary resigns, a new party secretary must be appointed and the commission advised within 20 working days.

We note that securing a new party secretary within 20 working days would be difficult for many parties but recognise the need for someone to assume responsibility for the party’s legal obligations.

Recommendation

We recommend that the Government make provision for, that when a party secretary ceases to hold office, the party appoint a default or acting secretary within five days, until a new party secretary is elected.

Electorate boundaries

In October 2013, the Representation Commission reviewed and declared new boundaries for the 2014 and 2017 general elections. Population growth prompted the creation of new
boundaries in Auckland, and boundaries in Christchurch were altered because of population movement after the earthquakes.

Before the new boundaries proposed by the review can be fixed, the Act prescribes that they be made available for public inspection and submission by way of objection and counter-objection. There is also a requirement for the objections to be summarised and made available for public inspection.

We consider that it would provide greater transparency and be timelier if the submissions regarding electoral boundaries could be published online, without the need to complete a summary for each.

**Recommendation**

We recommend that the Government enable all submissions regarding objections to proposed electoral boundaries, to be made available online, instead of the current requirement to produce a summary of all submissions.

There are now 64 general electorates and seven Māori electorates. About 387,000 people changed electorates as a result of the boundary review, and these were sent a notification from the commission in their enrolment update and EasyVote packs.

Most of the submissions about electoral boundaries focused on electoral tolerance levels, which are currently set at five percent. One submitter notes that raising the threshold to 10 percent would better incorporate “communities of interest” and therefore promote better representation. For example, the submitter observes that topographical features divide Gisborne into two distinct communities and that it was not possible to form electorates within the current tolerance threshold without either dividing Gisborne city or by crossing the mountain ranges to form an electorate composed of communities with negligible shared interest.

We think that consideration of the tolerance level is warranted. We note that the 1986 Royal Commission on the Electoral System recommended moving to a 10 percent threshold if MMP was adopted, and that a 10 percent threshold is currently used in the Local Electoral Act 2002.

As previously noted, we are aware that Statistics New Zealand is currently reviewing the census model, and that any changes to the boundary-setting process should take into account possible future changes to the census. Regardless of the outcome of this work we consider that the current five percent tolerance level for electorate boundaries should be reviewed.

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15 As a principle, every electorate should have nearly the same total population. Where this cannot be achieved, electorates can differ in size from each other by plus or minus 5 percent. This is called ‘tolerance’ and means an electorate can have a population total that is up to 5 percent more or 5 percent less than the average electorate size.
8 Minority view

New Zealand Labour Party minority view

While there have been areas where members of the Justice and Electoral Committee have held differing views on the recommendations put forward by this report, the majority have been well canvassed and sufficiently captured. There are however two areas where we are concerned that the recommendations, as they stand, will continue to leave thousands of voters disenfranchised unnecessarily.

In the last election, almost 10 percent of the population who were eligible to be on the electoral roll did not sign up before election day. Numbers suggest that the failure to enrol does not always mean a voter does not want to participate. For the 2014 election, more than 27,000 voters made the effort to vote but had their vote disallowed because they were not on the electoral roll.

We do not make the process of enrolling and voting as easy as we could, especially for those who change address and therefore fail to re-enrol or those enrolling for the first time before the official roll is printed.

This report presented an opportunity to make changes that would reduce the number of disenfranchised voters. For instance, a person who arrives at an advance voting place to cast their vote and finds that they are not on the electoral roll will have to fill in an enrolment form and complete a special vote form, before they can receive a ballot paper. If there are any errors between these two forms, they risk having their vote disallowed. Equally, someone who believes they are on the roll and simply fills in a special declaration form, will have their vote disallowed if it is found that they were incorrect and had not enrolled.

These risks could both easily be removed by treating a special vote declaration, completed in the period of advanced voting pre-election day, as an enrolment form. It is our view that this suggestion, which was made by the commission, was not only sensible but has the potential to dramatically reduce the number of invalid votes. We are extremely disappointed this is not the view of the government members of the committee, and that as a result, this recommendation has been voted down.

A second opportunity to reduce the number of invalid votes cast, would be to allow people to both enrol and vote on election day. With 17 days of advance voting prior to the election, where it is possible to enrol and vote at the same time, it has become arbitrary to decide that this cannot occur all the way through to the close of the polls. We do not believe allowing election day enrolment diminishes the importance of early enrolment, but if the point of enrolment is to allow a person to vote, surely all of the hurdles for that vote to be counted need to be removed.

The integrity of the voting system has been well maintained with the significant increase in early voting, and we do not accept that the risk outweighs the benefit of ensuring that next time, possibly 27,000 votes will be counted.
Appendix A

Committee procedure
This inquiry was initiated on 30 October 2014. We met between 30 October 2014 and 14 April 2016 to consider the 2014 general election. We received 211 submissions and heard evidence from 33 submitters. We received advice from the Ministry of Justice.

Committee members
Jacqui Dean (Chairperson)
Jacinda Ardern
Chris Bishop
Marama Fox
Jono Naylor
Denis O’Rourke
Maureen Pugh
Metiria Turei
Hon Louise Upston
Louisa Wall
Appendix B

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Adele Cann
Adelaide Roza-Marie
Alan Page
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Andrea Howland
Andrew Allen
Andrew McCormack
Angela Hart
Angus Rooney
Anisha Sanker
Annette Bergner
Anthony Cabraal
Annette Carr
Annette Taylor
Anthony Gray
Arnia Tamihana-Simich
Avigail Allan
Barry Coates
Benjamin Ogilvie
Blind Citizens of New Zealand
Blind Foundation
Bonnie Howland
Brendon Finlay
Brent Barrett
Brent Jackson
Brittany Peck
Brooke Stanley
Bruce King
Caitlyn Bayley
Cameron Currie
Cameron Jacob-Sauer
Carol Blair
Caroline Evans
Charlotte Billing
Cherilyn Walthew
Cheryl Johnston
Christopher Barlow
Clare Kitt
Clifford Paul Mason
Colin Cross
Conservative Party of New Zealand
Curdin Krummenacher
Curtis Guy
Dale Smith
Damian Sligo-Green
Daniel Haines
Daniel Kelly
Daniel Stride
Darryl Leslie Smith
David Farrar
David Gandar
David Green
David Maclure
David Read
Deaf Aotearoa
Dean Harliwich
Debbie Miller
Deborah Priest
Dennis Frank
Dina Jezdic
Disabled Liberation Aoteaora New Zealand
Donald Munro
Dr Hugh Barr
Ellie Craft
Erin Hodgson
Fred MacDonald
Frederic Kennedy
Gemma Plank
Gen Topp
Geraint Scott
Gina Lockyer
Glenn McConnell
Graeme Edgeler
Grant Livingston-Pooley
Green Party of Aotearoa New Zealand
Greg Rzesniowiecki
Hannah Duder
Heather Robertson
Hollie Russell
Ian McLean
Jacob Myhre
Jalanda Smith
James Butler
Jan King
Jane Langley
Jane Little
Jeanette Saxby
Jill Cody
Joann Palmer
John Anderson
John Hetherington
John Hipkins
Jordan Keyzer
Jordon Pearce
Jordan Rikys
Joshua Dean
Judy Gregor
JustSpeak
Kamera Raharaha
Karen Dobric
Karina Herbert
Kat Jenkins
Kathryn Horne
Katie Johnston
Kerry Haraki
Kieran Corlett
Kim Robinson
Kyle Bluck
Lana Fran Doyle
Laura O'Connell-Rapira
Lee Nicolson
Leisa Briggs
Les Jones
Lesleigh Romond
Leyton Glen
Liam Kiely
Lilli Cornwell-Young
Lizzie Sullivan
Louis Mayo
Louise Dudson
Luana Bosanquett-Heays
Lynsey Talagi
Margie Thomson
Mark McNicholl
Mark Moir
Mary R G McDonald
Mathew Blincoe
Matthew McKenzie
Mechelle Gregory
Meg Howie, Ask Away
Mel C
Melissa Bray
Michael Low
Michele Griffiths
Michelle Raill
Miriam Peirard
Monica Munro
Monica Whattam
Morgan Watkins
National Council of Women of New Zealand
National Youth Advisory Group
Neale McMillan
New Zealand Council of Trade Unions
New Zealand First – Maungakiekie Tamaki Branch
New Zealand Labour Party
New Zealand National Party
New Zealand Nurses Organisation
New Zealand People’s Mandate Party
Niamh Wingate
Nigel McNic
Olwyn Stewart
Oscar Dowling
Pat McCarthy
Patricia W Tiatia
Paul O’Reilly
Paul Pikaahu
Peter Aimer
Peter Eian Davies
Philip Hurdle
Philip Lyth
Phill Coxon
Priscilla Northe
Professor Andrew Geddis
Professor Jack Vowles
Ray Calver
Raymond Hopkins
Reuben Telfer
Rob Salmond
Robert Lloyd
Robin Benson
Roger Fowler
Rowena Hay
Ruby Powell
Sam Dyson
Sam Smith
Sarah Spence
Scarlett Parkes
Scott Hindman
Sean Kearney
Sebastien Rousse
Shane Gallagher
Shay Bryant
Simon Walker
Steph James
Stephen Dudding
Steve Withers
Tanya Wheeler
Tara Hikuroa
Tat Loo
Tayla Rapira
Ted Higgins
Television New Zealand
Terry McCann
Tim Kibblewhite
Tim Matthews
Tim Merkens
Tracey Livingston
Urs Bauer
Vincent Rowe
Wayne Crump
William Rea
Win Moore
Zela Charlton
Zoe Joblin
Zoe Lenzie-Smith
Inquiry into issues relating to the illegal possession of firearms in New Zealand

Report of the Law and Order Committee

Fifty-first Parliament
(Kanwaljit Singh Bakshi, Chairperson)
April 2017

Presented to the House of Representatives
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Inquiry into issues relating to the illegal possession of firearms in New Zealand

Summary of Recommendations

The Law and Order Committee makes the following recommendations to the Government:

Sale and supply of firearms and ammunition

1. that the law be amended so that a firearms licence is required to possess ammunition, unless the person in possession of the ammunition is under the immediate supervision of a firearms licence holder (page 7).

2. that the law be amended so that a firearms dealer’s licence be required to sell or supply ammunition by way of a business (page 7).

3. that the law be amended so that dealers be required to keep records of sales of ammunition (page 8).

4. that it create a Police registration process for websites that wish to facilitate the buying, selling, or trading of firearms, parts of firearms, or ammunition online. It would be an offence to operate such a website without current registration (page 8).

5. that the permit to procure process be extended to cover the sale or transfer of all firearms (page 9).

Definition of military-style semi-automatics

6. that the Police investigate the creation of a category of restricted semi-automatic firearm (rifle and shotgun) to replace the MSSA firearm endorsement category (page 10).

Effectiveness of licensing, training, and registering firearms

7. that firearms prohibition orders be implemented in New Zealand (page 12).

8. that the Police Arms Manual guidelines on determining who is fit and proper to possess firearms be codified within the Arms Act 1983, with any necessary modifications, to improve the overall certainty and consistency of the licensing process (page 13).

9. that it implement a stand-down period after revocation of a licence, before a new application for a firearms licence can be made (page 13).

10. that the Arms Act 1983 be amended to clearly state that a gang member or prospect must not be considered a fit and proper person to possess firearms and therefore must not hold a firearms licence (page 15).
that the law be amended to require the Police to record the serial numbers of all firearms possessed by licence holders upon renewal of their licence or inspection of their premises (page 16).

**Criminal offending with firearms**

that it review the penalties in the Arms Act 1983 (page 18).

that the law be amended so that where a dealer has committed an offence under the Arms Act 1983, the court must treat this as an aggravating factor at sentencing (page 18).

that the Police undertake further work to determine appropriate security standards for “A” category firearms (page 19).

that the law be amended to make it clear that the secure storage requirements must be met to the satisfaction of the Police, before a licence or endorsement can be issued (page 19).

that it extend the power under regulation 29 to allow the Police to enter premises to inspect the security of “A” category firearms (page 19).

that the Arms Act 1983 be amended so that failure to comply with the storage regulations must result in revocation of a firearms licence (page 19).

**Reducing the number of grey firearms**

that it clarify the amnesty in section 10 of the Arms Act 1983 and extend it to include MSSAs, “A” category firearms, and the handing in of firearms to the Police (page 21).

that the Police develop policy guidance so that, under the amnesty, when people hand in firearms that are unlawfully in their possession, or report firearms lost, stolen, or destroyed, the Police will have the discretion not to prosecute for the possession offence, subject to police inquiries not revealing offending other than breach of lawful possession of firearms(s) under the Arms Act 1983 (page 21).

**Importing firearms into New Zealand**

that it ensure that visitors who have imported firearms and have been in the country for up to twelve months for a sporting holiday or competition should have the export of the firearms checked by the Police when they leave New Zealand (page 24).
1 Introduction

In March 2016, the New Zealand Police seized 14 illegally owned firearms from a home in Takanini. Among the firearms seized were military-style semi-automatic firearms (MSSAs). As a result of this discovery and a general increase in firearm seizures by the Police, we resolved to carry out an inquiry into the illegal possession of firearms in New Zealand. We decided on the following terms of reference to guide the inquiry:

- how widespread firearm possession is among criminals, including gangs
- how criminals, gangs, and those who do not have a licence come into possession of firearms
- what changes, if any, to the current situation may further restrict the flow of firearms to criminals, gangs, and those who do not have a licence.

New Zealand has a very low crime rate with firearms, at about 1.4 percent of all violent crime. The Police believe that most illicit firearms in New Zealand have entered the illicit market through theft of individuals’ firearms or firearms from dealers’ premises, illegal transfer from a licensed owner to an unlicensed owner, or illegal importation into New Zealand.

In 2014/15, there were 242,056 licensed firearm holders in New Zealand. We note that the overriding majority of firearms users in New Zealand are law abiding. Thus, our recommendations aim to reduce the flow of firearms to criminals, gangs, and those who do not have a licence, without unfairly impinging on law-abiding firearms users.

There are three broad categories of firearms in the New Zealand market:

- those that are lawfully possessed by licence holders (with correct endorsements)
- those that are possessed by unlicensed people and are not held or used for criminal purposes (“grey” firearms)
- those that are used by criminals and gangs (unlicensed) in the commission of offences.

Background and overview of firearms control laws in New Zealand

Firearms control in New Zealand began with the Arms Ordinance of 1845, and the first detailed firearms legislation, the Arms Act, was passed in 1920. The Arms Act 1920 included a system of permits to procure firearms and an obligation to register individual weapons. Automatic pistols were declared to be unlawful weapons and a licence was required for the possession of other handguns.

The 1920 Act was replaced with the Arms Act 1958. Permits were required for the import of firearms and unlawful weapons (any automatic pistol), and for the possession of firearms and ammunition. A certificate of registration was required for all firearms and pistols. However, a single permit to procure a shotgun enabled the purchase of more than
one shotgun. No person was to be registered as the owner of any firearm if, in the opinion of police, that person was not a fit and proper person to be in possession of that firearm. The age limit was set at 16 years for the possession of firearms.

In 1973, checks on the firearms register found that 66 percent of entries were inaccurate in some respect, and that a large number of the rifles registered could not be located. The costs associated with maintaining the paper-based register outweighed its benefits, so it was decided to stop registering firearms and rely on a more intensive screening of applicants during the licensing process.

**Arms Act 1983**

The Arms Act 1983 came into force after a decade of consultation. Its purpose was to “consolidate and amend the law relating to firearms and to promote both the safe use and control of firearms and other weapons”. The Act provided lifetime licences to persons aged 16 years or over who the Police considered to be “fit and proper” to be in possession of a firearm. There was no requirement to register most weapons, except for pistols and restricted weapons, which also required a permit to procure.

**Arms Amendment Act 1992**

After the shooting of 13 people at Aramoana, there was a call for tighter firearm controls. The Amendment Act added MSSAs to the list of weapons that required a licence endorsement to possess and a permit to procure. The Act also revoked lifetime licences, required shooters to apply for new 10-year licences, and restricted ammunition sales to firearms licence holders.

**Arms (Military Style Semiautomatic Firearms and Import Controls) Amendment Act 2012**

Amendments passed in 2012 focused on the classification of MSSAs. They covered four main areas:

- a clearer and more adaptable definition of MSSAs
- an extension of regulation-making powers so that the Police can declare a firearm or type of firearm to be an MSSA
- a right of appeal to allow firearms owners to challenge the classification of a firearm as an MSSA
- restrictions on importing airguns that have the appearance of being pistols, restricted weapons, or MSSAs (these are defined as restricted airguns).
2 Sale of firearms and ammunition

Requirements for sale of firearms and ammunition

It is an offence to sell firearms, restricted weapons, or ammunition to a person who does not hold a firearms (or dealer’s) licence. A dealer’s licence permits the holder to sell, and manufacture for sale, firearms and airguns by way of a business. It lasts for one year from the date of issue.

Under section 43A of the Arms Act, selling firearms or ammunition by way of “mail order” requires a written order, signed by the purchaser and the Police, confirming that the purchaser holds a valid firearms licence. This section covers online purchases such as Trade Me transactions, unless the transaction is carried out in person. Where a sale is carried out in person, the seller is legally required to ascertain that the purchaser is the holder of a firearms licence, but a written order is not necessary.

Under section 43B of the Arms Act, it is an offence to sell or supply ammunition to a person who is not a firearms licence holder or a licensed dealer. The section also provides that it is a good defence to prove that:

- the ammunition was supplied to a person for use under the immediate supervision of a firearms licence holder; and

- when the person was in possession of the ammunition, they were always under the immediate supervision of a firearms licence holder.

A firearms dealer’s licence is not required to sell or supply ammunition by way of a business. We consider that this should be a legal requirement.

Recommendations

1. We recommend to the Government that the law be amended so that a firearms licence is required to possess ammunition, unless the person in possession of the ammunition is under the immediate supervision of a firearms licence holder.

2. We recommend to the Government that the law be amended so that a firearms dealer’s licence be required to sell or supply ammunition by way of a business.

Record of dealings by licensed dealers

The Arms Act requires licensed dealers to record the details of every receipt, sale, or manufacture of a firearm. It also requires the Police to inspect these records every 12

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1 Ammunition is not defined in the Arms Act, but it is interpreted in a similar way to “safety ammunition” as defined in various Hazardous Substances Regulations made under the Hazardous Substances and New Organisms Act 1996, namely in terms of an article that comprises:

(a) a cartridge, fitted with a primer and containing an explosive; and

(b) one or more projectiles contained wholly or partly within, or fitted to, the cartridge.
months. We consider that ammunition should also be covered by a legal requirement for dealers to keep records of a sale.

We note that there is no equivalent legal requirement for private sellers or buyers to record the details of a firearms transaction. We considered whether the Arms Act should be amended to create a legal requirement for all sellers to record the details of a transaction. However, such a requirement would be difficult, if not impossible, for the Police to enforce because of the private nature of such sales. In addition, although such a requirement might help in tracing a firearm when recovered from a crime, it would do little to target the illegal sale, or theft, of firearms.

Recommendation
3 We recommend to the Government that the law be amended so that dealers be required to keep records of sales of ammunition.

Sale of firearms and ammunition online

Many submitters raised concerns about the ability to purchase firearms online.

We note that only authenticated users may sell firearms on Trade Me, and only “A” category firearms may be advertised on Trade Me. However, sellers do not need to enter their firearms licence number before listing a firearm on the website. To bid or ask a question on a firearms listing on Trade Me, a person must enter their firearms licence number. However, this number is not validated.

We also note that it is possible to bypass certain requirements during an online transaction. For example, transactions may take place in person to avoid the “mail order” requirement, and there is no way to be sure that the firearm being delivered is the same firearm that was advertised online.

We heard that the Police are working closely with Trade Me in this area. We believe that providing online sellers like Trade Me with the ability to check a firearms licence number would strengthen the administration and management of firearms in New Zealand.

We recommend that the Government consider creating a registration process for online firearms dealers in order to enhance the transparency of online transactions. Specifically, we propose that any website that facilitates the buying, selling, or trading of firearms, parts of firearms, or ammunition in New Zealand must be registered with the Police. Registered websites would display proof of Police registration and it would be an offence to operate such a website without being registered.

Recommendation
4 We recommend to the Government that it create a Police registration process for websites that wish to facilitate the buying, selling, or trading of firearms, parts of firearms, or ammunition online. It would be an offence to operate such a website without current registration.
Permit to procure

Pistols, MSSAs, and restricted weapons can be supplied only to a purchaser who has a permit to procure issued by the Police. Permits may be issued only to persons with the appropriate endorsement and are valid for one month.

The Arms Regulations outline the process for obtaining a permit to procure. An application requires the name and firearms licence number of both the applicant and the owner, among other details.

We recommend that a permit to procure be required for the sale or transfer of all firearms. The permit process would give details of firearms transactions to the Police and it would allow them to slowly build up a database of firearms possessed by individuals. Although there would be an administrative burden on buyers, sellers, and the Police, the process would ensure better monitoring of private sales.

We heard that Police’s planning for the future includes processes that will enable permits to procure to be obtained online. This would reduce the administrative burden on buyers and sellers, especially those located in rural New Zealand. However, we note that some parts of the transaction will always be face to face, as required by the Arms Act.

Recommendation

5 We recommend to the Government that the permit to procure process be extended to cover the sale or transfer of all firearms.
3 Definition of military-style semi-automatics

Problems with the current definition of military-style semi-automatics

MSSAs are defined as any semi-automatic firearm that has any of the features listed in section 2 of the Arms Act. MSSAs require an “E” endorsement to possess, and are subject to increased security requirements, as set out in the Arms Regulations.

We are concerned about whether the current classifications are sustainable or enforceable. They make a distinction between MSSAs and other semi-automatic firearms (rifles and shotguns). However, it is difficult for legislation to take into account the interchangeability of parts and the wide variety of firearm grips. In particular, the way MSSAs are currently classified raises three grounds for concern:

- “A” category firearms can be converted to MSSAs
- dealers can manufacture MSSAs
- “A” category parts can be imported and used to make MSSAs.

To address this, one possible option would be to amend the Arms Act to require all semi-automatic rifles and semi-automatic shotguns to require an “E” category endorsement. Consequently, there would be a requirement to have an “E” endorsement for the possession of any semi-automatic firearm or shotgun, and to provide special reasons when applying to import these firearms.

Many submitters were opposed to this option because they feared it would entail significant costs for the firearms community. These costs include additional fees, paperwork, and security arrangements. Submitters also noted that many people have semi-automatic rifles and shotguns for sporting purposes.

Another option would be to classify as MSSAs all semi-automatic rifles and shotguns with detachable magazines, and those with integrated magazines that have a capacity of more than 15 rounds. This option would cover the majority of semi-automatic rifles that have detachable magazines.

Our preferred option is to redefine an MSSA as a semi-automatic with a magazine holding, or capable of holding, 11 rounds or more. This proposal was put to the Government in 2010 but did not progress. One difficulty with this proposal is that, unless there are controls on the purchase of large magazines, there would be many “A” category firearms in the community, subject to minimum controls, that could readily be converted to MSSAs by fitting a large magazine.

Recommendation

6 We recommend to the Government that the Police investigate the creation of a category of restricted semi-automatic firearm (rifle and shotgun) to replace the MSSA firearm endorsement category.
4 Effectiveness of licensing, training, and registering firearms

Current process of firearms licensing

The current regime focuses on people being “fit and proper” to possess firearms. The Police are responsible for administering firearms legislation. Firearms in New Zealand are primarily controlled by the Arms Act 1983, the Arms Regulations 1992, and the Arms (Restricted Weapons and Specially Dangerous Airguns) Order 1984. These are expanded by policy directions.

One of the objectives of the current firearms licensing regime is to “maintain public safety and reduce crime by promoting the safe use and control of firearms and other weapons”.

Persons applying for the issue or renewal of a firearms licence must be 16 years of age or older and be a fit and proper person to possess a firearm. A first-time applicant is required to attend and pass a firearms safety course before submitting their licence application. The Police interview applicants, inspect their firearm security arrangements, and interview referees to determine whether the applicant is fit and proper to possess a firearm.

A standard firearms licence (commonly referred to as an “A” licence) is issued under the Arms Act and permits the holder to possess sporting-type shotguns and rifles, and certain air rifles. However, specialist weapons such as pistols, MSSAs, and restricted weapons require an additional application for a licence endorsement. Firearms licences must be renewed every 10 years and endorsements need to be reapplied for at the termination of a firearms licence.

One of the conditions of a firearms licence is that all firearms possessed by the licensee must be stored securely. The Arms Regulations 1992 outline the security requirements, which are enhanced for pistols, MSSA firearms, and restricted weapons.

Screening of applicants

The current vetting process includes, but is not limited to:

- information held on police computer systems, including criminal records, intelligence data, and Court Orders such as Family Violence Protection Orders
- for first-time applicants, a face-to-face interview with an unrelated referee
- a face-to-face interview with the applicant and their partner, spouse, or next of kin
- physical inspection of the security in place for firearms
- recording information about firearms held, ensuring that the security inspected is appropriate for the firearms the applicant claims to possess

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2 Police Arms Manual 2002, paragraph 2.5.
• any other inquiry that the Arms Officer considers necessary.

Several submitters felt that more stringent restrictions ought to be applied to the current licensing regime. Their suggestions included raising the minimum age required to obtain a licence to 18 years, applying a more onerous vetting process, shortening the renewal period to five years, and introducing firearms prohibition orders.

We heard that reducing the duration of firearms licences from 10 years to five years would incur considerable administrative costs. In addition, it is unclear whether this increase in cost would provide any real benefit in reducing the number of firearms held by unlicensed people. This is because most licence holders successfully renew their licence every 10 years.

In Australia, firearms prohibition orders are used in three states. They are used to proactively manage high-risk individuals and their possession of, use of, and association with firearms. In New South Wales, anyone subject to such an order faces substantial penalties for possessing firearms. They cannot knowingly be in the company of people with firearms, and cannot knowingly reside at or visit a location where there are firearms. The police can stop and search a person who is subject to a firearms prohibition order. They can also search houses and vehicles the person occupies, without a warrant, to check whether an order has been breached.

The Minister of Police has indicated that consideration is being given to introducing firearms prohibition orders in New Zealand. We support this initiative where it strengthens the ability of the Police and the Judiciary to issue prohibition orders under certain prescribed circumstances.

**Recommendation**

7 We recommend to the Government that firearms prohibition orders be implemented in New Zealand.

**Codification of the “fit and proper” guidelines**

Under section 24 of the Arms Act 1983, the Police shall issue a firearms licence if a person is assessed as fit and proper to possess firearms. However, there is no legislative definition of “fit and proper” for the purpose of this section. As the administrator of the legislation, the Police have developed a process and standards to ensure compliance with this provision.

The Police Arms Manual 2002 describes a fit and proper person as “a person of good character who will abide by the Laws of New Zealand and the provisions of the Arms Act 1982, the Arms Amendment Act 1992 and the Arms Regulations 1992”. The Manual outlines that an applicant could be considered not a fit and proper person if:

• they have been the subject of a protection order
• they have shown no regard for the Arms Act or Arms Regulations
• they have been involved in substance abuse
• they have committed a serious offence against the Arms Act or any other Act, or a series of minor offences against the Arms Act
they have committed crimes involving violence or drugs
• they have affiliations with a gang involved in committing violent offences or in conflict with another gang
• they have been or are involved in matrimonial discord involving violence or threats of violence
• they have exhibited signs of mental ill health, or attempted to commit suicide or other self-injurious behaviour
• they have not complied with security conditions
• or if, for some other reason, they are considered not fit and proper.

The Police are reviewing whether there could be further legislative guidance for determining whether a person is fit and proper to possess a firearm.

**Recommendation**

8 We recommend to the Government that the Police Arms Manual guidelines on determining who is fit and proper to possess firearms be codified within the Arms Act 1983, with any necessary modifications, to improve the overall certainty and consistency of the licensing process.

**Revocations and refusals of firearms licences**

A firearms licence shall be refused where there are reasonable grounds to suggest that the applicant is not fit and proper to possess firearms. Where a licence has been granted, section 27 of the Arms Act governs the revocation of that licence. A revoked firearms licence may be reinstated on appeal to the Courts.

Some submitters, including the New Zealand Police Association, expressed concern about the revocation of firearms licences. In particular, they note that the Courts often reject key elements of the Manual’s policy when revoked licences are appealed. We believe that codifying the “fit and proper” guidelines into the Arms Act would address this issue.

However, we believe there should also be a stand-down period following revocation of a licence, before a new application for a firearms licence can be made.

**Recommendation**

9 We recommend to the Government that it implement a stand-down period after revocation of a licence, before a new application for a firearms licence can be made.

**Gang members and prospects**

The evidence indicates that unlawful firearms possession and use is an integral aspect of gang culture in New Zealand. In 2014, the Police analysed 3,969 patched members and prospects belonging to 32 New Zealand adult gangs. They looked at the proportion charged with a serious violence offence involving a firearm or an offence against the Arms Act. The analysis showed that 44 percent of the members and prospects had been charged
with an offence involving a firearm, and that 9 percent had been charged with five or more offences involving a firearm during their lifetime.

In April 2016, the Police identified 29 firearm licence holders who were members of a New Zealand adult gang. Six of these licences have since been revoked or surrendered.

We note that the current law creates difficulty in refusing to issue or renew a firearms licence to an applicant solely on the basis that they are a member of a gang. This is because determining whether a person is fit and proper requires consideration of several factors.

In the recent case of Innes v Police, it was found that gang membership is directly relevant to whether a person is fit and proper to hold a firearms licence.\(^3\) However, the fact that Mr Innes was a patched and active member of a gang that actively engages in criminal activity was not the sole reason that he was considered not fit and proper. Other factors were his failure to advise the Police of his current address, to surrender his licence after it was revoked, and to clarify the whereabouts of his firearms after his licence was revoked.

In June 2014, Cabinet approved the “Whole-of-Government Action Plan to Reduce the Harm Caused by New Zealand Adult Gangs and Transnational Crime Groups”. This Action Plan aims to combine law enforcement with social service intervention and has four key components:

- establishing a multi-agency Gang Intelligence Centre
- developing a programme of social initiatives, “Start at Home”, to support gang members and their families to turn away from the gang lifestyle
- establishing multi-agency Enforcement Taskforces to strengthen border protection, prevent the financing of crime, and target profit received from crime
- strengthening legislation, including options for a firearms prohibition order regime, the legal authority and protections for Police undercover operations and informants, and the use of drug detector dogs at domestic maritime ports and airports.

We support this Government initiative, and recommend that the Arms Act be amended to clearly state that a gang member or prospect must not be considered a fit and proper person to possess firearms and therefore must not hold a firearms licence.\(^4\)

The amendment would take the form of section 27A, which currently states that the Police may decide that a person’s involvement with domestic violence constitutes grounds for deciding that a person is not a fit and proper person to possess firearms and should not be issued with a firearms licence or should have their licence revoked. We believe that such an amendment would greatly reduce the number of firearms used by criminals and gangs in the commission of offences. It would also provide Police with the appropriate mandate to identify and pursue gang members who they believe are in the possession of firearms.

\(^3\) Innes v Police [2016] NZDC 4538, paragraph 42 of the judgement.

\(^4\) The definition of ‘gang’ would be the same as stated in section 4 of the Prohibition of Gang Insignia in Government Premises Act 2013.
**Recommendation**

10 We recommend to the Government that the Arms Act 1983 be amended to clearly state that a gang member or prospect must not be considered a fit and proper person to possess firearms and therefore must not hold a firearms licence.

**Firearms safety courses**

The Mountain Safety Council delivers the firearms safety course nationally under a letter of agreement with the Police. The course is primarily for new firearms licence applicants who are required to complete a firearms safety training course and pass a theoretical test.

The Whakatūpato programme is a joint venture between the Mountain Safety Council, the New Zealand Police, and iwi. It aims to provide firearms safety training to remote and rural communities where, for many reasons, it may be difficult to access this training. The training is generally delivered in a way that observes tikanga Māori. However, the content can be adapted to suit other community groups.

Submitters raised concerns about the Mountain Safety Council’s decision to shift from training delivered by volunteers to training delivered by paid staff. In particular, the concerns were that losing so many volunteers would mean that the training programme was no longer tailored to the community, and that this would be a disincentive for people to become firearms licence holders.

We understand that a tender process is under way for the delivery of the firearms safety programme. We expect that the outcome of the successful tender will be a programme that is widely accessible throughout New Zealand.

**Registration of firearms**

Because there is no system for individual firearms to be registered, the Police do not maintain a record of all firearms owned by firearm licence holders. The Police encourage owners to record the make, model, and serial number of their firearms on a free website called SNAP for identification and tracking purposes. However, this is not a legal requirement and is not enforceable.

The Police hold information about pistols, restricted weapons, and MSSAs possessed by licence holders. This is because such weapons may be sold or supplied only to a person holding a permit to procure, or imported by means of an import permit. A permit to procure is issued by a member of the Police, and individuals are required to confirm having taken possession of these firearms where such a permit has been issued. The Police use information from the permit process to record the details of the pistol, restricted weapon, or MSSA against the person's firearms licence.

There are several issues with registering firearms, many of which were raised in the 1997 Thorp Report and the 2001 report of the Law and Order Committee on the Arms Amendment Bill (No 2) 1999. These include:

- the cost of implementation and the time it would take
- lack of evidence that registration will result in a reduction of violence involving firearms
difficulties with obtaining a high degree of compliance and accuracy

- the number of illegal firearms that would remain outside the system (including those in possession of the criminal community), which would significantly reduce the benefits of registration.

In 1996, Australia implemented mandatory registration of all firearms. However, it is unclear whether the system reduced the use of illicit firearms. Although there was a decline in firearm homicides and firearm-related crime, most homicides in 2005-06 involved firearms that were not registered (90 percent) and offenders who did not have a firearms licence (87 percent).\(^5\)

We recommend that instead of creating a firearms register, the legislation be amended to require the Police to record the serial numbers of firearms owned by licence holders. This would be done when a licence holder renews their licence and the Police visit their premises to check their security arrangements, or when the Police inspect a licence holder’s premises for any other reason, such as change of address. This would involve a requirement for firearm owners to produce all their firearms on demand at the time of inspection. This approach would require fewer resources to maintain and would increase the amount of information available to the Police.

**Recommendation**

11 We recommend to the Government that the law be amended to require the Police to record the serial numbers of all firearms possessed by licence holders upon renewal of their licence or inspection of their premises.

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5 Criminal offending with firearms

Resolving burglaries and reducing theft of firearms

In 2015/16, more than 72,000 burglary victimisations were recorded, a 13.7 percent increase since 2014/15. Burglary from licensed firearms owners is deemed to be the primary source of firearms for criminals. Rural properties are often targeted as a source of illicit firearms because of the high availability of firearms and their remote location.

Research from the 1997 Thorp Report indicates that shotguns and rifles, including sawn-off weapons, were the weapons of choice for criminals and gangs. This is likely to be due to the limited availability of pistols and MSSAs, which are subject to higher security requirements and make up much less of the firearms market. Although it is very difficult to estimate the number of firearms in the possession of criminals and gangs, the Thorp Report estimated this at between 10,000 and 25,000 in 1997. No other formal estimate has since been made.

We heard that the Police have taken several steps in 2016 to target burglary, including a “Burglary Focus” national tasking, the development of a best-practice guide to responding to burglaries, district- and national-level operations, and a review of case files to identify opportunities for improvement.

In June 2016, the crime of dwelling burglary was raised from a volume crime to a priority offence. The new policy set the expectation that police would attend after every such burglary. We note that this applies only to house break-ins, and does not cover other residential or commercial burglaries, such as out-buildings or yards. However, where any firearm has been reported stolen, this is treated as a priority offence regardless of the type of premises.

Amending the penalties under the Arms Act 1983

Several submitters expressed concerns about the penalties under the Arms Act; in particular, that the current penalties have very little deterrent effect.

We heard that inflation has considerably devalued the financial penalties, reducing the financial hardship imposed on offenders. In addition, New Zealand has low maximum custodial penalties compared with overseas jurisdictions. This is because penalties under the Arms Act are treated as administrative breaches rather than as offences that can carry serious criminal consequences.

We note that many of the current penalties under the Arms Act are out of date and do not reflect the seriousness of the offences. We recommend that the Government review all of the penalties in the Arms Act, including:

- section 16: importing firearms without a permit
- section 20: possession of firearms without a licence
INQUIRY INTO THE ILLegal POSSESSION OF FIREARMS IN NEW ZEALAND

- section 43: selling or supplying a firearm to an unlicensed person
- section 45: unlawful carrying or possession of firearms, airguns, pistols, restricted weapons, or explosives except for lawful, proper, and sufficient purpose.

We also propose that if the person committing an offence under the Arms Act is a dealer, the court should treat this as an aggravating factor at sentencing. Dealers have to be particularly held to account because the impact of their offending can have greater consequences than a private owner’s non-compliance with the Arms Act.

Recommendations

12 We recommend to the Government that it review the penalties in the Arms Act 1983.

13 We recommend to the Government that the law be amended so that where a dealer has committed an offence under the Arms Act 1983, the court must treat this as an aggravating factor at sentencing.

Regular checks on the storage of firearms

Regulation 19 of the Arms Regulations makes every firearms licence subject to security precautions. It outlines the reasonable steps a licence holder must take including keeping on the holder’s premises one of the following:

- a lockable cabinet, container, or receptacle of stout construction in which firearms may be stored
- a lockable steel and concrete strong room in which firearms may be stored
- a display cabinet or rack in which firearms may be immobilised and locked so that none of them may be fired.

Regulation 28 sets out tighter security requirements for pistols, MSSAs, and restricted weapons. One option for increasing the security of firearms would be to extend the security standards for pistols, MSSAs, and restricted weapons to “A” category firearms. We recommend that the Police undertake further work to determine appropriate security standards for “A” category firearms. We think that the current standards need to be increased. However, we do not think that the new standards need to be as restrictive as those for pistols, MSSAs, and restricted weapons.

We recommend amending the legislation to make it clear that the secure storage requirements in regulations 19 and 28 must be met to the satisfaction of the Police before a licence or endorsement can be issued.

Regulation 29 empowers police to enter premises to inspect the security of these weapons, but this power does not extend to the security of “A” category firearms (sporting rifles and shotguns). We recommend that this power be extended to “A” category firearms to allow police to check that licensed users are complying with the storage regulations. We also recommend that non-compliance with the storage regulations be grounds to revoke a firearms licence.


**Recommendations**

14 We recommend to the Government that the Police undertake further work to determine appropriate security standards for “A” category firearms.

15 We recommend to the Government that the law be amended to make it clear that the secure storage requirements must be met to the satisfaction of the Police, before a licence or endorsement can be issued.

16 We recommend to the Government that it extend the power under regulation 29 to allow the Police to enter premises to inspect the security of “A” category firearms.

17 We recommend to the Government that the Arms Act 1983 be amended so that failure to comply with the storage regulations must result in revocation of a firearms licence.

**Increased resourcing**

Concerns have been raised about the amount of police resources available to target criminal offending and the importation of firearms. Organisations based in regional and rural areas expressed concern about the shortage of Police in rural areas. They believe that this is a primary cause of firearm theft in rural communities.

Firearms licensing by the Police is funded from a combination of Crown revenue and fee revenue from applications for firearms licences, dealers’ licences, and firearm licence endorsements. However, the revenue obtained from fees covers less than half of the cost of firearm licensing.\(^6\)

In 2015, the Police began a project to strengthen the administration and management of the Arms Act. Part of this project includes assessing all costs associated with administering the Act, and the current level of funding. We expect that the initial phase of this project will be concluded by the end of 2017, and that it will give a clearer picture of what needs to be done to meet future costs.

Ideally, the cost of administration and management of the Arms Act should be self-funded. That is, costs should be met through revenue generated by the licensing regime. We note, however, that if the costs of complying with the Act become a barrier to compliance, then it may be counterproductive to ensure that people become licence holders and maintain their licence.

\(^6\) Based on the Police’s 2013/14 and 2014/15 Annual Reports.
6 Reducing the number of grey firearms

Grey firearms

“Grey” firearms are firearms that are in the possession of unlicensed people for a variety of reasons, such as inheriting a firearm on the death of a licence holder, or the expiry of the gun owner’s licence. Grey firearms are not used for criminal purposes. There are concerns that thefts of these firearms are much less likely to be reported because the owner should not have been in possession of the firearm to begin with. Thus, we considered the possibility of an amnesty or buy-back scheme to reduce the number of grey firearms in New Zealand.

We heard that, as part of the review project, the Police are improving their follow-up of licences that are not renewed. This intends to capture “forgotten” firearms in cases where the licence holder dies, or in other circumstances that lead to a firearm being with an unlicensed person. The sharper management of grey firearms will reduce this avenue of supply to the illicit market.

Firearms amnesty

A firearms amnesty is a set period of time during which people can hand in to the Police firearms that they either do not want or do not have a licence or endorsement for, on the understanding that they will not be charged for unlawful possession under the Arms Act. No compensation is paid for the surrendered weapons, and people surrendering firearms or other items are not asked how the item came into their possession.

Since 1972, nine arms amnesties have been held in New Zealand. They are usually held in conjunction with changes to firearms legislation. The most recent amnesty was in 1999 and resulted in the surrender of 1,200 firearms. However, the campaign cost $350,000 in the form of newspaper advertisements, posters, and letters mailed to firearms licence holders.

We note that section 10 of the Arms Act in effect provides a permanent amnesty for pistols, restricted weapons, and in practice (though not stated), MSSAs. Section 10(2) allows these weapons to be handed in to a licensed arms dealer if, for any reason, the person does not want to hand it in to the Police. We recommend that the codified amnesty in section 10 be clarified and extended to MSSAs and “A” category firearms, and that it cover the handing in of firearms either to the Police or to dealers.

The Police can use their discretion at any time with respect to prosecuting offenders. We recommend that the scope for discretion be clarified in cases where, under the amnesty, people hand in firearms that are unlawfully in their possession, or report firearms lost, stolen or destroyed. In such cases the Police should exercise their discretion not to prosecute for the possession offence, subject to Police inquiries not revealing offending other than breach of lawful possession of firearms under the Arms Act 1983.
Buy-back scheme

Buy-back schemes compensate owners for firearms they no longer wish to retain. New Zealand has not had any buy-back operations, because the use of buy-backs as a gun control measure rests on the guns purchased being at substantial risk of criminal use. A decrease in the number of low-risk guns or guns owned by low-risk users will have little effect on criminal activity.

A range of issues also arise in relation to the buy-back of firearms, particularly MSSAs. Although a monetary reward would provide an incentive to surrender grey guns, on balance it appears that the risks and costs of implementing a buy-back programme outweigh the identifiable benefits.

During 1996/97, Australia operated a 12-month buy-back scheme for newly prohibited firearms. Arrangements were also made to compensate firearms dealers for loss of business related to prohibited firearms. During the buy-back, 643,726 prohibited firearms were handed in at a total cost to the Government of about A$320 million. It was estimated that this may have led to the removal of about 20 percent of the total stock of firearms.

We believe that our recommendations regarding the codified amnesty would significantly reduce the number of grey firearms in New Zealand. We do not think that a buy-back scheme is required to meet this objective.

Recommendations

18  We recommend to the Government that it clarify the amnesty in section 10 of the Arms Act 1983 and extend it to include MSSAs, “A” category firearms, and the handing in of firearms to the Police.

19  We recommend to the Government that the Police develop policy guidance so that, under the amnesty, when people hand in firearms that are unlawfully in their possession, or report firearms lost, stolen, or destroyed, the Police will have the discretion not to prosecute for the possession offence, subject to police inquiries not revealing offending other than breach of lawful possession of firearms(s) under the Arms Act 1983.
7 Importing firearms into New Zealand

Permit to import

In order to import any firearm or part of a firearm into New Zealand, a person must first apply for a permit to import from the New Zealand Police. The permit is issued to one person and may not be transferred to any other person. It is valid for 12 months and may be revoked by a police officer at any time. A permit is not required to import small arms ammunition.

Generally, a person will require a firearms licence, or a firearms licence with the appropriate endorsements, in order to import a firearm. However, the following firearms are listed as exceptions in section 22 of the Arms Act 1983, and do not require a firearms licence to possess (although a permit to import is still required):

- bolt gun or stud gun
- humane killer
- tranquilliser gun
- stock marking pistol
- underwater spear gun
- flare pistol
- deer net gun
- pistol that is part of a rocket or line throwing equipment
- miniature cannon
- antique firearm.

Regulation 10 outlines the information that the applicant must supply. This includes the make, model, calibre, and type of the firearm. Details of the applicant’s firearms licence are attached to the application, which identifies their licence, endorsements, and address. Applying for a permit to import pistols, MSSAs, restricted airguns, and restricted weapons requires the applicant to state “special reasons” as to why the weapon should be allowed into New Zealand.

A firearms dealer can apply for, and be issued with, any number of permits to import. Where a dealer applies to import firearms from different sources, separate permits are issued. Similar to an individual’s permit application, a dealer must also include the exact description of the firearms that they plan to import, including the make, model, calibre, and type of firearm. If a dealer wishes to apply for a permit to import a pistol, MSSA firearm, restricted weapon, or restricted airgun, a licence holder may nominate them to import such

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7 “Part” is defined in section 2 of the Arms Act 1983 as anything designed or intended to be an integral part of a pistol, restricted weapon, or MSSA but in relation to any other firearm, means the action for that firearm.
items on their behalf. However, no permit to import any of these items, except pistols, can be granted to a dealer who wishes to import such firearms to resell.

**Managing firearm imports**

The New Zealand Customs Service applies various clearance processes depending on the way firearms enter New Zealand. Records of imports are kept on Customs’ reporting system and any firearms and parts handled by Customs are stored in secure facilities. Shipments of firearms and parts enter into New Zealand through four main streams:

- import cargo stream for goods over $1000
- electronic cargo information stream for goods under $1000
- mail stream
- passengers importing firearms through airports.

When firearms or parts are detected in the cargo or mail streams, Customs officers intercept the item. The firearm or part is held until the importer can present an import permit and a firearms licence. Customs officers then check the description of the firearm on the import permit against the firearms or parts that have been received. However, we heard that because of a lack of resources, these checks are often not carried out as thoroughly as they could be.

**Visitors’ firearms licences and export permits**

A visitor’s firearms licence allows a person to possess firearms for hunting or competition in New Zealand for up to one year. When arriving in New Zealand, the applicant completes their application for a visitor’s licence by paying a fee and presenting their passport and the firearms licence issued by the country they live in. They may also apply to import firearms for these purposes.

If an applicant lives in a country that does not issue firearms licences, they need to prove that they can legally own a firearm in their own country and that they have been trained in firearms safety. These documents are examined for validity by the Police when a visitor arrives at the airport in New Zealand.

An applicant for a visitor’s firearms licence must also apply for a permit to import if they plan to bring their own firearm into New Zealand. Upon arrival, all firearms must be declared to Customs officials. If a person intends to remove a pistol, MSSA, or restricted weapon from New Zealand, they must apply for an export permit from the Ministry of Foreign Affairs and Trade (MFAT). If they are leaving New Zealand with a small number of sporting firearms, visitors who have been in the country for up to three months for a sporting holiday or competition are exempted from an export permit. However, they must still notify MFAT of the firearms that they are taking out of the country. Checks are not always conducted to make sure that the firearms a visitor brings into New Zealand are the same ones they leave with.

To ensure that firearms brought into the country by visitors have been lawfully disposed of or are being taken back with them, we recommend that the Police should check the firearms when the visitor leaves New Zealand.
We note that section 38 of the Act applies to a firearms licence holder who intends to remove a pistol, MSSA, or restricted weapon from New Zealand. They must give the Police at least four days’ notice of the intended removal, and must deliver their firearms licence to Police so that the endorsement can be amended. This does not relate to visitors, and is separate from the export requirements.

Recommendation

20  We recommend to the Government that it ensure that visitors who have imported firearms and have been in the country for up to twelve months for a sporting holiday or competition should have the export of the firearms checked by the Police when they leave New Zealand.
8 New Zealand First minority view

New Zealand First believes that this report does not adequately address the stated objectives of the inquiry.

Rather, it targets legitimate ownership of legally held firearms by licenced users, importers, and dealers, and recommends further restrictions on them by way of laws and regulations relating to them and their firearms.

The report centres on a stated presumption that theft from legitimate owners is the major source of illegal firearms falling into criminal hands, despite a clear lack of any tangible evidence supporting this claim.

The report fails completely to address the manifestly inadequate rate at which the Police either solve, or even investigate, reported thefts of firearms from legitimate owners. Further, the report provides no evidence that the policy announcements made by the Police with respect to burglary resolution rates between 2008 and 2016 are proving effective, or that they have resulted in an increase in the number of stolen firearms being recovered.

Of serious concern to New Zealand First is the failure to investigate or report on any potential pathways by which firearms may come into the illegal possession of criminals other than by theft from legitimate owners—for example, illicit importation and smuggling.

Whilst the report recommends law changes to prohibit gangs from legally owning firearms, it does not provide information or recommendations on the adequacy of sentences given to gang members and other criminals who commit offences involving illicit firearms.

New Zealand First would support an amendment to the Arms Act 1983 to specifically prohibit gang members and their prospects from being granted a firearms licence.

New Zealand First would support concrete recommendations for dramatically increasing sentences for crimes committed by gang members or their prospects involving firearms and for those sentences to be mandatory in order to deter such offending.

In conclusion, whilst there are some recommendations we would naturally agree with, we cannot support the general thrust or direction of this report or many of the recommendations contained therein.
Appendix A

Committee procedure
The committee met between 16 March 2016 and 5 April 2017 to consider the inquiry. We received 102 submissions from the organisations and individuals listed in Appendix B, and heard oral evidence from 20 submitters.

We received advice from the New Zealand Police.

Committee members
Kanwaljit Sign Bakshi (Chairperson)
Mahesh Bindra
David Clendon
Ian McKelvie
Stuart Nash
Maureen Pugh
Aupito William Sio
Lindsay Tisch
Jonathan Young

Ron Mark replaced Mahesh Bindra for this item of business.
Appendix B

List of submitters

Aaron J Hopper
Alan Walker
Alan Webster
Alec M
Alex Henshaw
Andrew Pepper
Anthony Blythen
Antonio Apostolakis
Barry Shaw
Bert Wilson
Brad M
Brad Smith
Brenton Hodgson
Bruce Graham
Bruce Murdoch
Bruce Rifle Club
Central North Island Gun Club Inc.
Chaz Forsyth
Chris Murphy
Christopher Macpherson
Colby Tyrrell
Council of Licensed Firearms Owners
Daniel Harrison
Dannie Abel, Brie Hale, Mariel Bocacao
Dr David Holdsworth
Dr Emmet McElhatton
Duncan McKee
Firearms Safety Specialist NZ
Gary
Gary Elmes
Gary Larkan
Gerard Phillips
Greater Wellington Muzzle-loading Club
Greg Jaggard
Griffin Adie
Iain Storey
Jaistone Mataio
James Airey
James D Henry
Jason Ward Allen
Joe Green
John Bryce
John Dyer
John Howat
John Mead
John Paul Browne
John T
John Thomas Ronaldson
K Robinson
Kevin F
Laila Farah, Lisa Jiang, Azel Cinco
Leonard Bridgeman
Mark Jewitt
Mark Wheeler
Martin Kavanagh
Melissa Veale, Erin Lockhart, India Porter, Katie Trott and Hazel Brodie
Michael Andrews
Michael Kinmond
Michele Domaneschi
Mike Loder
Monty Williams
Morgan O'Brien
Mountain Safety Council
New Zealand Antique and Historical Arms Association
New Zealand Police Association
Nikki Kelman
Northland Branch, New Zealand Antique & Historical Arms Association, Inc.
Paul Clark
Paul Rennie
Paulus Telfer
Phil C
Pierre Joubert
Pistol NZ
Professor Alexander Gillespie
R K Dean
Raymond O'Brien
Rob M
Robert Walker
Robin Meaclem
Rod Woods
Ross C
Ross Pierson
Rural Women New Zealand
Ryan Anderson and Chris Woodmass
Sam Estall
Samuel Sydow
Sean Wickham
Sporting Shooters Association of Australia
Sporting Shooters Association of New Zealand Inc.
Stephen Donoghue
Stephen Goodman
Stephen P Mawdesley
Stuart Murray
Terry Douglas
Tex Hood
Trade Me Limited
Warren Fitzsimmons
Wellington Community Justice Project
Wellington Service Rifle Association Inc.
Inquiry into the funding of specialist sexual violence social services

Report of the Social Services Committee

Fifty-first Parliament
(Alfred Ngaro, Chairperson)
December 2015

Presented to the House of Representatives
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Appendix 30
Inquiry into the funding of specialist sexual violence social services

Summary of recommendations

The Social Services Committee makes the following recommendations to the Government:

1. That it develop an overarching policy framework for an integrated whole-of-system approach to preventing and responding to sexual violence, including a whole-of-Government statement of intent. (page 19)

2. That it clearly set out the mandates, roles, and responsibilities of government agencies for sexual violence services. (page 19)

3. That it nominate a lead agency and establish an interagency organisation to lead and coordinate the Government’s response to sexual violence. (page 19)

4. That it support the specialist sexual violence social services sector to develop and manage itself. (page 19)

5. That it consult widely with stakeholders on proposals affecting funding and infrastructure arrangements. (page 19)

6. That it enable Māori to fully participate in policy development and planning processes, and that kaupapa and tikanga principles be integrated into these processes. (page 19)

7. That it develop and implement an integrated, purpose-built funding and service delivery model for specialist sexual violence social services to achieve desired coverage and access. (page 20)

8. That it allocate funding that takes into account minimum levels of service (as guided by good practice) for clients in all urban and rural areas, including additional funding for specific high-needs areas or groups, particularly for Māori and whānau, to ensure consistent cover. (page 20)

9. That it develop a long-term system for sexual violence data collection, incorporating a careful and consistent approach to data definitions, data capture, and information-sharing. (page 21)

10. That it collect data about specialist sexual violence service use and costs from government agencies and NGOs. (page 21)

11. That it commission targeted population-level research about sexual violence in New Zealand. (page 21)

12. That it commission research into specific groups affected by sexual violence, including research into Māori understandings and definitions of sexual violence, and research into the current effects of sexual violence within Māori whānau. (page 21)

13. That it develop a national violence prevention framework and action plan that would include sexual violence prevention as a major feature. (page 22)
14 That, over time, sexual violence prevention initiatives be informed by New Zealand-based research and evaluation. (page 22)

15 That integration be central to any new policy framework, national strategies, infrastructure projects, and funding and service delivery models for specialist sexual violence social services. (page 24)

16 That the Government draw from the Victorian funding and service delivery model in co-designing an integrated model for New Zealand, modified to meet New Zealand’s unique environment, including an acknowledgement of Māori needs. That services for those with concerning or harmful sexual behaviour be considered in a New Zealand integrated model. (page 24)

17 That it facilitate an assessment of existing good practice guidelines, a discussion of whether it is necessary to make them more consistent with each other, and a discussion of whether further guidelines are needed. As part of this, we recommend that the Government lead the development of a system of national standards for sexual violence services, acknowledging the need for kaupapa Māori. (page 25)

18 That any new model for specialist sexual violence social services properly consider the work of the Law Commission on the court experience for victims/survivors. (page 25)

19 That the Government assess whether changes should be made to the remuneration and working conditions of workers in the sexual violence sector, including

- access to professional development
- access to support such as clinical supervision
- whether there are enough staff to prevent “compassion fatigue”. (page 25)

20 That it assess whether professional accreditation standards and regulations that include kaupapa Māori and other culturally competent practice should be developed and introduced for workers in the specialist sexual violence social services sector. (page 25)

21 That it encourage shared training opportunities in the specialist sexual violence social services workforce. (page 26)

22 That it encourage training opportunities for general service providers in dealing with sexual violence. (page 26)

23 That it determine an acceptable minimum level of service, including appropriate geographic coverage of first response services. (page 26)

24 That it ensure that the opening hours of services are extended where necessary to achieve 24-hour, seven-day coverage for first response services. (page 26)

25 That it explore the use of diverse service delivery mechanisms, especially in remote areas. (page 26)

26 That it take account of provider capability and capacity when contracting. (page 26)

27 That, as part of a new model for specialist sexual violence social services, it ensure that services are accessible to all clients, including those with disabilities, and are whānau-centred, culturally competent, and responsive. (page 28)

28 That it engage with relevant parties to ensure that any new service delivery model includes whānau-centred, culturally competent service options for Māori. (page 28)
29 That it support mainstream service providers to become whānau-centred and culturally competent and work towards the integration of tikanga into practice. (page 28)

30 That it support and strengthen existing kaupapa Māori specialist sexual violence social services. (page 28)

31 That an integrated approach include a strategy to help organisations that support specific population groups to develop expertise in dealing with sexual violence and links with specialist sexual violence service providers. (page 28)

32 That the Government ensure that public information about services is in accessible formats and is well targeted to all audiences, especially high-need target groups. (page 28)
1 Introduction

On 21 August 2013, the Social Services Committee of the 50th Parliament began an inquiry into the funding of specialist sexual violence social services. The terms of reference were to review

- the state of specialist services and determine whether they reflect an integrated approach to service delivery, full coverage, and best practice
- specialist services, including those for Māori and other diverse ethnic communities, and assess whether they are accessible, culturally appropriate, and sustainable.

The Minister for Social Development provided advisers, whom the committee authorised to consult with relevant government agencies as appropriate.

The committee received submissions from 997 organisations and individuals. Organisations included service providers, research and advocacy groups, professional organisations, umbrella organisations, and health sector organisations. Individual submitters included victims/survivors of sexual violence, whānau and friends of victims/survivors, and workers in the sector, including social workers, educators, counsellors, and medical staff.

Some submissions represented many people. In particular, 214 people signed the submission from the Māori caucus of Te Ohaakii a Hine—National Network for Ending Sexual Violence Together (TOAH-NNEST), Ngā Kaitiaki Mauri. Ngā Kaitiaki Mauri also organised two hui for committee members, which 33 agencies and individuals attended.

The committee heard oral evidence from 87 submitters in Auckland and Wellington in 2014.

We are grateful for the time and effort of those who presented evidence. For some submitters, particularly those who have experienced sexual violence, it was clearly very difficult to write or speak about their experiences. We thank those submitters for their bravery and their perseverance. Their contributions to our inquiry have been valuable.

At the conclusion of the 50th Parliament, the Social Services Committee made an interim report on its inquiry. The interim report outlined the main issues submitters raised and noted certain recent initiatives that may help to address those issues. It noted several significant and complex issues that were worth pursuing. The interim report urged a select committee of the 51st Parliament to continue the inquiry as a matter of priority.

We reinstated the inquiry on 29 October 2014.

What are specialist sexual violence social services?

Specialist sexual violence social services provide information, first (crisis) response, and long-term support and treatment for those affected by sexual violence. They also carry out activities aimed at the primary prevention of sexual violence. Services include

- information through media such as printed material, telephone lines, and websites

1 We learned that most people prefer the term “victim/survivor”, so we have generally chosen to use this term.
• psycho-social support during medical and police processes
• counselling (both in person and by telephone, internet, or other communication technology)
• social support (such as emergency housing) and financial grants
• advocacy, including support for victims/survivors during police interviews or court processes
• treatment for those with concerning or harmful sexual behaviour (HSB)
• primary prevention programmes and social change campaigns.

Services may be provided
• by individual practitioners
• by non-governmental organisations (NGOs), or
• within government organisations (such as hospitals).

Providers are regarded as “specialist” if their service provision focuses mainly on sexual violence and if their staff have specialised knowledge and skills about issues stemming from sexual violence.

First response services are the psycho-social support services that victims/survivors need during and immediately after a crisis. First response services are delivered face-to-face and/or remotely until long-term support services are in place.

Evidence shows that specialist first response services are very important. A lack of these services, or insufficient or poor quality services, may exacerbate the harm or, at the very least, mean recovery takes longer.

Specialist sexual violence social services exist within a system that includes other health, justice, and social sector responses, such as medical forensic, general practice, emergency department, mental health, and social services.

**Costs of sexual violence**

Sexual violence causes significant social, health, and economic costs to individuals, families, and communities. The Treasury has estimated that it is our most expensive crime. Based on the Treasury’s research into the 2003/04 costs of crime, the estimated equivalent annual cost of sexual violence in 2012 was $1.8 billion.

Most of this cost is from victims/survivors suffering very long-term problems, such as pain, suffering, and psychological effects, which affect their ability to function well in society. A breakdown of the cost found that 18 percent was Government costs for services responding to sexual violence. The private sector (individuals, households, and businesses) bore 82 percent in lost output and intangible costs. We note that the estimate did not factor in costs incurred by NGOs that deal with the consequences of crime, such as Rape Crisis.

**Recent funding**

In the 2012/13 financial year, government agencies funded $29.07 million in community-based activity in the specialist sexual violence sector. The amount came from
the Accident Compensation Corporation (ACC) ($12.86 million)
• the New Zealand Police ($1.46 million)
• the Department of Corrections ($1.03 million)
• the Ministry of Justice ($3.12 million)
• the Ministry of Social Development ($7.88 million)
• the Ministry of Health ($2.72 million).

A breakdown of the $29.07 million by type of client shows that about $23 million (79 percent) went towards services for victims/survivors and that $6 million (21 percent) went towards HSB services. A breakdown by type of service shows that about $16 million (55 percent) was for contracted services from NGOs and that $13 million (45 percent) supported rehabilitation and access to the criminal justice system for victims/survivors.

In addition to the amount spent on community-based services, ACC funded about $33.6 million in financial, treatment, or rehabilitation entitlements for clients engaged with its sensitive claims unit.

We are aware that, since 2012/13, there have been significant changes in ACC, notably the introduction of its Integrated Services for Sensitive Claims (ISSC), which is described below. We were advised that ACC expects to spend $29.5 million on services equivalent to those on which it spent $12.86 million in 2012/13.

The status of some of the current funding for specialist sexual violence social services is stable. However, parts of it are under review, not funded beyond a certain date, or not enough to meet demand.

We note that Government funding does not meet the full costs of services. Many service providers rely on private and philanthropic funding, which is often one-off funding for a fixed period. Services were already suffering from underfunding before the global financial crisis and have endured further constraints since.

To stabilise existing services in the specialist sexual violence sector, the Government allocated an extra $10.4 million over two years in Budget 2014. Details of this are discussed below under the heading “2013 cross-agency review”.
2 Current services

Since the 1980s, the specialist sexual violence social services sector has grown from grassroots community organisations. Most services have been local. They have been funded at the community level, without formal nationwide infrastructure or permanent funding to support them.

We heard that limited, unstable funding, a large volunteer workforce, variable quality guidelines, and a lack of training are all issues that affect the sector. To date, there have been limited opportunities for an integrated and sustainable approach to delivering services.

Service providers are staffed by a mix of professional and non-professional workers. They rely heavily on volunteers. Professional workers belong to a range of professional bodies, but some staff may not belong to any such body.

Providers, services, and stakeholders

This section describes some of the service providers and stakeholders in the specialist sexual violence social services sector. There are a range of community-based specialist providers and prevention services, such as Rape Crisis, HELP, START, and Rape Prevention Education.

Doctors for Sexual Abuse Care (DSAC) is a national organisation. It was formed in 1988 to develop and maintain standards of practice in the delivery of medical and forensic services for sexual assault. It provides members with education and training, and information about service provision around the country.

Members are doctors working in the field; associate membership is available for nurses. DSAC is funded to deliver training and accreditation to medical personnel. In recent years, DSAC has received ad hoc funding from various agencies.

Sexual Abuse Assessment and Treatment Services (SAATS) are medical forensic services for victims/survivors. National funding for SAATS began in 2008, through a tripartite agreement between Police, the Ministry of Health, and ACC.

Contracts are held by District Health Boards (DHBs), which either deliver the service themselves or subcontract part or all of the service. Currently, all DHBs except South Canterbury have a SAATS contract. DSAC trains all SAATS doctors and nurses.

Te Ohaakii a Hine—National Network for Ending Sexual Violence Together (TOAH-NNEST) is a nationwide network representing providers working with all aspects of sexual violence. TOAH-NNEST was formed in 2006 and registered as an incorporated society in 2010. It represents a large number of organisations and individual providers.

TOAH-NNEST receives funding from the Ministry of Justice. Its roles include

- helping to build the capacity and capability of sexual violence service providers
- specialist advice to inform Government policy, legislation, research, strategy, and services
partnership and collaboration with the Government and other stakeholders on specific sexual violence initiatives

- helping the Government to meet better its Te Tiriti o Waitangi obligations regarding sexual violence issues for Māori
- being a national voice for sexual violence service providers
- developing best practice standards
- providing online information and resources to providers and the general public
- being a single access point for the Government and other stakeholders to consult and inform providers.

The Harmful Sexual Behaviour (HSB) sector provides perpetrator assessment and treatment services. Three organisations providing community-based HSB programmes are SAFE Network Incorporated (Auckland), WellStop Incorporated (Wellington), and the STOP Trust (Christchurch). The Department of Corrections also provides some HSB services.

The Male Survivors of Sexual Abuse Trust Aotearoa New Zealand (MSSAT) originated in Christchurch in 1991. It is made up of six trusts located around the country. All MSSAT organisations offer one-to-one and peer group support for male survivors and their significant others.

A National Sexual Violence Survivor Advocate Service is based with TOAH-NNEST. The service is contracted through the Ministry of Justice to provide an advocate for people personally affected by sexual violence.

This service is aimed at improving outcomes for victims/survivors, including facilitating and linking them to services, and supporting them if they choose to pursue a case through the courts. The service also helps to reduce attrition rates and reduce repeat victimisation.

Victim Support is not a specialist sexual violence social service. However, it is the only national, 24-hour, seven-day provider of services to crime victims. This means that Victim Support often provides back-up services when specialist sexual violence social service providers are not available. It provides support to about 2,500 victims of sexual violence a year.

Government agencies

No one government agency is responsible for specialist sexual violence social services. Funding for contracted services is divided among several agencies. The Government funds third party providers and also provides some services directly. Agencies with major roles and responsibilities include ACC, the Police, the Department of Corrections, and the Ministries of Health, Justice, and Social Development.

ACC is responsible for prevention and for long-term recovery. The Ministry of Social Development currently funds some first response services as well as non-mandated HSB treatment, but not on a formal, long-term basis. The Department of Corrections is responsible for mandated HSB treatment—community- and prison-based programmes for convicted offenders.

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2 That is, self-referred treatment, rather than treatment that a Court requires a person to attend.
FUNDING OF SPECIALIST SEXUAL VIOLENCE SOCIAL SERVICES

ACC

ACC funds counselling, health services, income support, and injury prevention. Its Sensitive Claims Unit assesses and manages claims for physical and mental injuries resulting from sexual violence. ACC also contributes to SAATS contracts.

In 2009, ACC introduced a new scheme for sensitive claims. However, the scheme was not well received. Concerns included that the changes were introduced too quickly, that it excluded more people than expected, and that there was minimal support available for clients outside the ACC system.

In response to an independent review in 2010, ACC made several changes to its sensitive claims services to improve access and ensure more timely provision of support. After a follow-up review in 2012, ACC began a comprehensive redesign of its sensitive claims services, which is further described below.

In addition, ACC has developed and is implementing its Integrated Strategy for Action on Sexual Violence. This strategy aims to integrate its prevention, first response, and long-term care and recovery services, and to make them more client-centred.

Primary prevention

In late 2013, ACC began a primary prevention programme involving several initiatives over five years. One such initiative, piloted in 2014 with support from the Ministry of Education, is Mates & Dates, a healthy-relationships programme based in secondary schools aimed at teaching young people skills to prevent sexual and dating violence. Mates & Dates is intended to be multi-year, taught by trained specialist facilitators, and nationally available. Around 40 schools have expressed an interest in having the programme.

We understand that ACC requires returns on its investments in injury prevention. In areas such as sexual violence prevention, it expects returns to emerge only in the long term. This means that ACC expects to reduce its claims liability through interventions that stop people from being injured in the first place.

First response

ACC is legislated to provide long-term care and recovery services to victims/survivors. We note that it is not legislated to directly fund or provide first response social services outside of the claims process. However, ACC has been exploring how it can work as a partner agency to support such services.

ACC contributes funding to DSAC for training to medical professionals and to SAATS for medical forensic care after sexual violence.

ACC has also worked with the Police to find ways to quickly connect victims/survivors to its services when they contact the Police.

Long-term care and recovery: Integrated Services for Sensitive Claims

In 2012, ACC began a comprehensive redesign of its sensitive claims services. Its new Integrated Services for Sensitive Claims (ISSC) went live in late 2014. The new service

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3 For the purposes of ACC, “sexual violence” means the offences listed in Schedule 3 of the Accident Compensation Act 2001.
4 The Sensitive Claims Clinical Pathway.
package is a move towards more responsive and client-centred services delivered by organisations and groups of providers. The ISSC offers expanded provider coverage, better access to services, support for families and whānau, and fully-funded services with no required co-payment.

The ISSC delivers support, assessment, therapy, and other specialist treatment services. Services can be tailored to meet clients’ individual needs. Counselling remains at the centre of the ISSC. Clients can enter, exit, and return to services as needed.

As well as its core services, the ISSC offers education and support for the client’s family and whānau, social work, funding of the client’s therapist to coordinate activities, and funding of a suitable cultural representative to guide the therapist.

However, ACC does not fund all aspects of long-term care and recovery. For example, it does not cover drop-in services or telephone services.

The ISSC is available to anyone who has experienced sexual violence in New Zealand. It is also available to anyone who has experienced sexual violence outside New Zealand while resident in New Zealand. It is not available to a victim/survivor who has experienced sexual violence overseas while not resident in New Zealand.

Services are available before and after a claim has been accepted. A client whose claim has been declined can receive support while being helped to access alternative services. Although sexual violence need not have been the predominant cause of the mental injury, it must have been a material or significant cause. This means that claims are declined when it is difficult to isolate sexual violence as a material or significant cause of the mental injury.

ISSC providers must be able to deliver all of ACC’s core support, assessment, and treatment services. Tenders were invited from organisations, groups of providers, and single providers with the ability to deliver all core services. Provider credentialing aims to achieve consistency between the professions.

There needs to be further investigation into the ISSC to see whether it incorporates kaupapa Māori into its services to ensure that there are culturally appropriate services.

**New Zealand Police**

Through their incident response and investigation work, the Police have contact with both victims and perpetrators of sexual violence. They also contribute to funding for DSAC and SAATS.

Work has been done to make Police investigations consistent throughout the country. All 12 Police districts have dedicated child protection teams and dedicated adult sexual assault coordinators. Seven districts have dedicated adult sexual assault teams.

Police techniques for preventing revictimisation range from giving crime prevention advice to first-time victims/survivors to formal plans for dealing with high-risk repeat victims/survivors.

The Police are part of a national forum involving TOAH-NNEST, Rape Crisis, DSAC, and Victim Support. The forum aims to improve the response to victims/survivors by providing a platform for consultation about policy and practice.

Several initiatives relating to sexual violence have been led by the Police, including hosting the first male survivor national hui in 2013. The Police have also developed and distributed an information brochure about the process for dealing with adult sexual assault.
The Police are involved in community prevention work. They deliver programmes in educational settings, such as *Keeping Ourselves Safe*. Although programme presenters are not required to encourage the reporting of sexual violence, they do so when appropriate.

Another Police role is targeted prevention in a community to reduce the risk posed by a known sex offender.

**Ministry of Social Development**

The Ministry of Social Development funds NGOs to deliver some social services to victims/survivors. The ministry’s Child, Youth and Family unit has a particular focus on supporting child victims/survivors and their families.

The ministry funds assessment and treatment programmes for adults who offend against children. It also funds early intervention programmes for children and young people who display concerning or harmful sexual behaviour. In 2012/13, such programmes were provided to 55 adults, 148 young people, and 36 children.

The ministry is working with ACC on a strategy to address youth needs in relation to sexual violence.

**Ministry of Health**

The Ministry of Health is another government agency that contributes to the sector directly. The ministry funds generic health services, such as doctors, counsellors, and mental health services. It also has some prevention contracts with NGOs and provides funding to DSAC and SAATS.

People are not eligible for DHB-funded mental health services if sexual abuse is the sole presenting problem. However, sexual abuse may result in, or co-exist with, mental health conditions such as depression, post-traumatic stress disorder, or anxiety. People with such conditions are eligible for mental health services. We note that there is variability in the way DHBs apply the exclusion.

**Ministry of Justice**

The Ministry of Justice administers an offender levy that provides financial assistance for victims of serious crime who are engaging with the criminal justice system. This includes paying for their expenses and support to attend court.

The ministry provides grants to NGOs to deliver local primary prevention initiatives that support a reduction in sexual violence. The ministry also provides network funding to TOAH-NNEST. It also funds a specialist provider (*Project Restore*) to do restorative justice work with offenders and victims/survivors.

**Department of Corrections**

Through its psychologists, the Department of Corrections provides prison- and community-based treatment for sex offenders. Those at high risk of reoffending are prioritised for treatment, followed by medium-risk and low-risk offenders respectively. About 175 prisoners receive group-based intensive treatment each year. Several are assessed as inappropriate for group treatment and are referred to individual psychologists.

Resources currently prioritise treatment services for child sex offenders.
The Department of Corrections also funds NGOs to deliver community-based treatment services to 70–100 offenders each year whom the Court orders to attend such services. These services are targeted to those who have committed sex offences against children. Treatment costs between $12,000 and $22,000 for each offender.

We note that offender treatment services are not available in all regions. Combined with high demand and risk prioritisation, this means that timely treatment services are not always available to those who may need them.

**Ministry of Education**

A range of services and programmes, including teacher training, is available to schools. They are provided by the Government as well as by NGOs. The Ministry of Education supports ACC’s *Mates & Dates* programme and has recently released updated sexuality education guides for schools. In addition, SuPERU (formerly the Families Commission) has produced a review of evidence and literature on what works in schools-based relationship education.

**Recent efforts to improve services**

**Taskforce for Action on Sexual Violence**

In 2007, a Taskforce for Action on Sexual Violence was established, made up of 10 Government chief executives and four representatives from TOAH-NNEST. Its report, in 2009, made recommendations about sexual violence prevention, improvements to frontline services, criminal justice reforms, and future directions for sector cooperation. There were 71 recommendations in the report: seven from the taskforce as a whole, and 64 through TOAH-NNEST.

The taskforce was disbanded before all the issues raised in the recommendations had been addressed. Unresolved issues included sexual violence prevention (primary prevention and preventing revictimisation) and frontline services (availability and quality).

**2013 cross-agency review**

In 2013, the Minister for Social Development commissioned a cross-agency review of sexual violence services. The aims were to review the state of the sector, provide support in the short term, and consider sustainable solutions for the long term.

The review was led by the Ministry of Social Development and overseen by a senior officials’ group with members from ACC, the Department of Corrections, the Police, and the Ministries of Education, Health, Justice, Women, and Social Development. The group reviewed particular services, including first response services, services for male survivors, and community-based HSB treatment.

It found that responsibility and funding throughout the country is not sufficient or secure. Short-term actions of the group focused on

- one-off data-gathering and research to fill knowledge gaps about the sector
- improving coordination between agencies to support joined-up and effective services
- prevention activities.
In the Budgets for 2014/15 and 2015/16, the group secured $10.4 million in new funding to be spent over the two years. The sum was allocated through Vote Health and administered by the Ministry of Social Development.

The sum was intended to relieve funding gaps, including 24-hour, seven-day crisis call-outs and emergency counselling services, HSB services, services for male survivors, and medical forensic services. The aim was not to extend existing services, nor to fill unmet demand, but to stabilise certain services while the Government considered long-term solutions.

We were advised that the senior officials’ group is satisfied that the funding has successfully stabilised existing services and increased the geographic reach and opening hours of some services in the short term. The funding ends on 30 June 2016, and long-term responsibility for the continuation of these services has not been confirmed.

The review confirmed the increasing demand for sexual violence services. It found that a stronger emphasis and a nationally coordinated approach are needed to prevent sexual violence and respond effectively when it happens. A national primary prevention strategy was developed, and options are being considered for its implementation.

We note that New Zealand’s human rights situation has been reviewed twice by the United Nations’ Universal Periodic Review (UPR) process, in 2009 and in 2014. In 2014, New Zealand responded to the UPR recommendations by setting out the work of the cross-agency review.

**Ministerial Group on Family Violence and Sexual Violence**

In 2014, a Ministerial Group on Family Violence was reconfigured to include Sexual Violence. The group comprises the Minister of Justice and the Minister for Social Development as co-chairs, plus 11 other ministers in related portfolios.

The group has developed a new cross-agency work programme that has recently received Cabinet approval. The goal of the work programme is to achieve an integrated system for preventing and responding to family violence and sexual violence. The new work programme focuses on understanding the whole system. It

- links and aligns the work already underway on family violence and sexual violence, including the Justice-led *Stronger Response to Family Violence* programme and Social Development-led *Family Violence: Achieving Intergenerational Change* programme
- looks at specific service areas, asking why multiple agencies appear to be funding similar services and whether creating single responsibility leads in particular areas can remove some complexity and confusion from the system
- seeks to build a better understanding of the current service mix, including gaps and overlaps.

We understand that ACC has assumed responsibility for leading the national primary prevention work in sexual violence that was started by the cross-agency review of the senior officials’ group. ACC is currently redeveloping the strategy under the Ministerial Group’s work programme.

The Ministerial Group proposes to report to Cabinet in March 2016 with advice on any required system changes and a plan of action to achieve them, including any proposals for Budget 2016.
3 Our findings

Broadly speaking, the inquiry process confirmed that current services do not provide consistent, effective cover and that current funding approaches are insufficient. Stable and effective services would significantly reduce the costs of sexual violence—both to society and to individuals.

We urge the Government to commit to ensuring that sustainable, efficient specialist sexual violence social services are available to everyone in New Zealand. We urge the Government to develop and implement a long-term approach to do this. This should include

- a model or models for governance that reflect the New Zealand context and Māori and non-Māori good practices
- funding
- the design and delivery of services across the continuum of intervention: prevention, first response, long-term care and recovery, and HSB services.

Strong collaboration between government agencies and NGOs is also crucial to the success of any attempt to improve the specialist sexual violence social services sector.

Several issues emerged from submissions and advice. These are set out below, along with our recommendations.

Governance

Submitters said that there is a lack of stable infrastructure and that the Government and those working in the sector need to work better together. We agree with submitters that integrated sector governance would ensure high quality services. It would also ensure the effective commissioning, funding, and monitoring of services. Government leadership and direction with good stakeholder consultation, that allows for Māori participation, would help to achieve this.

Governance should be clear at the level of institutional arrangements and relationships—that is, how the Government organises itself. Governance should also be clear at the level of infrastructure development and support—that is, how Government supports the sector to develop and maintain itself. There is limited sector coordination in this second area. However, we note, for example, that TOAH-NNEST has been supporting providers since 2006. This type of work could be built on.

Every stakeholder needs to know what their roles and responsibilities are. It would also be desirable for the Government to determine which agency should lead provision of sexual violence services.

Any changes should take account of existing institutions, legislation, and initiatives, such as the Ministerial Group on Family Violence and Sexual Violence. We also note ACC’s unique and substantial role, particularly in prevention and in long-term care and recovery.

ACC’s legislative basis and insurance-based approach have implications for the roles of other agencies. In deciding whether there should be a single lead funding agency or
multiple funding agencies that take a coordinated approach, it should be remembered that ACC may complicate matters for having a single funder. ACC’s enabling legislation prevents it from delegating funding responsibilities and from assuming other agencies’ responsibilities.

**Recommendations**

1. We recommend that the Government develop an overarching policy framework for an integrated whole-of-system approach to preventing and responding to sexual violence, including a whole-of-Government statement of intent.
2. We recommend that the Government clearly set out the mandates, roles, and responsibilities of government agencies for sexual violence services.
3. We recommend that the Government nominate a lead agency and establish an interagency organisation to lead and coordinate the Government’s response to sexual violence.
4. We recommend that the Government support the specialist sexual violence social services sector to develop and manage itself.
5. We recommend that the Government consult widely with stakeholders on proposals affecting funding and infrastructure arrangements.
6. We recommend that the Government enable Māori to fully participate in policy development and planning processes, and that kaupapa and tikanga principles be integrated into these processes.

**Funding**

A recurring theme in submissions was that services are under-funded and struggling to meet demand. Many services rely on unpaid work and volunteers. Funding is unstable and uncertain. Submissions suggested that kaupapa Māori services have been disproportionately affected by funding changes.

The short-term stabilisation funding ($5.2 million each year) was for two years ending 30 June 2016.

We understand that providers have been reporting a continuous and significant increase in demand for services. For example, ACC estimates that the number of people using its support, counselling, and other treatment services will increase by 10 percent each year for the next six years. This will need to be carefully monitored so that agencies are not overwhelmed.

The fragmented nature of funding arrangements, with an emphasis on partial funding, has been a particular issue. It does not promote sector collaboration or planning at the government and provider level. This means that providers seek funding from multiple sources. This takes time, and takes staff away from clients. It also causes instability because funding is usually short or medium term.

We support the idea of appropriately funding stable and effective services, and reaping the benefits of long-term financial and social savings. We consider that funding should be enough to ensure sustainable, integrated infrastructure and services.
Because of a lack of data, and because each client requires a customised mix of services and support, it is difficult to estimate a per-person funding amount for sexual violence services. An exception is HSB services, about which there is adequate funding information. However, the cost for these services varies according to the client’s age and whether they access other services. We encourage the Government to identify the full costs of services so that it can understand the funding required.

The Government could consider full rather than partial funding of sexual violence services. Also, funding providers for a minimum level of service would give them certainty even when client volumes fluctuate.

**Recommendations**

7. We recommend that the Government develop and implement an integrated, purpose-built funding and service delivery model for specialist sexual violence social services to achieve desired coverage and access.

8. We recommend that the Government allocate funding that takes into account minimum levels of service (as guided by good practice) for clients in all urban and rural areas, including additional funding for specific high-needs areas or groups, particularly for Māori and whānau, to ensure consistent cover.

**Data**

Data is very important. However, there is not enough data to tell us who is involved, how much money is spent, and how much funding is needed in the sector. The available information is limited, and there is a lack of New Zealand-based research and evaluation on sexual violence.

Information sources include surveys, offences reported to the Police, sensitive claims data collected by ACC, and contract information reported by service providers. The main problems in the data are that

- sexual violence is under-reported
- many providers keep little or no data because confidentiality is important to their clients
- different providers record different types of data
- victims/survivors may see several different providers
- contracting and reporting processes vary between government agencies.

In the United States, the United Kingdom, and Australia, personal safety surveys provide population data about sexual violence. For example, an ongoing, nationally representative survey that assesses experiences of sexual and intimate partner violence among adults has recently started in the United States.6

We need to gather consistent, accurate data, being mindful of privacy concerns and the need for data to inform and improve response efforts. Data would help in determining demand and the required funding, estimating the incidence of sexual violence, learning

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6 The survey is run by the Centers for Disease Control and Prevention.
about factors contributing to that incidence, and informing the Government’s approach to ensuring that services are appropriate.

### Recommendations

9 We recommend that the Government develop a long-term system for sexual violence data collection, incorporating a careful and consistent approach to data definitions, data capture, and information-sharing.

10 We recommend that the Government collect data about specialist sexual violence service use and costs from government agencies and NGOs.

11 We recommend that the Government commission targeted population-level research about sexual violence in New Zealand.

12 We recommend that the Government commission research into specific groups affected by sexual violence, including research into Māori understandings and definitions of sexual violence, and research into the current effects of sexual violence within Māori whanau.

### Prevention

Many submitters said that more emphasis should be given to preventing sexual violence from occurring in the first place. Prevention strategies can include national campaigns, community-led social change initiatives, school-based programmes promoting healthy and safe relationships, and programmes for targeted groups such as ethnic communities. There should be prevention programmes aimed at people of all ages.

International evidence indicates that long-term, integrated approaches to preventing violence against women and girls are increasingly regarded as good practice. These approaches are being implemented in countries such as Australia and the United Kingdom.

These approaches can be implemented under the umbrella of a national action plan. They tend to focus on preventing violence against women, rather than preventing sexual violence. Although there are good reasons to develop primary prevention activities that take into account the similarities between sexual violence and other forms of violence against women, it is important to recognise that they are not identical.

A key feature of integrated approaches is that violence prevention initiatives are implemented at three levels. The primary level aims to prevent violence from happening in the first place.

The secondary level aims to prevent (or reduce) short-term effects. We note that victims/survivors are more likely to be revictimised, not necessarily by the same perpetrator. Also, victims/survivors can be re-traumatised through their service experiences, such as having to tell their stories multiple times.

The tertiary level aims to prevent long-term trauma to victims/survivors and to rehabilitate perpetrators. We were advised that sex offender programmes have been proven to be effective: lower recidivism is strongly correlated with completing the programme.

A national action plan could include the following prevention features:

- recognising that females are disproportionately represented as victims/survivors
• recognising Māori are disproportionately represented as victim/survivors and kauapapa Māori approaches to prevention are the most effective for Māori

• preventing violence by tackling its causes, changing attitudes and behaviours that condone violence, and promoting equality between women and men, respectful relationships, positive male behaviours, and women’s economic independence

• protecting women and children from revictimisation

• improving system responses by strengthening the workforce, providing high-quality and appropriate services, and taking account of the links between the various forms of violence against women

• early intervention and access to appropriate programmes for perpetrators, including community and self-referred clients

• weaving sexual violence prevention into policy developments throughout the Government, building on previous initiatives or other related reforms such as health, housing, disability, and immigration

• coordinated, cross-sectoral partnerships between the Government, business, and the community

• monitoring outcomes to identify successful approaches

• supporting Māori to increase their awareness of sexual violence and to develop tikanga-based responses to sexual violence.

Prevention in ethnic communities needs to be specifically addressed. Techniques to reach ethnic minority communities include

• using ethnic media

• integrating information about domestic violence into other programmes for ethnic groups

• using prenatal care services as a means for making contact

• providing information early in the immigration process

• emphasising positive concepts such as family harmony rather than directly referring to violence.

**Recommendations**

13 We recommend that the Government develop a national violence prevention framework and action plan that would include sexual violence prevention as a major feature.

14 We recommend that, over time, sexual violence prevention initiatives be informed by New Zealand-based research and evaluation.

**Integrated service**

We heard that services should be integrated throughout the whole system. Specialist and generic providers should cooperate to provide a flexible, responsive, and holistic service
that provides all necessary support to each victim/survivor, including to their family, whānau, friends, and other informal helpers.

In 2010, the Ministry of Women’s Affairs found that integrated, multidisciplinary approaches work well for victims/survivors overseas. It reported that, in the 1990s and 2000s, the United Kingdom, Australia, Denmark, and South Africa acted on recommendations to integrate services for sexual violence into “hubs” or “one-stop-shops” where all services are provided in one location. Coordinated, but not necessarily co-located, sexual violence services have existed in the United States and Canada since the 1970s. Examples of state-wide, coordinated, confidential phone and online services are found in Australia, and we discuss these below.

In New Zealand, some services are integrated. An example is Bay of Plenty Sexual Assault Support Services. This is a free service for children, adolescents, and adults recently affected by sexual assault or abuse. It provides medical examinations, counselling, family therapy, and a 24-hour helpline. We were advised that it is more common in New Zealand for services to entail a first response facility and a series of call-out and referral processes. By nature kaupapa Māori services tend to be integrated, dealing with the whole family.

Although the scope of our inquiry is for specialist sexual violence social services, we observe that successful service integration would include relevant general services (such as GPs) and non-social services (for example, medical services as opposed to social services such as counselling).

**Australian models**

We looked at funding and service delivery models in Australia, with a focus on crisis services in Victoria, New South Wales, and Queensland.

We consider the Victorian model very good. Victoria has a strong and collaborative community sector, clear delineation of functions between NGOs and government agencies, and good coordination between services, including several co-located service facilities.

During the last decade, Victoria has delivered a suite of judicial, legislative, policing, funding, and procedural reforms. It has been at the forefront of advances in national policy and strategy.

Victoria’s Department of Health and Human Services provides funding for the NGO sector. This funding is allocated to the following three areas:

- crisis care
- counselling, advocacy, and support services
- community education and specialist consultation.

The Victorian model was developed in consultation with the NGO sector and had support from stakeholders. It allows both the public sector and NGOs to take a flexible approach to service delivery, while working within a fixed funding envelope and requiring the attainment of high-level targets.

In New South Wales, services are predominantly publicly funded and delivered. Local Health Districts coordinate funding and service delivery in their districts. They have varying minimum requirements for levels of service.

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7 This department is responsible for health, mental health, aged care, and community and housing services.
The NGO sector in New South Wales is relatively small. NGOs receive state or federal funding as well as funding from other public and private agencies. Funding is typically based on historical levels of demand and resourcing.

Queensland has a fragmented approach compared to Victoria and New South Wales. Diverse government and community organisations deliver services. Services are often limited to specific groups of victims/survivors. Queensland Health funds certain services provided by NGOs and health service districts. Service provision and contracting arrangements vary throughout the state. Funding for NGOs is typically on a grant basis, and funded agencies provide activity reports to Queensland Health.

We note that the Australian models are aimed at victims/survivors but not at people with concerning or harmful sexual behaviour. Also, in considering an Australian example, New Zealand’s differences should be remembered—in particular, our cultural uniqueness and our outcomes-based funding models. Any system or service redesign should factor in the unique needs of particular cultural groups, including Māori as tangata whenua and Treaty partners, Pacific peoples, and other ethnic communities.

Changes may need to be implemented slowly or adjusted to local situations. The experience from Australia is that significant lead times mean better implementation of new approaches.

Recommendations

15  We recommend that integration be central to any new policy framework, national strategies, infrastructure projects, and funding and service delivery models for specialist sexual violence social services.

16  We recommend that the Government draw from the Victorian funding and service delivery model in co-designing an integrated model for New Zealand, modified to meet New Zealand’s unique environment, including an acknowledgement of Māori needs. We recommend that services for those with concerning or harmful sexual behaviour be considered in a New Zealand integrated model.

Good practice

Delivering services in line with good practice ensures that they are consistently effective. It also prevents revictimisation.

ACC, TOAH-NNEST, and other NGOs have produced various guidelines on good practice for sexual violence services. Workers also belong to a range of professional bodies that each have their own guidelines. This may lead to a lack of consistency about quality expectations throughout the sector. Additionally, staff may not belong to any such body and some voluntary staff are not qualified, so there is no relevant body for them to belong to.

Good practice is informed by research evidence as well as professional opinion, victims/survivors’ experiences and feedback, and Government review. Good practice addresses activities and services for perpetrators, victims/survivors, situations, and communities. It applies to the continuum of intervention: from prevention activities, to first response services, to long-term treatment and recovery services.
The Government can promote good practice in its contracts with providers. Our recommendations about integrating services would also promote good practice.

We note that many submissions identified an integrated approach to service delivery as intrinsic to good practice at two levels: at the level of clients and across services at the levels of primary prevention, first response and long-term recovery.

**Court experience**

We are aware that the Law Commission is examining pre-trial and trial processes, with a focus on sex offence cases, to identify good practice for improving the court experience of complainants. We understand this work is expected to finish in late 2015, and we would like to see it properly considered.

**Recommendations**

17 We recommend that the Government facilitate an assessment of existing good practice guidelines, a discussion of whether it is necessary to make them more consistent with each other, and a discussion of whether further guidelines are needed. As part of this, we recommend that the Government lead the development of a system of national standards for sexual violence services, acknowledging the need for kaupapa Māori.

18 We recommend that any new model for specialist sexual violence social services properly consider the work of the Law Commission on the court experience for victims/survivors.

**Workforce**

Submitters said that the sexual violence workforce faces a range of issues, including low remuneration and few professional development opportunities. We heard that accreditation standards, improved working conditions, and shared training opportunities between agencies could help to improve this.

In addition, submitters suggested sexual violence education for those working in generic frontline social, health, and education services, and in other sectors such as hospitality and media. We agree that general services need to know about sexual violence because many victims/survivors come into contact only with general services. Staff in these services should be able to respond appropriately.

Development and training in the prevention education workforce is also important.

**Recommendations**

19 We recommend that the Government assess whether changes should be made to the remuneration and working conditions of workers in the sexual violence sector, including

- access to professional development
- access to support such as clinical supervision
- whether there are enough staff to prevent “compassion fatigue”.

20 We recommend that the Government assess whether professional accreditation standards and regulations that include kaupapa Māori and other culturally competent
practice should be developed and introduced for workers in the specialist sexual violence social services sector.

21 We recommend that the Government encourage shared training opportunities in the specialist sexual violence social services workforce.

22 We recommend that the Government encourage training opportunities for general service providers in dealing with sexual violence.

Service coverage

The distribution of some services is uneven, resulting in geographical gaps in services. People living in remote areas find it harder to access certain services. They are usually further away from emergency and secondary services, and are less likely to have landline or cellphone coverage. We heard that only about 70 percent of females (and fewer males) have access to 24-hour, seven-day specialist crisis support services.

Submitters were concerned about long travel times to reach necessary services. They said that transport costs and a lack of public transport make it particularly difficult for rural people on low incomes to attend services. We heard that delays can further traumatise people needing crisis treatment. Also, people may not be able to afford the extra time needed to reach services from remote locations.

We note that face-to-face services are affected by geographic location more than telephone or internet services.

Another issue submitters raised was that specialist sexual violence social services are not consistently available throughout the country. We heard that all communities, including rural ones, should have easy access to services. We also heard that first response services such as helplines, call-out support, and crisis counselling services should be available 24 hours a day, seven days a week.

Consideration should be given to where there are geographic or opening-hour gaps, what capability and capacity would be required to deliver services, and how these gaps can be addressed.

Creative, diverse service delivery mechanisms could be especially useful in remote areas. They could include home visits, mobile services for remote areas, online support, and telephone and text counselling.

Recommendations

23 We recommend that the Government determine an acceptable minimum level of service, including appropriate geographic coverage of first response services.

24 We recommend that the Government ensure that the opening hours of services are extended where necessary to achieve 24-hour, seven-day coverage for first response services.

25 We recommend that the Government explore the use of diverse service delivery mechanisms, especially in remote areas.
We recommend that the Government take account of provider capability and capacity when contracting.

Appropriateness of services for Māori and other groups

Regrettably, we heard that there are major barriers to services for some victims/survivors of sexual violence. Services should be more flexible in meeting the diverse needs of various population groups.

Members of specific cultural groups, such as Māori, Pacific peoples, and other ethnic communities, experience higher rates of sexual violence and/or face specific issues with accessing and benefiting from services. For example, Māori women experience high rates of sexual violence. Submissions suggested that they would benefit from service options informed by kaupapa Māori. Research shows that culturally responsive services are better at helping survivors to recover.

Some other population groups are particularly vulnerable, such as children, people with disabilities, and people who are lesbian, gay, bisexual, transgender, or intersex. People in these groups may be more likely to experience sexual violence. However, existing services may not cater for them adequately. For people with disabilities, some existing services are not physically accessible.

Additionally, other groups—such as men and people in prison—may not be recognised as survivors of sexual violence. Existing services may also not cater for them adequately.

Some unique groups are small and will have low numbers of sexual violence clients. For these, it may be efficient to develop expertise about them within existing sexual violence services and to develop expertise about sexual violence within organisations that provide for unique groups.

For example, a victim/survivor from an ethnic minority may feel comfortable with a general support organisation for ethnic women. The organisation would need an understanding of sexual violence and its effects, and links with specialist services so that it could refer clients when required.

We note that ACC expects its providers to adhere to its Guidelines on Māori Cultural Competencies for Providers and to have a thorough grounding in the theory and application of cultural responsiveness, as described in Sexual Abuse and Mental Injury: Practice Guidelines for Aotearoa New Zealand (also known as the Massey Guidelines).

Whānau ora

In New Zealand, a whānau ora perspective can be appropriate. “Whānau ora” translates as “well families”. It is about cooperation and recognising the connections between people, not just at a whānau level, but including hapū, iwi, various government entities, non-government organisations, and the private sector.8

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In a whānau-centric service model, whānau would identify their own needs and how best to address them. There are two main issues with such a model in the context of specialist sexual violence social services:

- how it would work, either from a preventive perspective or from the perspective of a victim/survivor
- statutory requirements must be met, particularly for the safety of children and young people.

**Recommendations**

27 We recommend that, as part of a new model for specialist sexual violence social services, the Government ensure that services are accessible to all clients, including those with disabilities, and are whānau-centred, culturally competent, and responsive.

28 We recommend that the Government engage with relevant parties to ensure that any new service delivery model includes whānau-centred, culturally competent service options for Māori.

29 We recommend that the Government support mainstream service providers to become whānau-centred and culturally competent and work towards the integration of tikanga into practice.

30 We recommend that the Government support and strengthen existing kaupapa Māori specialist sexual violence social services.

31 We recommend that an integrated approach include a strategy to help organisations that support specific population groups to develop expertise in dealing with sexual violence and links with specialist sexual violence service providers.

32 We recommend that the Government ensure that public information about services is in accessible formats and is well targeted to all audiences, especially high-need target groups.
4 Conclusion

Specialist sexual violence social services are crucial to mitigating the costs of sexual violence. Ensuring that people get help to address the psychological trauma resulting from sexual violence and support through the health and justice processes is vital. It reduces long-term costs and improves the wellbeing and contributions to society of victims/survivors.

The first aim in our terms of reference was to inquire whether the state of services reflects an integrated approach to service delivery, full coverage, and best practice. We have found that it does not. Our second aim was to inquire whether services are accessible, culturally appropriate, and sustainable. We are not satisfied that they are.

It is clear that an overhaul of New Zealand’s sexual violence services sector is needed. Leadership from the Government is critical, and we urge the Government and all stakeholders to collaborate towards developing a system that meets the needs of all New Zealanders. Addressing sexual violence also aligns well with the Government’s Better Public Services goals of supporting vulnerable children and reducing rates of violent crime and reoffending.

We are aware that this inquiry has coincided with the Government’s work in the area of sexual violence, especially the review by the cross-agency senior officials’ group and the work programme of the Ministerial Group on Family Violence and Sexual Violence.

We understand that the sexual violence senior officials’ group is now working under the Ministerial Group on Family Violence and Sexual Violence. We would expect that these groups could take up our recommendations and incorporate them into their work programme. We envisage that they will address the question of leadership in the sector.

We reiterate that an integrated whole-of-system approach, including a purpose-built funding and service delivery model, would work best for delivering specialist sexual violence social services in New Zealand. We encourage the Government to progress our recommendations with urgency.
Committee procedure

The Social Services Committee of the 50th Parliament met between 21 August 2013 and 30 July 2014 to consider the inquiry. It called for public submissions with a closing date of 10 October 2013. It received 997 submissions from organisations and individuals, and heard oral evidence from 87 submitters. It heard evidence in Auckland and Wellington, and presented an interim report towards the end of the 50th Parliament on 31 July 2014.

We reinstated the inquiry on 29 October 2014. We met between 29 October 2014 and 2 December 2015 to consider the inquiry. The Ministry of Social Development provided advice.

Committee members

Alfred Ngaro (Chairperson)
Darroch Ball
Matt Doocey
Jan Logie
Todd Muller
Jono Naylor
Dr Parmjeet Parmar
Carmel Sepuloni
Stuart Smith
Poto Williams
Inquiry into the operation of the Social Workers Registration Act 2003

Report of the Social Services Committee

Fifty-first Parliament
(Alfred Ngaro, Chairperson)
December 2016

Presented to the House of Representatives
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Inquiry into the operation of the Social Workers Registration Act 2003

Summary of recommendations

The Social Services Committee makes the following recommendations to the Government:

1. That it make registration mandatory for social workers (page 12).

2. That it permit only registered social workers to practise social work, as defined in a legislative instrument (Order in Council or regulations) (page 13).

3. That it permit only registered social workers to use the title “social worker” (page 13).

4. That it introduce a particular form of registration for social work students (page 13).

5. That it require social workers to practise in accordance with scopes of practice to be developed by the Social Workers Registration Board and as prescribed by notice in the Gazette (page 13).

6. That it:

   (a) retain, for a one-year transitional period only, registration on the basis of practical experience under section 13 of the Social Workers Registration Act 2003, and

   (b) confirm that the removal of section 13 after a transitional period would not affect the validity of the registration of social workers who, before that section is removed, have obtained full registration on the basis of section 13 (page 15).

7. That it remove the requirement for social workers who have a recognised New Zealand qualification to carry out competence assessments when applying for registration and at five-year intervals (page 16).

8. That it enable the Social Workers Registration Board to require social workers to carry out competence programmes or assessments in specified circumstances, such as where concerns have been raised about their competence, or for social workers with overseas qualifications (page 16).

9. That it require social workers to complete, each year, a number of hours as specified in regulations of continuing professional development approved by the Social Workers Registration Board. We recommend that this continuing
INQUIRY INTO THE OPERATION OF THE SOCIAL WORKERS REGISTRATION ACT 2003

professional development include a proportion of cultural competence development, as appropriate (page 16).

10 That it require the Social Workers Registration Board to recognise only qualifications that produce graduates with the cultural competence required to practise social work in New Zealand (page 17).

11 That, in light of recommendation 9, the Government remove the requirement for social workers who have a recognised New Zealand qualification to complete cultural competence assessments (page 17).

12 That it additionally enable the Social Workers Registration Board to require social workers to carry out cultural competence programmes or assessments in specified circumstances, such as where concerns have been raised about their cultural competence, or for social workers with overseas qualifications (page 17).

13 That it require the Social Workers Registration Board to recognise only qualifications that produce graduates with the communication skills required to practise social work in New Zealand (page 17).

14 That it enable the Social Workers Registration Board to assess a social worker’s communication skills in specified circumstances, such as where concerns have been raised about their communication skills, or for social workers with overseas qualifications that were not in English (page 17).

15 That it expand and clarify the definition of fitness to practise by removing the current partial prescription from legislation and empowering the Social Workers Registration Board to prescribe criteria or prerequisites to assess whether someone is a fit and proper person to practise social work (page 20).

16 That it require the Social Workers Registration Board, when determining an applicant’s fitness to practise social work, to do a full Police check, including convictions normally withheld under the Criminal Records (Clean Slate) Act 2004, discharges without conviction, and family violence reports (page 20).

17 That it empower the Social Workers Registration Board to review a social worker’s fitness to practise at any time (page 24).

18 That it empower the Social Workers Registration Board to take the following actions where, after review, concerns are identified about a social worker’s fitness to practise:

(a) refuse to issue a practising certificate

(b) impose conditions on a social worker’s practising certificate

(c) if the review was carried out on direction from a complaints assessment committee, refer the matter back to the same complaints assessment committee
(d) if the review was not carried out on direction from a complaints assessment committee, refer the matter to a complaints assessment committee (page 24).

19 That it require the Social Workers Registration Board to assess social workers’ fitness to practise both at the time of applying for registration and on applying for practising certificates (page 25).

20 That it empower the Social Workers Registration Board to choose from the following actions, in addition to its existing options, when notified of concerns about a social worker’s ability to perform their work adequately:

(a) suspend or impose conditions on the social worker’s practising certificate or registration on an interim basis until the concerns are addressed

(b) review the social worker’s fitness to practise

(c) refer the matter to a complaints assessment committee (page 25).

21 That it require registered social workers and their employers to notify the Social Workers Registration Board when they have reason to believe that:

(a) because of a mental or physical condition, a registered social worker cannot adequately perform the functions needed to satisfactorily practise social work

(b) a registered social worker is not a fit and proper person to practise social work

(c) a registered social worker may pose a risk of harm to the public because they do not have the competence required to practise social work

(d) a registered social worker has breached the social workers’ code of conduct or has committed another disciplinary offence or a criminal offence under the Social Workers Registration Act 2003 (page 26).

22 That it change the name “complaints assessment committee” in the Social Workers Registration Act 2003 to “professional conduct committee” (page 27).

23 That it assign responsibility for receiving and assessing complaints, and appointing and reconstituting complaints assessment committees, to the Social Workers Registration Board (page 27).

24 That it require the Social Workers Registration Board to screen notifications of criminal convictions against social workers and decide whether to refer them to a complaints assessment committee (page 28).

25 That it expand the investigative powers of complaints assessment committees to include powers to request and require documents or information to be provided to them (page 29).
26 That it empower complaints assessment committees to consider other conduct or matters relating to social workers that come to their attention during their investigation (page 29).

27 That it expand the options available to complaints assessment committees when determining the outcome of their investigations, to include:

(a) directing an apology from the social worker to the complainant
(b) appointing an independent person to act as a conciliator
(c) directing mediation of the complaint, including to the Employment Relations Authority mediation process
(d) referring the subject matter of the complaint to the New Zealand Police
(e) censuring the social worker
(f) directing the social worker to undergo training, counselling, or mentoring (page 29).

28 That it require that the chairperson and deputy chairperson of the Social Workers Complaints and Disciplinary Tribunal are lawyers (page 31).

29 That it require Social Workers Complaints and Disciplinary Tribunal panels to be made up of the chairperson or deputy chairperson of the tribunal, three members who are registered social workers, and one lay member (page 31).

30 That it widen the definition of “professional misconduct” in section 82(2) of the Social Workers Registration Act 2003 to include any conduct that has brought or that is likely to bring discredit on the social work profession (page 32).

31 That it amend the Social Workers Registration Act 2003 to allow the Social Workers Complaints and Disciplinary Tribunal to cancel a social worker’s registration on any ground of discipline, including removing the threshold of “gross or severe” professional misconduct before registration can be cancelled for professional misconduct (page 33).

32 That it expand the sanctions available to the Social Workers Complaints and Disciplinary Tribunal, to include powers to:

(a) suspend a social worker for a period of up to three years
(b) take any course of action that is available to a complaints assessment committee (page 33).

33 That it make it clear that, except in interim situations, cancellation or suspension affects a social worker’s registration rather than their practising certificate and that cancellation or suspension of registration automatically cancels or suspends a practising certificate (page 34).
34 That it ensure that, whenever cancellation of registration is available against a social worker, the lesser sanctions of suspension and imposition of conditions are also available (page 34).

35 That it empower the Social Workers Registration Board and/or the Social Workers Complaints and Disciplinary Tribunal to impose, in conjunction with suspension, conditions on a social worker’s return to practise (page 34).

36 That it allow immediate interim suspension or conditions to be imposed on a social worker when there are reasonable grounds to believe that:

(a) the social worker is not competent or fit to practise social work or is not able (for example, because of a physical or mental condition) to perform adequately the functions required to practise social work satisfactorily, and

(b) the suspension or conditions are reasonably necessary in light of the purposes of the Social Workers Registration Act 2003 (page 35).

37 That it remove from legislation the 10-day time limit for interim extensions (page 35).

38 That it examine the legislative options to determine which would be the best means for implementing these recommendations (page 36).
1 Introduction

As part of a wider ministerial review of the operation of the Social Workers Registration Act 2003, the Minister for Social Development presented an issues paper to us. The paper identified and discussed key issues with the current operation of the Act, including its relationship with other legislation, such as the Vulnerable Children Act 2014.

The Minister asked us to consider these issues and the options for addressing them, with a view to making recommendations to the Government for legislative reform.

In this context, the terms of reference for this inquiry were to consider:

- whether registration of social workers should be mandatory, and the potential challenges to registration at present
- the adequacy of current competence assessments and other prerequisites for registration
- how fitness to practise social work is assessed by the Social Workers Registration Board
- the level of oversight of social workers by the board
- the process and powers of the complaints assessment committee
- the adequacy of grounds of discipline and sanctions available to the Social Workers Complaints and Disciplinary Tribunal
- the appropriateness of suspension and cancellation of registration and practising certificates as sanctions for non-compliance.

Current process for registering social workers

The Act enables a person to apply to the Social Workers Registration Board to be registered as a social worker. The board must decide whether the person is competent and a fit and proper person to practise social work.

Registered social workers must hold a practising certificate to practise social work. In certain circumstances, the board can put conditions on a social worker’s registration or practising certificate. Practising certificates must be renewed every year.

Registered social workers are subject to oversight and discipline from the board, the tribunal, and, in some cases, the Health and Disability Commissioner.

Registering as a social worker is voluntary. Anybody can use the title “social worker”, and statistics show that people do.

According to the board, there were almost 6,000 registered social workers in November 2016. Census information from 2013 shows that about 18,000 people identified as “social workers” in a wide definition that includes occupations such as health promotion officer,
community worker, family support worker, youth worker, and disabilities services officer. The number of people who identified as “social workers” in 2013, based on a narrower definition, was 6,128.¹

¹ The 2013 census figure of 18,330 social workers was based on the wide NZSCO99 (New Zealand Standard Classification of Occupations 1999) definition of social work. The narrow definition of “social worker” was based on ANSCO (Australian and New Zealand Standard Classification of Occupations).
2 Mandatory registration

For the reasons outlined below, we agree with most submitters that social worker registration should be mandatory.

Registration in other professions

We were advised on how other professions approach registration. We particularly looked at health practitioners, teachers, and lawyers, who, like social workers, interact with children and adults needing personal help. Members of these professions must be registered before they may carry out certain work.

Health practitioners

Doctors, nurses, chiropractors, dieticians, dentists, dental hygienists and therapists, medical radiation technologists, medical laboratory scientists, midwives, occupational therapists, optometrists, osteopaths, pharmacists, physiotherapists, podiatrists, and psychologists are among the professions regulated by the Health Practitioners Competence Assurance Act 2003.

Each of these professions is governed by an authority as set out in the Health Practitioners Competence Assurance Act. The authorities’ role includes defining the scope of their profession.

Registered health practitioners only may use titles and descriptions identifying them as that kind of professional. They may perform only services that are in their “scope of practice”, and they must have a practising certificate to practise.

Certain activities (for example, surgical procedures) can be practised only by registered practitioners. It is an offence for an unregistered person to perform them or to imply that they are willing to do so.

Teachers

In order to be engaged in a teaching position (as defined in the Education Act 1989), teachers must be registered and must hold a practising certificate. Teachers are subject to the disciplinary oversight of the Education Council.

Lawyers

Under the Lawyers and Conveyancers Act 2006, it is an offence for lawyers who do not hold a practising certificate to provide legal services or to hold themselves out to be lawyers.

Social workers

In 2003, when Parliament was considering the Social Workers Registration Bill, relatively few social workers had formal qualifications. We believe that, 13 years later, there are
enough professional social workers with formal qualifications to support mandatory registration.

Mandatory registration provides an assurance of competence, accountability, and fitness to practise. It would help to protect public safety, and it would enhance the professionalism of social workers. These are two purposes of the Act.

Who should be registered?

A major question is who should have to register as a social worker.

It would make sense to require registration of those doing certain defined work, rather than just those with the title “social worker”. This would remove the ability to circumvent the requirement to register by simply changing job title while doing the same job. Also, it would prevent people in non-social-work roles, which should not be covered, from using the title “social worker”.

We are aware that many people use the title “social worker” even though they are not performing what we consider should be defined as social work. If registration becomes mandatory, these people would have to start using different titles, such as “social service worker” or “support worker”, to better describe their occupation.

Reserving the title “social worker” for registered social workers would help make sure that only those who meet the criteria for registration can purport to be a social worker.

Also, some people working in positions that would be defined as social work do not use the title “social worker”. These people should be required to register.

We consider that social work students should also be registered. A special student registration, with appropriate criteria and restrictions, would help to protect public safety during student placements.

Defining social work

The tribunal has developed a body of case law about whether a person is considered to be practising social work. This could be continued if registration becomes mandatory.

Alternatively, legislation could set out the definition. This would have the advantage of being seen as more easily accessible to the public than case law. However, we do not consider a statutory definition of social work to be essential; we would be comfortable if the definition continued to develop under case law.

It would be useful if the board could prescribe general and specialist scopes of practice within the definition of social work, similar to the authorities’ role in health professions. This would allow for additional prerequisites in certain areas of social work, such as social workers exercising statutory powers or performing statutory functions. It would also allow for specialisation after further post-qualification education.

Recommendations

1. We recommend that the Government make registration mandatory for social workers.
We recommend that the Government permit only registered social workers to practise social work, as defined in a legislative instrument (Order in Council or regulations).

We recommend that the Government permit only registered social workers to use the title “social worker”.

We recommend that the Government introduce a particular form of registration for social work students.

We recommend that the Government require social workers to practise in accordance with scopes of practice to be developed by the Social Workers Registration Board and as prescribed by notice in the Gazette.
3 Competence and other prerequisites for registration

Current registration process
Applicants are entitled to be registered as social workers under the Act if the board is satisfied that they:

- have a recognised New Zealand or overseas qualification
- are competent to practise social work
- are fit and proper to practise social work
- are competent to practise social work with Māori and other ethnic and cultural groups
- have gained enough practical experience, which the board has prescribed as 2,000 hours of supervised social work practice.

The first three points (qualification, competence, and fitness to practise) are the core prerequisites. We discuss qualifications, competence, and other prerequisites in this chapter and fitness in the next.

Practical experience instead of formal qualifications
If a social worker does not have an appropriate qualification, section 13 of the Act provides that they can be registered if their “practical experience in practising social work in New Zealand is enough to compensate for the lack of such a qualification”.

We find it acceptable for social workers to rely on their practical experience if they entered the profession before the Act came into force and before social work qualifications were readily available.

However, it is time to remove this protection for new social workers. It is now good practice for organisations hiring social workers who have recently entered the profession to choose those who have a recognised tertiary qualification in social work.

We consider it appropriate to gradually phase out the recognition of practical experience. It is fair to allow a transitional period during which social workers could apply for registration under section 13. This would clarify the expectation that those who are newly entering the profession should have a qualification, while allowing a limited time for those with practical social work experience to register.
Recommendation

6 We recommend that the Government:

(a) retain, for a one-year transitional period only, registration on the basis of practical experience under section 13 of the Social Workers Registration Act 2003, and

(b) confirm that the removal of section 13 after a transitional period would not affect the validity of the registration of social workers who, before that section is removed, have obtained full registration on the basis of section 13.

Competence assessments should be removed

The requirement under Part 3 of the Act to complete a competence assessment is in addition to having an appropriate qualification. Social workers must repeat the competence assessment every five years to keep their practising certificates.

This requirement is peculiar to social work. Other regulated professions, such as health practitioners, teachers, and lawyers, have no practical assessment as a prerequisite to registration (or admission to the bar in the case of lawyers).

When deciding which qualifications to recognise, the board assesses the professional competence that is taught in social work courses. If a social worker has passed a course that the board recognises, we consider it prudent to assume that they are competent. We note that, since 2008, the board has not required new graduates to do the separate competence assessment before they apply for registration. However, new graduates must complete a competence assessment within two years of completing their qualification.

We are aware that the board intends to replace five-yearly competence re-certification with a process based on the social worker’s critical reflection in their continuing professional development (CPD) log. As discussed below (see recommendation 9), CPD should be a requirement for all social workers. The board intends to audit CPD hours along with critical reflection. The yearly CPD hours requirement would ensure that registered social workers address their competence on an ongoing basis rather than once every five years.

We note also that the board is developing proposals to strengthen its oversight of new social workers. We mention this below, under cultural competence, although it also applies here because the proposals aim to improve social worker competence generally.

Further, the board’s oversight of registered social workers, including disciplinary and complaints processes, means that the board can review the competence of a social worker at any time.

We believe that it would be appropriate to assume that a formally qualified social worker is competent until cause for concern arises, in which case the relevant processes would be engaged.

We note, too, that, if registration becomes mandatory, competence assessments would take up much of the board’s time and resources because of the increase in applications.
Recommendations

7 We recommend that the Government remove the requirement for social workers who have a recognised New Zealand qualification to carry out competence assessments when applying for registration and at five-year intervals.

8 We recommend that the Government enable the Social Workers Registration Board to require social workers to carry out competence programmes or assessments in specified circumstances, such as where concerns have been raised about their competence, or for social workers with overseas qualifications.

Continuing professional development

As with other professions, it is good practice for social workers to continue to develop professionally as their career progresses. CPD maintains and enhances a person’s knowledge, expertise, and competence. It takes into account the needs of the individual, their employer, the profession, and society. It is related to current work and to future career development.

Social workers should be required to complete at least 20 hours of CPD per year. We support continuing the current requirement for registered social workers to record their CPD activities.

Recommendation

9 We recommend that the Government require social workers to complete, each year, a number of hours as specified in regulations of continuing professional development approved by the Social Workers Registration Board. We recommend that this continuing professional development include a proportion of cultural competence development, as appropriate.

Cultural competence

Currently, the board assesses every applicant’s competence to practise social work with Māori and other ethnic and cultural groups. This is called cultural competence.

We are aware that the board is examining competence assessment, including cultural competence, as part of the wider review of the Act. It is developing proposals for:

- a kaitiakitanga\(^2\) framework within social work education and social work practice to assess and strengthen, at a deeper level than prescribed in the Act, social workers’ competence to work with Māori
- support and assessment in the first year of practice to further educate, supervise, and mentor new social workers.

We look forward to learning about the board’s final proposals for the kaitiakitanga framework and extra oversight of new social workers. We expect the proposals to help raise the level of cultural competence so that all social workers can work comfortably and successfully with families and children from all ethnicities.

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\(^2\) Guardianship, taking care of.
We consider that, in combination with these proposals and recommendation 9 above about CPD, it would be enough for the board to consider, in deciding which qualifications it recognises, whether a qualification includes components that would mean a graduate would have cultural competence.

The board should still be able to require formal cultural competence assessments for people without a recognised New Zealand qualification—especially those with overseas qualifications.

We note that applicants under section 13 have their cultural competence assessed as part of that process.

**Recommendations**

10 We recommend that the Government require the Social Workers Registration Board to recognise only qualifications that produce graduates with the cultural competence required to practise social work in New Zealand.

11 In light of recommendation 9, we recommend that the Government remove the requirement for social workers who have a recognised New Zealand qualification to complete cultural competence assessments.

12 We recommend that the Government additionally enable the Social Workers Registration Board to require social workers to carry out cultural competence programmes or assessments in specified circumstances, such as where concerns have been raised about their cultural competence, or for social workers with overseas qualifications.

**Communication skills**

The board considers communication skills to be an aspect of being a fit and proper person to practise social work. We consider that communication skills fit better with competence than with fitness to practise.

The board presumes that applicants have good communication skills if their qualification was taught and assessed in the English language. Other applicants must satisfy the board that they can communicate well in English.

We find that the best way to assess communication skills is the same as that recommended for cultural competence: for the board, in assessing qualifications, to consider whether a course will produce graduates with the appropriate communication skills and to recognise only those courses.

**Recommendations**

13 We recommend that the Government require the Social Workers Registration Board to recognise only qualifications that produce graduates with the communication skills required to practise social work in New Zealand.

14 We recommend that the Government enable the Social Workers Registration Board to assess a social worker’s communication skills in specified circumstances, such as
where concerns have been raised about their communication skills, or for social workers with overseas qualifications that were not in English.
4 Fitness to practise

Fitness to practise is another prerequisite for social worker registration. We have chosen to discuss fitness in a chapter of its own because it goes to the foundation of a person’s character and suitability for social work. This is in contrast to competence, which, as mentioned in the previous chapter, can often be ascertained from the fact that a person has gained a recognised social work qualification.

**Better defining fitness to practise**

The concept of fitness to practise is complicated by the way it is partially prescribed in the Act. Under section 47, the board may find a person not fit and proper to practise social work if they:

- have been convicted of an offence punishable by imprisonment for three months or more, the nature and circumstances of which reflect adversely on their fitness to practise
- are unable to perform adequately the functions required to practise social work satisfactorily, or
- are not of good character and reputation.

We believe that the legislation should provide a more complete definition of fitness to practise. Either it could be entirely detailed in legislation or the legislation could provide an overarching definition, with details set out by the board.

We note that health practitioners are considered unfit for registration if they have mental or physical health issues that make it inappropriate for them to practise. Under the Health Practitioners Competence Assurance Act, a person is unfit for registration if they are “unable to perform the functions required for the practice of that profession because of some mental or physical condition”.³

This is a good starting point for fitness to practise social work, and it should be expanded beyond just physical or mental health. In examining whether an applicant is a fit and proper person to practise social work, the board should consider:

- any mental or physical health issues
- their criminal history (discussed below)
- whether they have been professionally disciplined, here or overseas, at work or at an educational institution, in a way that reflects adversely on their fitness to practise
- whether they have practised social work in breach of obligations to register or to hold a practising certificate
- public safety

³ Health Practitioners Competence Assurance Act 2003, section 16(d).
• whether they display respect towards
  o people
  o the cultural and social values of New Zealand
  o the law
  o the views of others
• whether they uphold the public and professional reputation of social workers
• their reliability and trustworthiness in carrying out duties.

**Recommendation**

15 We recommend that the Government expand and clarify the definition of fitness to practise by removing the current partial prescription from legislation and empowering the Social Workers Registration Board to prescribe criteria or prerequisites to assess whether someone is a fit and proper person to practise social work.

**Criminal offences**

To help the board decide whether a person is fit to practise, section 50 of the Act requires the board to ask the New Zealand Police whether the person has any criminal convictions.

It would be useful for the board to be informed of convictions normally withheld under the Criminal Records (Clean Slate) Act 2004 and family violence reports. This would allow it to be properly informed when assessing an applicant’s fitness to practise social work. The information would be helpful because social work roles frequently involve interacting with children and other vulnerable people.

**Recommendation**

16 We recommend that the Government require the Social Workers Registration Board, when determining an applicant’s fitness to practise social work, to do a full Police check, including convictions normally withheld under the Criminal Records (Clean Slate) Act 2004, discharges without conviction, and family violence reports.

**Safety checking under the Vulnerable Children Act 2014**

A person’s ability to work safely with children is part of being fit to practise social work.

Part 3 of the Vulnerable Children Act is about checking that those who work with children are appropriate to do that work. “Safety checking” is required for children’s workers who have regular or overnight contact with a child without a parent or guardian being present. These workers must be safety checked before they start work, then every three years.

Safety checking is limited to people working in certain publicly funded services, including

• care and protection coordination
• services arising out of decisions made at family group conferences
• social or support services
The components of a safety check are set out in the Vulnerable Children (Requirements for Safety Checks of Children’s Workers) Regulations 2015. The safety check includes:

- confirming the identity of the person
- obtaining relevant information, including:
  - a police record
  - a chronological summary of work history for the last five years
  - the name of any professional organisation, licence, or registration that the person belongs to or holds, if relevant to the proposed children’s work
  - the name of at least one independent referee
- an interview with the person
- contacting at least one referee to ask for relevant information
- contacting at least one professional organisation that the person belongs to or holds a licence or registration from, to ask for relevant information
- an assessment of the risk that the person would pose to the safety of children if employed or engaged as a children’s worker, taking into account the information obtained and any guidelines.

A periodic safety check is completed every three years after the first check. It requires:

- confirming whether the person has changed their name since the last safety check
- obtaining a police record
- obtaining the name of relevant professional organisations that the person belongs to or holds a licence or registration from
- contacting at least one such organisation to ask for relevant information
- performing the same risk assessment as for the initial safety check.

A “core worker” is a children’s worker who could be present alone with a child or who has primary responsibility for the child. Nobody may be a core worker if they have been convicted of a specified offence, including a child sex offence or a serious violence offence. However, a departmental chief executive may grant an exemption if they are satisfied that the worker will not pose an undue risk to the safety of children.

**Could safety checking be combined with the fitness assessment?**

The Vulnerable Children Act requirement on employers to check police records overlaps with the board’s requirement to check for convictions when determining a social worker’s fitness to practise.

We considered whether the safety-checking role and the role of assessing fitness to practise could be combined to increase efficiency. Could a social worker who is assessed as fit to practise also be considered to have passed a safety check under the Vulnerable Children
Act? Should fitness-to-practise checks be expanded so that they cover the Vulnerable Children Act checks?

We found that there are good reasons to keep these two checks separate.

Under the Vulnerable Children Act, safety checks are made with a particular employment role in mind. The employer is best placed to check a person’s safety because they know the day-to-day activities needed in the particular role.

Also, not all social workers would come within the scope of the Vulnerable Children Act. Not every social worker will be a “children’s worker” under the Vulnerable Children Act, either because of the kind of work they do or because of their employment situation. For example, the Vulnerable Children Act applies only to services that are provided or funded by State or local authorities.

Requiring the board to do Vulnerable Children Act checks would duplicate checks that employers should do and make the social worker registration process unnecessarily complex.

We conclude that it is better to keep the checks required for social worker registration separate from those required under the Vulnerable Children Act.
5 Oversight of social workers

The board’s oversight role
As well as registering social workers and issuing practising certificates, the roles of the board include:

- reviewing a registered social worker’s competence at any time
- reviewing a registered social worker’s fitness to practise when a complaints assessment committee decides it should
- receiving notifications of concern about a social worker’s performance.

Complaints process
The Act establishes the tribunal to process complaints against registered social workers and to administer discipline. The tribunal is made up of at least eight board-appointed members and one person appointed by the Minister. Board members are not allowed to be members of the tribunal.

Complaints assessment committees are appointed from time to time to examine complaints, convictions, or concerns about a social worker. Each committee consists of three people appointed by the chairperson of the tribunal in consultation with the board. Two of them are registered social workers. The other is a layperson.4

We examine the committee and tribunal processes in the following two chapters. In this chapter, we look at the board’s role.

Competence
When a social worker’s competence is at issue, the board may review their competence. Under the Act, the board may do this at any time.

If necessary, the board may follow this with a formal competence assessment. If it finds that a social worker is no longer competent, the board may impose conditions on or suspend their registration or practising certificate.

Fitness to practise
The board must assess a person’s fitness to practise either when they apply for registration or when a complaints assessment committee directs the board to do so. This would happen after a complaint has been made against the social worker or they have received a conviction.

If fitness is assessed under the direction of a complaints assessment committee and concerns are identified, the board has two options: either it generates a new complaint or it

4 Social Workers Registration Act 2003, section 66.
suspends the social worker’s registration or practising certificate. The board does not have the power to put conditions on the person’s registration or practising certificate, or to refer the matter back to the original complaints assessment committee for further action. We think that these options should be available to the board because they may be the best course of action in some cases.

We note the circularity of making a complaint for a matter that was originally referred to the board by a complaints assessment committee. We make recommendations below to address this (recommendation 18(c) and (d)). See also recommendation 26, about enabling a complaints assessment committee to consider any concerns that come to its attention during an investigation.

**Recommendations**

17 We recommend that the Government empower the Social Workers Registration Board to review a social worker’s fitness to practise at any time.

18 We recommend that the Government empower the Social Workers Registration Board to take the following actions where, after review, concerns are identified about a social worker’s fitness to practise:

(a) refuse to issue a practising certificate

(b) impose conditions on a social worker’s practising certificate

(c) if the review was carried out on direction from a complaints assessment committee, refer the matter back to the same complaints assessment committee

(d) if the review was not carried out on direction from a complaints assessment committee, refer the matter to a complaints assessment committee.

**Practising certificates**

Registered social workers apply to the board’s registrar for practising certificates. The registrar issues the certificate, refuses to issue one, or refers the application to the board. If the application is referred, the board decides whether to issue a certificate or not and can impose conditions as it sees fit.

When a registered social worker applies for a practising certificate, the board is not required to consider whether the person is fit to practise social work. Under section 30 of the Act, the registrar must refer an application to the board if he or she suspects that the applicant is not a fit and proper person to practise social work. However, we believe that it would be proper to require the board (or its registrar) to expressly consider the question of fitness to practise for every application for a practising certificate.

Fitness to practise is essential for protecting public safety and for upholding professional standards. It should be assessed regularly, and the board should be able to act appropriately to ensure that registered social workers are fit and proper to practise. The opportune time to assess fitness is when social workers apply for their practising certificates.
Recommendation

19. We recommend that the Government require the Social Workers Registration Board to assess social workers’ fitness to practise both at the time of applying for registration and on applying for practising certificates.

Reporting concerns about a social worker

A person who believes that a registered social worker is not able to adequately perform the functions necessary to practise social work satisfactorily may tell the registrar of the board. The registrar gives the information to the chairperson of the board for consideration at the board’s next meeting.

If appropriate, the board may then suspend the social worker’s registration for up to 10 days. It may also require the social worker to have a medical examination. Depending on the circumstances, if the board then considers that the matter should be dealt with urgently, it may suspend the social worker’s registration or practising certificate (or both), or make them subject to conditions.

We consider that the options when suspending a registration or practising certificate should be expanded. For example, it would be useful if the board could state how long a suspension will be for. This would help to increase public safety and professional standards.

We discuss interim suspension further in chapter 8.

Recommendation

20. We recommend that the Government empower the Social Workers Registration Board to choose from the following actions, in addition to its existing options, when notified of concerns about a social worker’s ability to perform their work adequately:

(a) suspend or impose conditions on the social worker’s practising certificate or registration on an interim basis until the concerns are addressed

(b) review the social worker’s fitness to practise

(c) refer the matter to a complaints assessment committee.

Mandatory reporting

Social workers do not have to inform the board if they are concerned about a colleague’s performance or conduct. We believe that such reporting should be mandatory.

We note that it is mandatory for health practitioners to tell their relevant authority when they are concerned about the performance of another health practitioner because of a mental or health condition. Lawyers are required to tell their governing body if they have concerns about the misconduct of another lawyer.

We consider that social workers should be subject to similar standards.
It should be mandatory for a social worker to swiftly inform the board of concerns about the suitability, competence, or conduct of a registered social worker. This would contribute to public safety and the maintenance of professional standards.

**Recommendation**

21 We recommend that the Government require registered social workers and their employers to notify the Social Workers Registration Board when they have reason to believe that:

(a) because of a mental or physical condition, a registered social worker cannot adequately perform the functions needed to satisfactorily practise social work

(b) a registered social worker is not a fit and proper person to practise social work

(c) a registered social worker may pose a risk of harm to the public because they do not have the competence required to practise social work

(d) a registered social worker has breached the social workers’ code of conduct or has committed another disciplinary offence or a criminal offence under the Social Workers Registration Act 2003.
6 Complaints assessment committees

Complaints assessment committees are appointed as and when needed. Their role is to look into complaints and convictions against a social worker. A new complaints assessment committee is established for each case.

Name of complaints assessment committees

Complaints assessment committees are about more than just complaints. They consider complaints, convictions, or notifications from employers about alleged professional misconduct.

In our opinion, the name of these committees should properly reflect their scope. Health practitioners use “professional conduct committees”, and we think that this name would be appropriate in the social work profession.

Recommendation

22 We recommend that the Government change the name “complaints assessment committee” in the Social Workers Registration Act 2003 to “professional conduct committee”.

Administration of the complaints process

Complaints assessment committees are mainly administered by the tribunal. The chairperson of the tribunal:

- is notified of complaints by the registrar or by the Health and Disability Commissioner
- screens complaints before they are referred to a complaints assessment committee
- appoints complaints assessment committees and reconstitutes them if necessary.

Although the tribunal is primarily a judicial body, these tasks are largely administrative. We consider that it would be more appropriate for the board to be responsible for these tasks.

Also, some matters that go to a complaints assessment committee will end up being considered by the tribunal as a charge against the social worker. This raises the potential for conflicts of interest, because the chairperson of the tribunal has already received and screened the complaint. In doing so, they may have seen prejudicial information that is not presented to the tribunal when it later considers the charge.

Recommendation

23 We recommend that the Government assign responsibility for receiving and assessing complaints, and appointing and reconstituting complaints assessment committees, to the Social Workers Registration Board.
Screening convictions before they are referred

Under section 63 of the Act, every conviction against a social worker punishable by three months’ imprisonment or more is referred to the chairperson of the tribunal.

As noted above, complaints are screened before they are referred to a complaints assessment committee. However, notifications of convictions are referred to a complaints assessment committee without any screening.

We consider that convictions should be screened too. This would improve efficiency, because convictions that do not warrant referring would not go through the complaints assessment committee process.

Having the board, rather than the tribunal, screen convictions would be consistent with our recommendation that the board screen complaints. The board already assesses convictions in the context of fitness to practise. This positions it well to assess whether a conviction is of a nature or gravity that would warrant a complaints assessment committee considering it.

Recommendation

24 We recommend that the Government require the Social Workers Registration Board to screen notifications of criminal convictions against social workers and decide whether to refer them to a complaints assessment committee.

Preliminary investigation powers

We considered whether investigative powers should be granted to the body in charge of screening complaints and convictions before they are referred to a complaints assessment committee.

Options included powers to contact and request information from the complainant, the social worker, or the employer.

We note that legislation regulating other professions does not include such detail.

We do not consider it necessary to specially grant investigative powers to the board in screening complaints and convictions. Too much specification could confine the board in its preliminary consideration of a matter.

Complaints assessment committee powers

A complaints assessment committee must consider and decide on a complaint or a conviction as soon as reasonably practicable after it is received. Committees have powers under section 71 of the Act:

• to carry out or arrange for any investigations they think necessary
• to take into account any investigations or assessments that have already been carried out
• to require a complaint to be supported by a statutory declaration.
Committees must give parties an opportunity to provide a written statement, and they may allow parties to appear in person.

We consider that the investigative powers of complaints assessment committees should be expanded. These powers would assist committees to perform their functions properly and make effective and informed assessments of the conduct or concerns referred to them.

They should include powers to require documents or information.

Committees should also be empowered to consider other matters about social workers that come to their attention during their investigation. This would allow concerns to be addressed properly and would also prevent the circular process of a case being sent back to the committee later.

**Recommendations**

25 We recommend that the Government expand the investigative powers of complaints assessment committees to include powers to request and require documents or information to be provided to them.

26 We recommend that the Government empower complaints assessment committees to consider other conduct or matters relating to social workers that come to their attention during their investigation.

**Possible outcomes of committee investigations**

Under section 71, complaints assessment committees have four options available to them when considering cases. They can decide:

- that the board should review the competence or fitness of the social worker
- that a complaint should be submitted to conciliation
- that a complaint or conviction should be submitted to the tribunal (in which case, the committee must frame an appropriate charge and lay it before the tribunal)
- that no further steps should be taken.

Expanding these options would be consistent with other professions and would ensure that committees can choose the best option for the wide range of circumstances they consider.

**Recommendation**

27 We recommend that the Government expand the options available to complaints assessment committees when determining the outcome of their investigations, to include:

(a) directing an apology from the social worker to the complainant
(b) appointing an independent person to act as a conciliator
(c) directing mediation of the complaint, including to the Employment Relations Authority mediation process
(d) referring the subject matter of the complaint to the New Zealand Police
(e) censuring the social worker
(f) directing the social worker to undergo training, counselling, or mentoring.
7 Social Workers Complaints and Disciplinary Tribunal

Functions of the tribunal include administering the complaints process and exercising disciplinary powers over registered social workers.\(^5\)

Charges before the tribunal can come from a complaints assessment committee or from the Director of Proceedings under the Health and Disability Commissioner Act 1994.

Hearings convene as soon as reasonably practicable after charges are laid and are generally held in public.\(^6\)

Membership of tribunal

The tribunal consists of a chairperson, a deputy chairperson, a lawyer, and five other members appointed by the board, plus at least one layperson appointed by the responsible Minister.

Each charge is heard by a group of five members: the chairperson or deputy chairperson, the lawyer, two of the board-appointed members, and the Minister-appointed member.

The chairperson and deputy chairperson play a central role in regulating proceedings of the tribunal. Proceedings often involve issues of law, and decisions are similar to court judgments. A working legal knowledge is central to the process and outcomes of the tribunal.

The importance of legal knowledge leads us to conclude that the tribunal chairperson should be a lawyer. Having a lawyer as chairperson would help to ensure that hearings are conducted fairly and properly.

For the same reasons, we consider that the deputy chairperson should also be a lawyer.

Recommendations

28 We recommend that the Government require that the chairperson and deputy chairperson of the Social Workers Complaints and Disciplinary Tribunal are lawyers.

29 We recommend that the Government require Social Workers Complaints and Disciplinary Tribunal panels to be made up of the chairperson or deputy chairperson of the tribunal, three members who are registered social workers, and one lay member.

---

\(^5\) Social Workers Registration Act 2003, section 115.

\(^6\) Social Workers Registration Act 2003, sections 75(3) and 79.
Grounds for disciplining a social worker

Under section 82 of the Act, the tribunal can penalise a social worker if it finds that the social worker has:

- been guilty of professional misconduct (discussed below)
- been guilty of conduct unbecoming of a social worker and reflecting adversely on their fitness to practise
- been convicted in court of an offence punishable by at least three months’ imprisonment that was committed in circumstances that reflect adversely on their fitness to practise
- not complied with restrictions on their registration.

Professional misconduct

Section 82(2) defines professional misconduct as

- breaching the code of conduct
- while working as a social worker, holding oneself out to be registered while not holding a current practising certificate.

In our view, this definition is too narrow. Professional conduct should be more broadly defined, to include conduct that has discredited or that is likely to discredit the profession. We note that this aligns with principle 9 of the social worker code of conduct, which is to maintain public trust and confidence in the social work profession.

The ability to interpret “professional misconduct” more broadly would align with the approach taken in other professions, such as health practitioners and lawyers.

Recommendation

30 We recommend that the Government widen the definition of “professional misconduct” in section 82(2) of the Social Workers Registration Act 2003 to include any conduct that has brought or that is likely to bring discredit on the social work profession.

Sanctions available to the tribunal when disciplining a social worker

Under section 83 of the Act, the tribunal can choose one or more of the following penalties against a social worker whom it finds grounds for disciplining:

- cancelling registration (and requiring that certain conditions be satisfied before the social worker can reapply for registration)
- suspending registration for up to 12 months
- making an order that the social worker may work only in accordance with stated restrictions (such as employment restrictions or supervision) for up to three years
- censuring the social worker
- fining the social worker up to $10,000
- requiring them to do additional training and/or professional development
• paying part or all of the costs and expenses related to the matter.

**Drafting ambiguity**

We were advised of a drafting issue in section 83(2), which prohibits the tribunal from cancelling a social worker’s registration “unless it finds him or her guilty of gross or severe professional misconduct”.

One interpretation of this could be that the tribunal may cancel a social worker’s registration only if it has found the social worker guilty of (gross or severe) professional misconduct; it may not cancel a registration on any of the other grounds of discipline in section 82. This interpretation inappropriately confines the tribunal’s assessment of suitable penalties for particular misconduct.

We prefer the interpretation that gives better effect to the intent of sections 82 and 83: that, where a social worker has been found guilty of professional misconduct, their registration can be cancelled only if that misconduct was “gross or severe”.

**Recommendation**

31 We recommend that the Government amend the Social Workers Registration Act 2003 to allow the Social Workers Complaints and Disciplinary Tribunal to cancel a social worker’s registration on any ground of discipline, including removing the threshold of “gross or severe” professional misconduct before registration can be cancelled for professional misconduct.

**More sanctions should be available to the tribunal**

The strength and range of sanctions available to the tribunal are more limited than in other professions, such as health practitioners, teachers, and lawyers. We believe that they should be expanded.

The tribunal should be able to take any of the actions that we recommend be available to complaints assessment committees (see recommendation 27).

The tribunal should be able to suspend registration for longer than 12 months. Three years would be in line with sanctions available in other similar professions.

**Recommendation**

32 We recommend that the Government expand the sanctions available to the Social Workers Complaints and Disciplinary Tribunal, to include powers to:

(a) suspend a social worker for a period of up to three years

(b) take any course of action that is available to a complaints assessment committee.
8 Suspending and cancelling practising certificates and registration

In this chapter, we discuss the provisions in the Act about suspending and cancelling either or both of registration or practising certificates. We look at the consistency of these provisions, including the appropriateness of suspension powers pending the assessment and determination of a complaint or charge against a social worker.

Consistency needed for suspension and cancellation powers

There are many situations in which registration and practising certificates can be cancelled, be suspended, or become subject to conditions. These are dotted throughout the Act, but the approach is inconsistent. For example, under section 49, the board can suspend registration or a practising certificate if it determines that a social worker is not fit to practise, but it does not have the option of imposing conditions.

We consider that the law relating to suspension and cancellation should be clearer. The board and the tribunal should have the full hierarchy of options open to them when considering what to do about misconduct or incompetence.

It would be useful if they could impose conditions, such as supervision requirements, to take effect at the end of a suspension period. Appropriate conditions would help to manage the social worker back into their role successfully.

Sanctions on registration and on practising certificates should be logical and consistent. For example, it should be clear that suspending a social worker’s registration necessarily suspends their practising certificate.

Recommendations

33 We recommend that the Government make it clear that, except in interim situations, cancellation or suspension affects a social worker’s registration rather than their practising certificate and that cancellation or suspension of registration automatically cancels or suspends a practising certificate.

34 We recommend that the Government ensure that, whenever cancellation of registration is available against a social worker, the lesser sanctions of suspension and imposition of conditions are also available.

35 We recommend that the Government empower the Social Workers Registration Board and/or the Social Workers Complaints and Disciplinary Tribunal to impose, in conjunction with suspension, conditions on a social worker’s return to practise.

They are listed in paragraph 281 of the Minister’s Issues Paper.
Interim suspension

We note that the board has a very limited interim suspension power. Essentially, it can make an interim suspension only when a person cannot practise social work satisfactorily because of a mental or physical health issue.

This does not cover all the situations it should. For example, immediate interim suspension should be available as a response to notification of a very serious criminal conviction or if a complaints assessment committee discovers information that could put public safety at risk.

We believe that the board and the tribunal should be able to impose immediate suspension when needed to protect public safety and maintain professional standards. This would enable immediate risks to be addressed while the complaints and disciplinary processes carry on.

Another flaw is that interim suspensions apply only for 10 days. This is not enough time for a complaint or concern about a social worker to be properly resolved. Interim suspensions should apply until the board is satisfied that the issue has been dealt with.

Recommendations

36 We recommend that the Government allow immediate interim suspension or conditions to be imposed on a social worker when there are reasonable grounds to believe that:

(a) the social worker is not competent or fit to practise social work or is not able (for example, because of a physical or mental condition) to perform adequately the functions required to practise social work satisfactorily, and

(b) the suspension or conditions are reasonably necessary in light of the purposes of the Social Workers Registration Act 2003.

37 We recommend that the Government remove from legislation the 10-day time limit for interim extensions.
9 Summary and conclusion

We have inquired into the operation of the Act and its interaction with other legislation such as the Vulnerable Children Act 2014. We have concluded that there is need for legislative reform.

Our main recommendations for change are:

- that registration should be mandatory for social workers and social work students
- that social workers with a recognised New Zealand qualification should be presumed to be competent
- that social work registration on the basis of practical experience be phased out
- that a social worker’s fitness to practise be assessed regularly
- that social workers and employers be required to notify the board if they have concerns about, among other things, a social worker’s fitness to practise
- that the board’s options be expanded when dealing with concerns about a social worker
- changes relating to complaints assessment committees and the tribunal.

We do not recommend any changes relating to safety checking under the Vulnerable Children Act 2014.

We note the need to ensure that cultural competence is a core requirement for social workers, and we encourage the board to continue developing its policies and processes in this area to improve current arrangements. In our view, this represents moving from a “tick box” exercise to more meaningful assessment.

Best means for achieving reform

We note that there will be advantages and disadvantages in each of the main options for achieving our recommendations:

- amending the Social Workers Registration Act
- repealing and replacing the Social Workers Registration Act
- repealing the Social Workers Registration Act and incorporating social work into the Health Practitioners Competence Assurance Act
- amending the Social Workers Registration Act and incorporating social work partially into the Health Practitioners Competence Assurance Act.

Recommendation

We recommend that the Government examine the legislative options to determine which would be the best means for implementing these recommendations.
Appendix A

Committee procedure
The committee met between 1 June and 30 November 2016 to consider the inquiry. We called for public submissions with a closing date of 13 July 2016. We received 29 submissions from the organisations and individuals listed in Appendix B and heard oral evidence from seven submitters.

We received advice from the Ministry of Social Development and the Social Workers Registration Board.

Committee members
Alfred Ngaro (Chairperson)
Darroch Ball
Matt Doocey
Hon Paul Goldsmith
Jan Logie
Jono Naylor
Dr Parmjeet Parmar
Maureen Pugh
Carmel Sepuloni
Phil Twyford
Appendix B

List of submitters

Anglican Trust for Women and Children
Aotearoa New Zealand Social Workers Association
Arthur J Curson (aka Buster)
Barnardos NZ
Barry Maher
Birthright New Zealand
Child, Youth and Family Services
Corina Alipate
Department of Social Work of the University of Auckland
Emily Jones
Erica Henderson
Erin Mechan
Fiona Gleeson
Josephine Burgi
Kieran O’Donoghue
National Collective of Independent Women’s Refuges
New Zealand Council of Christian Social Services
NZ Public Service Association
Office of the Children’s Commissioner
Ray Calver
Riripeti Halbert
Robert William Walker
Roger Ngahooro
Sarah Boch
Social Service Providers Aotearoa
Stand Children Services Tu Maia Whānau
Susanne Croft
Te Pūtahitanga o Te Waipounamu
Whitireia Community Polytechnic
Alterations to the 2014/15 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and 2015/16 draft budgets for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment

Report of the Officers of Parliament Committee

Fifty-first Parliament
(Rt Hon David Carter, Chairperson)
March 2015

Presented to the House of Representatives
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Alterations to the 2014/15 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and 2015/16 draft budgets for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment

**Recommendation to the House**

The Officers of Parliament Committee recommends that the House commend to the Governor-General, by way of an address pursuant to section 26E of the Public Finance Act 1989, alterations to the 2014/15 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, estimates of expenses to be incurred for each appropriation in 2015/16 in Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and a capital injection to the Office of the Ombudsman, and requests that they be incorporated into an Appropriation Bill.

**Recommendation to the Government**

The Officers of Parliament Committee recommends that the Government examine the situation regarding the annual audits of cemetery trusts and reserve boards, and consider amending the relevant Acts to relieve the Auditor-General of this audit responsibility, while providing for a more cost-effective approach to financial assurance regarding such entities.

**Introduction**

In order to maintain the independence of the Officers of Parliament, the Public Finance Act 1989 provides for funding for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment to be determined by Parliament through the Officers of Parliament Committee.

We received submissions from each officer detailing proposed alterations to their 2014/15 appropriations, and their draft budgets for 2015/16 and out-years. We examined these submissions in conjunction with advice from the Treasury, and our recommended alterations for 2014/15, and estimates for 2015/16 and out-years, are detailed in this report.

We recommend that the House commend these alterations and estimates to the Governor-General for inclusion in the main Appropriation Bill for the coming financial year, or in the Appropriation Bill dealing with the Supplementary Estimates for the current financial year. All figures in this report are GST-exclusive or GST-exempt unless otherwise noted.
Summary of the committee’s recommendations

The following tables give an overview of the changes we support in the 2014/15 appropriations for the Officers of Parliament, and in their draft budgets for 2015/16 and subsequent years.

### Vote Audit: alterations for 2014/15

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### Vote Ombudsmen: adjustments for 2015/16 and out-years

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**Comprising:**

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- **Corporate and support capability**: 33
- **Security of staff and information**: 161
- **Complaints and investigation**: 33

**New total capital**

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</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td><strong>3,199</strong></td>
<td><strong>3,049</strong></td>
<td><strong>3,049</strong></td>
<td><strong>3,049</strong></td>
</tr>
</tbody>
</table>
Office of the Controller and Auditor-General

Alterations to the 2014/15 appropriations for Vote Audit

We note the following changes to the Vote Audit appropriations for 2014/15. No changes are sought to the annual appropriations.

- An increase of $27,000 in the permanent legislative authority (PLA) baseline arising from a determination by the Remuneration Authority.
- An increase of $2.705 million resulting from an updated forecast for the revenue-dependent appropriation for Audit and Assurance Services.

The following table shows the effect of the changes.

<table>
<thead>
<tr>
<th>Alterations for 2014/15</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual appropriation (unchanged)</td>
<td>9,457</td>
</tr>
<tr>
<td>Current PLA</td>
<td>923</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>27</td>
</tr>
<tr>
<td>New PLA</td>
<td>950</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA) for 2014/15</strong></td>
<td><strong>10,407</strong></td>
</tr>
<tr>
<td>Current revenue-dependent appropriation</td>
<td>75,390</td>
</tr>
<tr>
<td>Change in forecasts</td>
<td>2,705</td>
</tr>
<tr>
<td><strong>New revenue-dependent appropriation for 2014/15</strong></td>
<td><strong>78,095</strong></td>
</tr>
</tbody>
</table>

Permanent legislative authority

The salaries of the Controller and Auditor-General and the Deputy Controller and Auditor-General are revised annually on the basis of determinations by the Remuneration Authority, and are funded under permanent legislative authority. The increase of $27,000 in the PLA for 2014/15 arises from a determination by the Remuneration Authority to increase the remuneration of the Auditor-General and her deputy.

The increase to the PLA baseline will also apply in subsequent years.

Revenue-dependent appropriation for Audit and Assurance Services

This appropriation covers the expenses incurred by the Auditor-General in auditing Crown agencies, local authorities, and other entities for which the Auditor-General has auditing responsibility. The appropriation is revenue-dependent—that is, all expenses are limited to the amount of revenue derived from the entities audited. Audit fee forecasts are updated annually according to the expected amount of audit activity.

The increase in 2014/15 mainly reflects timing issues between financial years. Delays in the 2013 audits of schools resulted in about $1 million of revenue and expense being reforecast. The remainder of the adjustment is to provide an allowance for arrears and other work completed by contract audit providers.
2015/16 draft budget for the Office of the Controller and Auditor-General

We note the increase of $27,000 in the PLA for 2015/16 and out-years as a result of a determination by the Remuneration Authority.

We recommend the following adjustments to the appropriations for the Office of the Controller and Auditor-General:

- an increase of $400,000 per annum from 2015/16 to improve the delivery of the Auditor-General’s inquiries function
- an increase of $180,000 per annum from 2015/16 to improve the Office’s analysis capability
- increases of $300,000 in 2015/16 and $2 million in 2016/17 to the annual appropriation Audit and Assurance Services, to be funded from accumulated surpluses of third-party revenue collected in previous years.

Permanent legislative authority

We note that an increase of $27,000 in the Controller and Auditor-General’s permanent legislative authority for 2015/16 and subsequent years arises from a determination issued by the Remuneration Authority to increase the salaries of the Auditor-General and Deputy Auditor-General. The PLA rises to $950,000.

Auditor-General’s inquiry function

We support an increase of $400,000 per annum from 2015/16 in the appropriation Statutory Auditor Function to improve the delivery of the Auditor-General’s inquiries function.

The Office of the Auditor-General has a performance measure requiring that 80 percent of findings on completed inquiries be reported within three months for routine enquiries, six months for significant enquiries, and 12 months for major enquiries. The Auditor-General notes that inquiries are increasing in complexity, and she is concerned that resource constraints are increasingly hampering the office’s ability to complete any but the routine inquiries within the expected time.

We signalled in our report on the office’s budget last year that funding for the Statutory Auditor Function has been static for several years, and that the adequacy of the existing appropriation would need to be reviewed at some stage. We accept that the office has done well to find efficiency savings up to this point, but concur that an increase in the appropriation is now warranted to allow the office to meet performance expectations for this important work. The proposed increase would allow the office to create a dedicated inquiries team with three additional staff members.

Analysis capability

We support an increase of $180,000 per annum from 2015/16 to improve the office’s analysis capability. We note that the Auditor-General signalled in her Strategic Intentions 2014/15 to 2017/18 that the office aims to make more use of the information it gathers from public entities in the course of its audit work. We see long-term value for New Zealand from doing so; the Office of the Auditor-General gathers a great deal of information about public sector entities in the course of its audits, which could be used to recognise and analyse trends and themes as a basis for recommended improvements.
The office has already started to carry out such work from within existing resources, for example examining sector-wide issues in the health sector, and the challenges facing local authorities in funding and managing water services and roads. To carry the approach further, however, the office needs to enhance its analytical capability, and to redesign its business processes to support the development and analysis of data sets. The proposed increase would fund two suitably qualified staff for this work.

Audit and Assurance Services revenue-dependent appropriation

This appropriation covers expenses incurred on audits of government departments, local bodies, and other agencies; the Office of the Controller and Auditor-General recovers its costs from fees paid by the agencies audited. Last year we supported the establishment of a memorandum account so that any surplus from fees collected in one year could be retained and taken into account in setting fees for subsequent years. As we noted then, Parliament’s approval through this committee would need to be sought for an increased appropriation to meet any shortfall. However, such an increase would not be funded from Crown revenue, but from surpluses of third-party revenue collected in other years. The accumulated surplus at 30 June 2015 is forecast to be $2,295,000.

The Auditor-General is forecasting deficits of $125,000 in 2015/16 and $1.812 million in 2016/17 for Audit and Assurance Services. In order to cover these amounts and provide a buffer, increases to the annual appropriation of $300,000 in 2015/16 and $2 million in 2016/17 are sought. We support these increases on the basis that they will be funded from the memorandum account, and will not be a cost to the Crown.

Summary of proposed changes

The following table shows the effect the proposed changes would have on the Vote Audit baseline.

<table>
<thead>
<tr>
<th>Adjustments for 2015/16 and out-years</th>
<th>2015/16 $000</th>
<th>2016/17 $000</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual appropriation</td>
<td>9,427</td>
<td>9,197</td>
<td>9,197</td>
<td>9,197</td>
</tr>
<tr>
<td>Auditor-General Inquiries</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>Improving the Office’s analysis capability</td>
<td>180</td>
<td>180</td>
<td>180</td>
<td>180</td>
</tr>
<tr>
<td>Audit and assurance deficits</td>
<td>300</td>
<td>2,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>New annual appropriation</strong></td>
<td><strong>10,307</strong></td>
<td><strong>11,777</strong></td>
<td><strong>9,777</strong></td>
<td><strong>9,777</strong></td>
</tr>
<tr>
<td>Current PLA</td>
<td>923</td>
<td>923</td>
<td>923</td>
<td>923</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>27</td>
<td>27</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>New PLA</td>
<td>950</td>
<td>950</td>
<td>950</td>
<td>950</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td><strong>11,257</strong></td>
<td><strong>12,727</strong></td>
<td><strong>10,727</strong></td>
<td><strong>10,727</strong></td>
</tr>
<tr>
<td>Revenue-dependent appropriation</td>
<td>73,543</td>
<td>73,700</td>
<td>80,471</td>
<td>78,971</td>
</tr>
<tr>
<td>Adjustment for change in forecasts</td>
<td>1,679</td>
<td>1,567</td>
<td>1,980</td>
<td>1,779</td>
</tr>
<tr>
<td><strong>New revenue-dependent appropriation</strong></td>
<td><strong>75,222</strong></td>
<td><strong>75,267</strong></td>
<td><strong>82,451</strong></td>
<td><strong>80,750</strong></td>
</tr>
</tbody>
</table>
Other issues

The Auditor-General is required by statute to be the auditor of small entities such as cemetery trusts and reserve boards.¹ There are 142 such entities; most are tiny, but the cost for the office to carry out the necessary work is significant, totalling $353,000 for the most recent audits of all these entities. In contrast with audits of larger organisations, where costs are recovered from the entity, audits of cemetery trusts and reserve boards are funded by the Crown under the output class Audit and Assurance Services. However, the Crown funding for these audits, of $150,000 a year, has not been increased since 2004. The Auditor-General notes that her office has been absorbing the resultant loss.

While we do not support an increase in funding for this activity in the light of fiscal constraints, we consider that the situation facing the Auditor-General warrants further examination. We note that the Auditor-General considers that the cost of completing these audits outweighs the accountability benefit, particularly as little public interest is shown in the results of the audits.

We strongly recommend that the Government examine the situation regarding the annual audits of cemetery trusts and reserve boards, and consider amending the relevant Acts to relieve the Auditor-General of this audit responsibility, while providing for a more cost-effective approach to financial assurance regarding such entities. We would hope to see the situation resolved within the next two years so that such audits do not remain a drain on the Auditor-General’s funding.

Office of the Ombudsman

Alterations to the 2014/15 appropriations for Vote Ombudsman

Permanent legislative authority

The salaries of the Ombudsmen are revised annually on the basis of determinations by the Remuneration Authority, and are funded under permanent legislative authority. The increase of $19,000 in the PLA for 2014/15 arises from a determination by the Remuneration Authority to increase the remuneration of the Ombudsmen. Such adjustments are implemented automatically.

Expense transfers

In considering the proposals in Budget 2014, we supported an expense transfer of up to $86,000 to enable the Office of the Ombudsman to complete three major projects. This transfer was dependent on the office having an equivalent surplus at the end of the 2013/14 financial year. We note that this surplus was achieved, and therefore support the expense transfer requested.

We also support an expense transfer of $72,000 from 2014/15 to 2015/16 for the office to complete a project relating to the United Nations Convention on the Rights of Persons with Disabilities, in partnership with the Human Rights Commission. We note that a reorganisation at the commission delayed this work.

Adjustment for secondment (fiscally neutral)

The Office of the Ombudsman has staff on secondment, and expects reimbursement of some costs from a third party. We support an increase in appropriation of $190,000 in 2014/15 only, which will be supported by revenue from other sources.

The following table summarises the alterations for 2014/15.

<table>
<thead>
<tr>
<th>Alterations for 2014/15</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual appropriation</td>
<td>9,703</td>
</tr>
<tr>
<td>Expense transfer from 2013/14</td>
<td>86</td>
</tr>
<tr>
<td>Expense transfer to 2015/16</td>
<td>(72)</td>
</tr>
<tr>
<td>Fiscally-neutral adjustment for secondment</td>
<td>190</td>
</tr>
<tr>
<td><strong>New annual appropriation for 2014/15</strong></td>
<td><strong>9,907</strong></td>
</tr>
<tr>
<td>Current PLA</td>
<td>665</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>19</td>
</tr>
<tr>
<td>New PLA</td>
<td>684</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td><strong>10,591</strong></td>
</tr>
</tbody>
</table>
2015/16 draft budget for the Office of the Ombudsman

We note that the PLA for remuneration of the Ombudsmen increases by $25,000 in 2015/16 and subsequent years as the result of a determination by the Remuneration Authority to increase the remuneration of the Ombudsmen.

We recommend the following adjustments to the appropriations for, and capital of, the Office of the Ombudsman:

- an increase of $166,000 in 2015/16 and subsequent years for proactive advice, training and guidance
- an increase of $390,000 in 2015/16 and subsequent years for the employment of two additional investigators and the contracting of specific expertise to assist with inspections and monitoring under the Crimes of Torture Act 1989 and the United Nations Convention on the Rights of Persons with Disabilities
- an increase of $360,000 in 2015/16 and subsequent years for additional resources in the office’s corporate and support capability
- an increase of $113,000 in 2015/16 and $126,000 in 2016/17 and subsequent years to ensure the security of the office’s staff and information
- an increase of $340,000 in 2015/16 and subsequent years for complaints and investigations
- a one-off capital injection of $260,000 in 2015/16, comprising $11,000 for proactive training and guidance, $22,000 for inspections and monitoring, $33,000 for corporate and support capability, $161,000 for security of staff and information, and $33,000 for complaints and investigations.

Proactive advice, training and guidance

Over time the Office of the Ombudsman has been evolving from its traditional role as an investigator of complaints, increasingly responding to requests for advice, training, and guidance from a wide range of agencies. Over the past four years it has started to take a more proactive role in providing assistance, seeing this as an effective way of ensuring good practice in the administration and delivery of public services. We note that this form of “modern Ombudsman” role was strongly advocated by the Law Commission, and endorsed by the Government in its response to the commission’s report on its review of Official Information legislation: it said that agencies “should continue to look to the Office of the Ombudsman for guidance”.

We accept that requests for the office’s assistance and training are likely to continue to grow, and support its funding request for an additional person at senior advisor level to continue this work. We therefore support an increase of $166,000 in 2015/16 and subsequent years, plus a capital injection of $11,000 in 2015/16, for this purpose.

Inspections and monitoring

The Ombudsman is designated as a National Preventative Mechanism (NPM) under the Crimes of Torture Act 1989 (OPCAT), and is required to inspect the facilities and assess the treatment of people in New Zealand’s 102 detention facilities (17 prisons, 75 health and

---

2 Government response to Law Commission report “The public’s right to know: Review of the official information legislation”.
disability centres, 9 youth justice and child care and protection residences, and one immigration centre). It is also designated as an Independent Monitoring Mechanism (IMM) under the United Nations Convention on the Rights of Persons with Disabilities (UNCRPD). While resources have previously been provided for these two areas, the previous Officers of Parliament Committee agreed that resources should be reviewed when uncertainty about the workload involved was resolved.

We note that the Ombudsman is concerned about the office’s ability to fulfil its obligations under the OPCAT, and that the UN Subcommittee on Prevention of Torture reviewed the New Zealand situation in August 2014 and suggested that it had reached a critical point. It made three strong recommendations for additional funding, capacity, and expertise, suggesting that a lack of resources could find New Zealand in breach of its international obligations.

We support an increase of $390,000 in 2015/16 and subsequent years, plus a capital injection of $22,000 in 2015/16 for associated costs, for an additional two investigators and the contracting of specific expertise to help perform the Office of the Ombudsman’s inspections and monitoring role.

Corporate and support capability

Over the past few years, more resources have been provided to improve the Ombudsmen’s investigation and monitoring role. To support this growth in the office and ensure its efficient running, the Ombudsmen have funded three key corporate support positions out of savings: a finance and business services manager, and a human resources manager and advisor. The office now seeks to confirm these roles as baseline positions and fund them accordingly. We have considered the request carefully, and support an increase of $360,000 in 2015/16 and subsequent years, plus a capital injection of $33,000 in 2015/16, to enhance the corporate and support capability for the Ombudsmen. However, we recommend that future funding be subject to an external review of the office’s requirements.

As we have already reported to the House, the term of the Chief Ombudsman is due to expire, and a replacement is expected to be appointed by the end of this year. To coincide with this change, we consider that there would be significant merit in commissioning an external review of the operation and resourcing of the Office of the Ombudsman to provide a baseline assessment for the incoming Chief Ombudsman. We propose to agree with the incoming Chief Ombudsman, once he or she is appointed, the terms of such an external review. We intend to recommend that the cost of the external review be included in the 2015/16 Supplementary Estimates for Vote Ombudsmen. If the review were to be carried out in advance of the Supplementary Estimates being enacted, we would request that the cost of the review be met from imprest supply.

Security of staff and information

We note that the office is frequently the last resort for complainants who have been aggrieved in various ways, and threatening approaches and security incidents have increased over the last two years. The office has therefore reviewed the security of its staff, facilities, and information. We support an increase of $113,000 in 2015/16 and $126,000 in

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3 Interim report on Inquiry into the appointment of an Ombudsman and Chief Ombudsman, 12 March 2015.
2016/17 and subsequent years, and a capital injection of $161,000 in 2015/16, to improve the security of staff and information.

Complaints and investigations

We note that in Budget 2013, the committee agreed to a budget increase for six additional investigation staff; as a result the number of outstanding cases at the end of the year has decreased. We applaud the efforts of the Ombudsmen and their staff to achieve this reduction.

We support the provision of an additional $340,000 in 2015/16 and subsequent years, and a capital injection of $33,000 in 2015/16 for associated costs, to provide for three additional investigator positions, including one who would have a wider role of improving State sector administration. We note that the Ombudsmen consider that their ability to fulfil their legislated role in responding to complaints and carrying out investigations would be compromised without these additional resources. We trust that further improvement in the office’s responsiveness will result.

Summary of proposed changes

The following table shows the effect of our recommended changes on the 2015/16 appropriation for Vote Ombudsmen and the baseline for subsequent years.

<table>
<thead>
<tr>
<th>Adjustments for 2015/16 and out-years</th>
<th>2015/16 $000</th>
<th>2016/17 $000</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>9,796</td>
<td>9,796</td>
<td>9,796</td>
<td>9,796</td>
</tr>
<tr>
<td>Complaints and investigations</td>
<td>340</td>
<td>340</td>
<td>340</td>
<td>340</td>
</tr>
<tr>
<td>Proactive advice, training and guidance</td>
<td>166</td>
<td>166</td>
<td>166</td>
<td>166</td>
</tr>
<tr>
<td>Inspections and monitoring</td>
<td>390</td>
<td>390</td>
<td>390</td>
<td>390</td>
</tr>
<tr>
<td>Corporate and support capability</td>
<td>360</td>
<td>360</td>
<td>360</td>
<td>360</td>
</tr>
<tr>
<td>Security of staff and information</td>
<td>113</td>
<td>126</td>
<td>126</td>
<td>126</td>
</tr>
<tr>
<td>Expense transfer from 2014/15</td>
<td>72</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>New annual appropriation</strong></td>
<td><strong>11,237</strong></td>
<td><strong>11,178</strong></td>
<td><strong>11,178</strong></td>
<td><strong>11,178</strong></td>
</tr>
<tr>
<td>Current PLA</td>
<td></td>
<td>665</td>
<td>665</td>
<td>665</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>New PLA</td>
<td>690</td>
<td>690</td>
<td>690</td>
<td>690</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td><strong>11,927</strong></td>
<td><strong>11,868</strong></td>
<td><strong>11,868</strong></td>
<td><strong>11,868</strong></td>
</tr>
</tbody>
</table>
Current capital | 1,816 | 1,816 | 1,816 | 1,816
---|---|---|---|---
Capital injection | 260
Comprising:
  Proactive training and guidance | 11
  Inspections and monitoring | 22
  Corporate and support capability | 33
  Security of staff and information | 161
  Complaints and investigations | 33
New total capital | 2,076 | 2,076 | 2,076 | 2,076

**Other issues**

We note that the office continues to consider its staff disadvantaged in their remuneration rates relative to people in comparable positions in other agencies. However, in the light of fiscal constraints we are unable to support any additional funding to increase staff remuneration.
Parliamentary Commissioner for the Environment

Alterations to the 2014/15 appropriations for Vote Parliamentary Commissioner for the Environment

We note one change to Vote Parliamentary Commissioner for the Environment in 2014/15—an increase of $13,000 in the PLA for the commissioner’s remuneration. The increase arises from a determination issued by the Remuneration Authority; such adjustments are implemented automatically.

The following table shows the effect of this change on the Vote’s baseline.

<table>
<thead>
<tr>
<th>Alterations for 2014/15</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual appropriation (no change)</td>
<td>2,890</td>
</tr>
<tr>
<td>Current PLA</td>
<td>296</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>13</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td><strong>3,199</strong></td>
</tr>
</tbody>
</table>

2015/16 draft budget for the Office of the Parliamentary Commissioner for the Environment

We note the increase of $13,000 in the PLA for 2015/16 and out-years as a result of a determination by the Remuneration Authority to increase the commissioner’s remuneration.

Addition to annual appropriation

The Environmental Reporting Bill proposes to establish a new system for reporting on the environment, which would entail a new review and commentary role for the Parliamentary Commissioner for the Environment. Last year, the committee recommended an increase of $450,000 in the annual appropriation for the Office of the Parliamentary Commissioner for the Environment for 2014/15 and the following year to provide for this purpose, and an increase of $300,000 for 2016/17 and subsequent years, with this funding to be reassessed as the workload became clear.

The commissioner has said that she is now much clearer on what the new role involves, and we note that she is now likely to seek the further $150,000 from 2016/17. We intend to review the adequacy of the commissioner’s baseline funding in our budget consideration next year.

Summary of proposed changes

The following table shows the effect of the proposed changes on the 2015/16 appropriation for Vote Parliamentary Commissioner for the Environment, and the baseline for subsequent years.
## Adjustments for 2015/16 and out-years

<table>
<thead>
<tr>
<th></th>
<th>2015/16 $000</th>
<th>2016/17 $000</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current annual appropriation</strong></td>
<td>2,890</td>
<td>2,740</td>
<td>2,740</td>
<td>2,740</td>
</tr>
<tr>
<td><strong>Current PLA</strong></td>
<td>296</td>
<td>296</td>
<td>296</td>
<td>296</td>
</tr>
<tr>
<td><strong>Adjustment for remuneration determination</strong></td>
<td>13</td>
<td>13</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td>309</td>
<td>309</td>
<td>309</td>
<td>309</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td>3,199</td>
<td>3,049</td>
<td>3,049</td>
<td>3,049</td>
</tr>
</tbody>
</table>
Committee procedure

We met on 12 and 26 March 2015 to consider the alterations to the 2014/15 appropriations and the draft budgets for 2015/16 for the Officers of Parliament. We heard evidence from the Chief Ombudsman, the Controller and Auditor-General, and the Parliamentary Commissioner for the Environment, and received advice from the Treasury.

Committee members

Rt Hon David Carter (Chairperson)
David Clendon
Hon Te Ururoa Flavell
Tim Macindoe
Hon Trevor Mallard
Carmel Sepuloni
Barbara Stewart

Evidence and advice received

Chief Ombudsman, Budget Submissions including Baseline Updates for Vote Ombudsmen, dated 30 January and 10 March 2015.


The Treasury, Assessment of 2015 Budget and Baseline Submissions for the Officers of Parliament, received 9 March 2015.
Alterations to the 2015/16 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and 2016/17 draft budgets for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment

Report of the Officers of Parliament Committee

Fifty-first Parliament
(Rt Hon David Carter, Chairperson)
March 2016

Presented to the House of Representatives
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Alterations to the 2015/16 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and 2016/17 draft budgets for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment

**Recommendation**

The Officers of Parliament Committee recommends that the House commend to the Governor-General, by way of an address pursuant to section 26E of the Public Finance Act 1989, alterations to the 2015/16 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, estimates of expenses to be incurred for each appropriation in 2016/17 in Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and a capital injection to the Office of the Ombudsman, and requests that they be incorporated into an Appropriation Bill.

**Introduction**

In order to maintain the independence of the Officers of Parliament, the Public Finance Act 1989 provides for funding for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment to be determined by Parliament through the Officers of Parliament Committee.

We received submissions from each officer detailing proposed alterations to their 2015/16 appropriations, and their draft budgets for 2016/17 and out-years. We examined these submissions in conjunction with advice from the Treasury. Our recommended alterations for 2015/16, and estimates for 2016/17 and out-years, are detailed in this report.

We recommend that the House commend these alterations and estimates to the Governor-General for inclusion in the main Appropriation Bill for the coming financial year, or in the Appropriation Bill dealing with the Supplementary Estimates for the current financial year. All figures in this report are GST-exclusive or GST-exempt unless otherwise noted.
Summary of the committee’s recommendations

The following tables give an overview of the changes we support in the 2015/16 appropriations for the Officers of Parliament, and their draft budgets for 2016/17 and subsequent years.

Vote Audit: alterations for 2015/16

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<thead>
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Vote Audit: adjustments for 2016/17 and out-years

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### Vote Ombudsmen: adjustments for 2016/17 and out-years

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### Vote Parliamentary Commissioner for the Environment: alterations for 2015/16

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<thead>
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</table>
Office of the Controller and Auditor-General

Alterations to the 2015/16 appropriations for Vote Audit

PLA adjustment

The salaries of the Auditor-General and Deputy Auditor-General are revised annually on the basis of determinations by the Remuneration Authority, and are funded under permanent legislative authority (PLA).

We note that the PLA increases by $22,000 in 2015/16 (and $8,000 in 2016/17 and subsequent years) as a result of a determination by the Remuneration Authority to increase the remuneration of the Auditor-General and her deputy. Such adjustments are implemented automatically.

Adjustment for Audit and Assurance Deficit

We recommend an increase of $200,000 in the annual appropriation for audit and assurance services in 2015/16.

As we explain below in relation to the budget for 2016/17, the Auditor-General has updated the forecasts of revenue and expenditure associated with the audits required of her office. A deficit of $174,000 is expected in 2015/16. Although this deficit will be covered by funds already in the office’s memorandum account, an annual appropriation is required to authorise any forecast expense in excess of forecast revenue. An increase of $200,000 in the annual appropriation is required to provide a small buffer.

The following table shows the effect of the changes for 2015/16.

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</table>

We recommend that these changes be incorporated into the 2015/16 Supplementary Estimates.
I.15B

BUDGET REPORT FOR OFFICERS OF PARLIAMENT

2016/17 draft budget for the Office of the Controller and Auditor-General

PLA adjustment

We note the increase of $8,000 in the permanent legislative authority for 2016/17 and out-years as a result of a determination by the Remuneration Authority to increase the remuneration of the Auditor-General and Deputy Auditor-General.

Statutory Auditor Function: Assistance to Pacific secretariat

The Auditor-General has been supporting the secretariat of the Pacific Associations of Supreme Audit Institutions (PASAI) for the past three years.

We recommend an additional appropriation of $230,000 a year for 2016/17 and subsequent years, funded by the Ministry of Foreign Affairs and Trade, to allow the office to continue to provide this support.

Audit and Assurance Services revenue-dependent appropriation (RDA)

The appropriation for Audit and Assurance Services covers the expenses incurred by the Auditor-General in auditing Crown agencies, local authorities, and other entities for which the Auditor-General has auditing responsibility. The appropriation is revenue-dependent. That is, the annual expense that can be incurred under the RDA is limited to the amount of revenue derived from the entities audited. Audit fee forecasts are updated annually according to the expected amount of audit activity.

The Auditor-General has reforecast expenses and revenue for this appropriation. The following changes in expenses are expected:

- an increase in audit rates of 2–2.5 percent a year, reflecting increases in the cost of the auditing workforce
- a provision for the cost of auditing local authorities’ long-term plans in 2018 (such audits are required every three years, causing a spike in the office’s budget)
- an increase of 2 percent in accommodation costs and 1 percent in general operating costs.

The Auditor-General operates a memorandum account for its audits, enabling surpluses in one year to be offset by deficits in another year, and allowing charges to be varied following the accumulation of surpluses or deficits. An annual appropriation is required for years in which deficits are expected in order to cover expenses in excess of revenue, even though the revenue required to support the deficit is in the office’s bank account from previous years. A buffer of about $350,000 is provided to avoid any unappropriated expenditure.

At the start of 2015/16, the accumulated surplus in the memorandum account was $2,119,000. The Auditor-General forecasts that it will reduce to $357,000 by the end of 2019/20 on the basis of the following forecasts:

- 2015/16: deficit of $174,000
- 2016/17: deficit of $1,324,000
- 2017/18: surplus of $1,178,000
- 2018/19: deficit of $260,000
• 2019/20: deficit of $1,182,000.

We note that the Treasury has examined and supports the forecast changes.

We recommend the following adjustments in the annual appropriation for Audit and Assurance Services to take account of the revised forecasts:

• 2016/17: a reduction of $350,000
• 2017/18: no change
• 2018/19: an increase of $600,000
• 2019/20: an increase of $1,500,000.

Summary of proposed changes

The following table shows the effect the proposed changes would have on the Vote Audit baseline.

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<tr>
<th>Adjustments for 2016/17 and out-years</th>
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Office of the Ombudsman

Alterations to the 2015/16 appropriations for Vote Ombudsmen

PLA adjustment
The salaries of the Ombudsmen are revised annually on the basis of determinations by the Remuneration Authority, and are funded under permanent legislative authority (PLA).

We note that the PLA increases by $23,000 in 2015/16 (but decreases in subsequent years) as a result of a determination by the Remuneration Authority. Such adjustments are implemented automatically.

One-off adjustments for 2015/16 only
We recommend the following one-off adjustments to the appropriations for 2015/16 only:

- an increase of $18,000 to investigate the relocation of the Christchurch office
- an increase of $78,000 to cover the recruitment costs of the new Chief Ombudsman
- a fiscally-neutral increase of $180,000 to cover costs that will be offset by revenue other.

One-off appropriation for office accommodation in Christchurch
The Office of the Ombudsman is currently seeking new premises in the Christchurch CBD as its current Christchurch office, secured immediately after the 2011 earthquake, does not meet several critical requirements. We will review a detailed funding proposal once new premises have been found. In the interim, we support one-off funding of $18,000 to assist with property advisory, legal, project management, and moving costs.

One-off appropriation for recruitment costs
The office has incurred $78,000 in costs for the recruitment of a new Chief Ombudsman. The Treasury supports the office’s request for an additional appropriation to reimburse these costs, in line with normal practice.

One-off appropriation for fiscally-neutral transfers
We support an increase of $180,000 for a fiscally-neutral transaction to offset costs associated with a project under the Optional Protocol to the Convention Against Torture (for which the office expects a grant from the United Nations); and costs related to an injury claim for which the office expects to receive reimbursement from the ACC.

Other adjustments in 2015/16
We also recommend the following adjustments to the appropriations for the Office of the Ombudsman in 2015/16; adjustments for subsequent years are discussed later in this report:

- an increase of $40,000 for ICT systems and capability
- an increase of $15,000 for increased rental costs in Auckland.
ICT systems and capability

The Chief Ombudsman considers further investment necessary to update the office’s ICT systems and capability, and to make proper use of ICT capital approved in the 2014/15 budget.

While the bulk of costs would fall in 2016/17 and out-years, an increase of $40,000 in the appropriation for 2015/16 is sought to progress business cases for an electronic content management system and complaints management system. We support this increase in the Supplementary Estimates.

Auckland office rental

Rent on the Ombudsmen’s Auckland office was reviewed on 1 October 2015. An independent reviewer considers the 11.35 percent increase proposed by the owners to be reasonable. The Treasury concurs with us in supporting an increase of $15,000 in the appropriation for 2015/16 to meet this cost.

The following table summarises the alterations for 2015/16.

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We recommend that the changes for 2015/16 be incorporated into the 2015/16 Supplementary Estimates.
2016/17 draft budget for the Office of the Ombudsman

We note that the PLA for remuneration of the Ombudsmen decreases by $22,000 in 2016/17 and subsequent years as the result of a determination by the Remuneration Authority.

We recommend the following adjustments to the appropriations for, and capital of, the Office of the Ombudsman:

- a time-limited increase to clear aged investigations
- an increase for proactive compliance investigations under the Official Information Act 1982 (OIA) and the Local Government Official Information and Meetings Act 1987 (LGOIMA)
- an increase for ICT systems and capability
- an increase to address anomalies in staff remuneration
- an increase for increased rental costs in Auckland.

Workload and aged investigations

The workload of the Office of the Ombudsman has expanded considerably, with complaints and other contacts increasing by about 40 percent over the past 5 years. In 2014/15 the office received 12,151 complaints and other contacts about the administrative conduct and decisions of government agencies.

In the past two years we have acknowledged these increased pressures by supporting funding for eight additional investigating staff. We are pleased by the progress that the office has made with the additional staff and its continuous improvement in practices. The office achieved a net clearance rate in 2014/15 of 98.5 percent.¹ We note that the office is not seeking any further funding increase to meet the current demand for its services.

However, while we commend the progress made in responding promptly to current issues, we share the office’s concern that the number of “aged” investigations—those pending for a year or more—remains unacceptably high. At 31 December 2015, the office had 659 investigations of between 1 and 6 years old. We note that such investigations are often the more complex ones, requiring focused attention from experienced and senior staff. We heard that it has become difficult for the office to allocate sufficient resources to these investigations without compromising its current work.

The office’s investigations relate to complaints about the fairness, reasonableness, and/or legality of the administrative conduct of central and local government agencies. We agree with the office that investigating and resolving such complaints is very important to maintain high standards in public sector practices, and the public’s confidence.

As a way forward, the Chief Ombudsman has requested additional funding on a temporary basis to set up a dedicated unit of seven staff to clear the backlog of aged investigations. The proposal is for a maximum of 3 years and envisages 5 senior investigators, 1 assistant investigator, and 1 manager.

¹ This rate measures the number of complaints and contacts closed in a reporting year as a proportion of the total number of complaints and contacts received during the year.
We recognise that the Office of the Ombudsman is seeking this additional funding on a temporary basis only, to address a specific and important issue. We therefore support the proposal and recommend an additional appropriation of $925,000 in 2016/17, and $965,000 in both 2017/18 and 2018/19, and a capital injection of $88,000 in 2016/17 only to enable the office to clear the backlog of aged investigations while progressing its normal work.

**Official information: compliance investigations**

The Chief Ombudsman proposes to establish a unit to focus on proactive investigation and auditing of the practices of State sector agencies in complying with official information requests. This follows a review by the previous Chief Ombudsman, which offered several recommendations for improvement. The review commented in particular that, to be an effective watchdog of the Official Information Act, the office should not only investigate the complaints referred to it in a timely manner, but should also actively monitor the official information activities of agencies and report on its findings to Parliament and the public.\(^2\)

The Chief Ombudsman is concerned that the office’s resourcing is insufficient for it to undertake more than ad hoc scrutiny of how the more than 135 central government agencies and 3,000 local entities are applying the requirements of official information legislation.\(^3\) He seeks funding for three investigators and a principal advisor, which he considers the minimum needed to start conducting regular audits of agencies’ OIA practices and to report on them publicly.

The office notes that such work would help the public to have trust and confidence that requests for access to information are being dealt with appropriately and that access is not being denied unnecessarily. It would also improve transparency and accountability within the State sector, and international perceptions of New Zealand.

We concur with the office that such work is desirable, and accept that it cannot be funded adequately within current baselines. We recommend additional funding of $564,000 a year in 2016/17 and out-years, and an additional capital injection of $50,000 in 2016/17 only, for the establishment of a unit to conduct and report on OIA compliance investigations. We propose to review the performance and funding in preparation for Budget 2019.

**ICT systems and capability**

The Chief Ombudsman seeks additional funding to upgrade the office’s ICT capability and to make the best use of capital funding provided in the 2014/15 budget.

In 2014/15 the office was provided with additional funding and a capital injection amounting to $991,000 to update its electronic content management system (ECMS), with the expectation that it could integrate its existing information technologies. A 3-year strategic plan has now been developed for the office’s information systems. This has revised the original ECMS cost estimates slightly, and has identified that additional ICT funding is needed in several areas to provide an integrated solution for the office’s information management and ICT systems.

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\(^2\) Chief Ombudsman Dame Beverley Wakem, “Not a Game of Hide and Seek”, 8 December 2015, p. 136.

\(^3\) The Official Information Act 1982 (OIA) and the Local Government Official Information and Meetings Act 1987 (LGOIMA).
The additional funding would cover:

- licensing and software upgrades ($295,153 annually)
- specialist services for intranet development ($80,000 in 2016/17 only)
- moving servers to an offsite hosting environment (capital of $153,055, and $84,000 annually)
- user training for ECMS ($34,000 in 2016/17 only)
- business plan for replacing complaints management system ($10,000 in 2016/17 only)
- modernising desktop, communication, and mobile technology (capital of $258,301)
- part-time Chief Information Officer capability ($113,400 annually)
- provision of $51,400 in 2016/17 and $102,839 in 2017/18 and out-years to cover depreciation on the capital equipment, and $16,454 in 2016/17 and $32,908 in 2017/18 and out-years for capital charge on the capital injection.

We discussed these assessments with the Chief Ombudsman, and the possibility of sharing services with another agency. We note that the office’s technology is considerably behind the times, and accept that the additional funding would allow it to make the best use of ICT capital already agreed to, and would go a good way to meeting its future needs.

We note that some further funding may be sought for the replacement of the office’s complaints management system, which is two decades old, once a business case has been developed.

We recommend an additional appropriation of $684,000 in 2016/17 and $628,000 in 2017/18 and out-years, plus a capital injection of $411,000 in 2016/17, for the improvement of the office’s ICT systems and capability as detailed above.

**Auckland office rental**

The rental on the Ombudsmen’s Auckland office was reviewed in October 2015. An independent reviewer has assessed that the 11.35 percent rent increase is reasonable. We recommend an additional appropriation of $20,212 in 2016/17 and out-years to meet this cost.

**Staff remuneration anomalies**

For several years at our budget reviews the office has emphasised that it considers its staff disadvantaged in their remuneration rates relative to comparable positions in other agencies. We have noted this concern but have in the past felt unable to support any additional funding to increase staff remuneration.

The Chief Ombudsman reports that the discrepancy with the market has widened, and the office has seen an increase in experienced staff leaving. Staff turnover in 2014/15 was 20 percent, and this rate has continued in the current year. The Chief Ombudsman is also concerned about anomalies within the office. It has had to pay current market salaries to attract suitable staff, so that existing staff, with training and experience, are at a relative disadvantage.
The office has therefore again requested additional funding to bring the office’s salary rates into line with market rates. The proposed increase would comprise a 2 percent average annual market movement and a 3 percent allowance for performance-related remuneration.

We recognise that the office’s staff fulfil an important and demanding role, and accept that turnover has reached an unacceptable level. We support the request for additional funding to correct existing anomalies and promote the retention of staff.

We recommend an additional appropriation of $341,000 in 2016/17, increasing by 5 percent a year in out-years, to correct the remuneration anomalies.

**Summary of proposed changes**

The following table shows the effect of our recommended changes on the 2016/17 appropriation for Vote Ombudsmen and the baseline for subsequent years.

<table>
<thead>
<tr>
<th>Adjustments for 2016/17 and out-years</th>
<th>2016/17 $000</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
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<td>OIA compliance investigations</td>
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<td>ICT systems and capability</td>
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<td><strong>14,381</strong></td>
<td><strong>14,399</strong></td>
<td><strong>13,453</strong></td>
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</table>

| Other matters: security requirements |

The office has been reviewing its arrangements for protecting sensitive and classified information, following the Government’s introduction of Protective Security Requirements in 2015. It plans to undertake a detailed security risk assessment in mid-2016, and notes that this may point to the need for substantial changes in its current facilities. We will consider the cost implications of the review at a future meeting.
Parliamentary Commissioner for the Environment

Alterations to the 2015/16 appropriations for Vote Parliamentary Commissioner for the Environment

PLA adjustment

The salary of the Parliamentary Commissioner for the Environment is revised annually on the basis of determinations by the Remuneration Authority, and funded under permanent legislative authority (PLA).

We note an increase in the PLA of $14,000 in 2015/16 and subsequent years as a result of a determination by the Remuneration Authority. Such adjustments are implemented automatically.

The following table shows the effect of this change on the Vote’s baseline.

<table>
<thead>
<tr>
<th>Alterations for 2015/16</th>
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<tr>
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<tr>
<td>New PLA</td>
<td>323</td>
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<tr>
<td>New baseline (annual and PLA)</td>
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</table>

We recommend that the change for 2015/16 be incorporated into the 2015/16 Supplementary Estimates.
We note the increase of $14,000 in the PLA for 2016/17 and out-years as a result of a determination by the Remuneration Authority to increase the commissioner’s remuneration.

Environmental reporting

The Environmental Reporting Act 2015 has given the Parliamentary Commissioner for the Environment a new function: to review and write commentaries on twice-yearly reports about the state of the environment produced by the Ministry for the Environment and Statistics New Zealand. The commissioner has completed the first of these independent commentaries, on the Air Domain, and is now working on a second, synthesis, report.

When we assessed the commissioner’s budget in 2014, we recognised that additional funding would be needed for the office to carry out this important role without compromising its existing work. At that stage, however, we could not confirm the level of resources that would be needed to meet the additional responsibilities. We therefore supported an increase in the office’s baseline of $450,000 for two years (2014/15 and 2015/16), lowering to an additional $300,000 for 2016/17 and out-years. We recognised at the time that the funding for later years might not be adequate and recommended that it be reassessed once the workload became clearer.

Having completed the first commentary, the commissioner has now been able to detail for us the work involved and the staff resources needed. She considers that the commentary function will require $550,000 a year to cover the four specialist staff members hired for this role in late 2014, plus some funding for expert consultants and overheads. The commissioner has therefore requested an increase of $250,000 in the office’s annual baseline from 2016/17—in effect, the addition of $100,000 to the initial baseline increase.

We consider the request reasonable. We value the commissioner’s independent reporting role, which provides important accountability for the public on environmental matters. We accept that the office runs on a tight budget with a strong emphasis on cost-effectiveness.

We therefore recommend an addition of $250,000 to the office’s annual appropriation in 2016/17 and out-years.

Summary of proposed changes

The following table shows the effect of the proposed changes on the 2016/17 appropriation for Vote Parliamentary Commissioner for the Environment, and the baseline for subsequent years.
## Adjustments for 2016/17 and out-years

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<thead>
<tr>
<th></th>
<th>2016/17 $000</th>
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<td><strong>2,990</strong></td>
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</tr>
<tr>
<td>Adjustment for remuneration determination</td>
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<tr>
<td>New PLA</td>
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</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
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<td><strong>3,313</strong></td>
<td><strong>3,313</strong></td>
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Appendix

Committee procedure
We met on 3 and 17 March 2016 to consider the alterations to the 2015/16 appropriations and the draft budgets for 2016/17 for the Officers of Parliament. We heard evidence from the Chief Ombudsman, the Controller and Auditor-General, and the Parliamentary Commissioner for the Environment, and received advice from the Treasury.

Committee members
Rt Hon David Carter (Chairperson)
David Clendon
Hon Te Ururoa Flavell
Tim Macindoe
Hon Trevor Mallard
Carmel Sepuloni
Barbara Stewart

Evidence and advice received
Controller and Auditor-General, Four-year Budget Plan and Baseline Update 2015/16 to 2019/20, dated 26 January 2016.

Chief Ombudsman, Vote Ombudsmen Budget Proposals including Supplementary Estimates for 2015/16 and Main Estimates for 2016/17, dated 26 January 2016.


Code of practice for the provision of assistance by the Auditor-General to the House, select committees, and members of Parliament

Report of the Officers of Parliament Committee

Fifty-first Parliament
(Rt Hon David Carter, Chairperson)
June 2016

Presented to the House of Representatives
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<td>Standing Orders</td>
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Code of practice for the provision of assistance by the Auditor-General to the House, select committees, and members of Parliament

Recommendation
The Officers of Parliament Committee recommends to the House that it adopt the following revised code of practice for the provision of assistance by the Auditor-General to the House, select committees, and members of Parliament.

Introduction

Background

1 Under Standing Order 395(2) we conducted a review of the Code of Practice for the Provision of Assistance by the Auditor-General to Select Committees and Members of Parliament.1 The code sets out how decisions are to be taken on the nature and extent of assistance to be provided by the Auditor-General.

2 This code was first implemented in 1994. It was reviewed in 2002 following the enactment of the Public Audit Act in 2001, and again in 2007. Because there have been several changes to Standing Orders in the last nine years, we considered it timely to again review the code to ensure that it reflects current practices accurately. We also wished to ensure that the code establishes a sound framework for deciding the nature and extent of assistance to be provided to the House, its select committees, and members of Parliament by the Auditor-General.

Comment

3 While this code of practice is not binding, we intend that it should be used as a guide to best practice. We consider it important that select committees and members of Parliament ensure that their interactions with the Auditor-General are appropriate to the specific circumstances, and that they respect the Auditor-General’s independence. On the other hand the Auditor-General must recognise his or her part in helping Parliament to discharge its functions.

General guidelines

4 The Auditor-General was established as an Officer of Parliament under section 7 of the Public Audit Act 2001. The Auditor-General’s role exists to help Parliament to maintain the financial integrity of our system of government. This gives rise to regular interaction between Parliament and the Auditor-General.

5 The Auditor-General provides reports to the House on whether public entities carry out and account for their activities in a manner consistent with Parliament’s intentions.

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1 Officers of Parliament Committee, Code of Practice for the Provision of Assistance by the Auditor-General to Select Committees and Members of Parliament, 2007, I.15C.
Auditor-General may also provide assistance to select committees and members of Parliament when they are holding public entities to account and considering bills.

6 Section 9 of the Public Audit Act requires the Auditor-General to act independently in executing the office’s functions, duties, and powers. This means that the Auditor-General must act without political bias or direction. It is therefore appropriate that a code of practice exists to guide the working relationship between the House, its select committees, and the Auditor-General, so that Parliament’s needs can be effectively and appropriately addressed in a way that respects the role and status of select committees, and the Auditor-General’s independence.

7 This code of practice therefore provides guidance for managing each of the main ways in which the Auditor-General may interact with Parliament, select committees, and members, namely the provision of assistance with

- select committee Estimates and annual review examinations
- select committee consideration of bills
- select committee inquiries
- select committee consideration of reports by the Auditor-General
- requests or inquiries made directly to the Auditor-General by members of Parliament.

Definitions

8 Auditor-General—For the purposes of this code of practice, references to the Auditor-General should be taken to mean the Controller and Auditor-General, appointed under section 7 of the Public Audit Act, and to include the Deputy Controller and Auditor-General, every employee of the Controller and Auditor-General, and every appointed auditor who has been authorised under the Public Audit Act.

Estimates and annual review examinations

9 The Auditor-General is available to provide select committees with independent assurance on the performance and accountability of public entities. The Auditor-General is the public-sector auditor, and has particular responsibility and expertise in appropriation, financial management, and reporting systems, and in questions of financial and service performance, waste, probity, governance, and accountability.

10 The Auditor-General may assist select committees during the consideration of Estimates and annual review examinations in areas including

- advising the Finance and Expenditure Committee on the form and content of any standard questionnaire to be used for Estimates examinations
- written and oral advice to committees, including suggested areas for questioning
- reviewing the evidence provided to the committee during the examination
- support in the preparation of the committee’s report on the examination.

Nature and extent of assistance to be provided by the Auditor-General

11 The Auditor-General and the Finance and Expenditure Committee should consult each year on the general nature and extent of the assistance to be provided to select
committees. The Auditor-General should provide assistance to committees in accordance with this code of practice and with the terms agreed with the Finance and Expenditure Committee.

12 Committees conducting Estimates examinations may wish to seek technical advice from the Auditor-General, which is independent of the Government and officials.

13 Committees conducting annual reviews may wish to ask the Auditor-General to provide further details of an entity’s audit results, or the report on the accountability statements, and may request information on any other matter connected to the annual review on which the committee seeks independent assurance.

14 The Auditor-General should normally be regarded as an adviser to the committee when providing any assistance for Estimates and annual review examinations. In certain circumstances in annual review examinations, the Auditor-General may be regarded as a witness where the committee specifically calls for the Auditor-General to account for the conclusions of the audit of the entity under review. In such circumstances, the Auditor-General, like any other witness, may be questioned. The committee must ensure that this is made clear to the Auditor-General when requesting that he or she appear as a witness before the committee.

15 As an adviser the Auditor-General may consult other parties, including the administering department or entity under review, to ensure that the advice provided to the committee is correct. The Auditor-General may also disclose the nature of the advice to be provided, when the circumstances require, if the committee has agreed to this disclosure in accordance with Standing Orders.

16 The Finance and Expenditure Committee, when preparing a standard questionnaire to be used by committees in Estimates examinations, may invite the Auditor-General to provide advice on the form and content of the questionnaire.

17 Each committee may invite the Auditor-General to advise on questions that may be provided to the appropriation Minister, administering department, or entity under review for answer. Where such an invitation is accepted, the Auditor-General will provide a written brief on significant issues and suggested lines of questioning before the hearing of evidence, and will also provide an oral briefing in support of the written briefing if requested by the committee.

18 Any questions resulting from the Auditor-General’s advice will be put to the appropriation Minister, administering department, or entity under review as questions of the committee, and will not be represented as questions of the Auditor-General.

19 A committee may request that the Auditor-General attend the hearing of evidence, particularly where the Auditor-General could assist in interpreting and connecting the evidence provided. The committee, however, should have regard to the Auditor-General’s status as an adviser before asking questions of him or her during a hearing of evidence. As a general rule, questions should be directed to the relevant witness for a response.

20 The Auditor-General may, if requested, assist a committee in preparing its report on the Estimates or annual review examination.

**Select committee consideration of bills**

21 A bill is referred by the House to a select committee for consideration after its first reading (Standing Order 288).
22 The select committee to which a bill is referred examines the bill and determines whether to recommend that the bill be passed, and may recommend amendments (Standing Order 292).

23 A select committee considering a bill may wish to obtain advice that is independent of the advice given to it by the government officials.

Assistance by the Auditor-General

24 Where a bill contains matters in which the Auditor-General has responsibilities, knowledge, or expertise, a committee may ask the Auditor-General to act as an adviser to it on the bill.

25 If the Auditor-General agrees to provide assistance, the committee will appoint the Auditor-General as an adviser (Standing Order 211).

Submissions by the Auditor-General

26 On occasion, the Auditor-General may decide to make a submission on a bill. In such cases he or she would if necessary appear before the committee as a witness on the same basis as other submitters.

Select committee inquiries

27 Select committees are empowered under Standing Orders to initiate inquiries or briefings into matters of policy, administration, and expenditure relating to each individual department, Office of Parliament, Crown entity, public organisation, or State enterprise relating to their respective subject areas, as specified in Standing Orders.

28 Committees may wish to procure specialist assistance for inquiries or briefings involving highly specialised topics, while general investigative assistance may be desirable for inquiries or briefings requiring the analysis, evaluation, and amalgamation of information.

Assistance by the Auditor-General

29 Committees may wish to use the expertise and skills available from the Auditor-General when conducting an inquiry or briefing, particularly as the Office is independent of both the Executive and any public-sector organisation that may be the subject of inquiry. The Auditor-General is the public-sector auditor, and has particular responsibility and expertise in appropriation, financial management, and reporting systems, as well as questions of financial and service performance, waste, probity, governance, and accountability. In addition, the investigative disciplines used by the Auditor-General in inquiries and performance audits may be similar to those required by the committee.

30 If the committee is considering conducting an inquiry or briefing into the financial expenditure, activities, or other aspects of an organisation, the Auditor-General can

- advise on possible options or terms of reference for the inquiry
- advise on the approach the committee might take when conducting the inquiry or briefing
- act as an adviser to the committee during the conduct of its inquiry or briefing, while relying on the committee’s powers to gather evidence.
31 Alternatively, the Auditor-General could choose to use the Office’s statutory powers to conduct an inquiry or performance audit of the matter if it falls within the Auditor-General’s expertise. This would be undertaken independently of the committee, although it might be desirable for the Auditor-General to report to the committee on the results of the inquiry or performance audit upon its completion.

32 The Auditor-General will agree with the committee on the specific terms and conditions of any assistance to be provided to the committee.

33 The Auditor-General must consult with the Officers of Parliament Committee before agreeing to provide assistance that may divert significant resources from other functions carried out by the Office.

Examination of Auditor-General’s reports

34 The Auditor-General regularly presents various reports to the House in the exercise of his or her statutory duties.

35 General-purpose reports, which are published in the parliamentary paper B.29 series, each comment on a number of matters that warrant the attention of Parliament. Special-purpose reports will contain the results of inquiries or performance audits undertaken by the Auditor-General. The matters raised may warrant the attention of other parties in addition to Parliament.

36 A report from the Controller and Auditor-General is referred to the Finance and Expenditure Committee for consideration or referral to another select committee (Standing Order 396).

Assistance by the Auditor-General

37 If a committee wishes to be provided with more information on an Auditor-General’s report, then the Auditor-General will first provide a briefing to it on the report (Standing Order 189). The Auditor-General would have the status of a witness at this point. Where a committee wishes to hear evidence from the Auditor-General as a witness, he or she will be clearly advised of this fact.

38 When planning to report to the House on any report of the Auditor-General, a committee may, however, seek further assistance from the Auditor-General in deciding the nature and extent of the committee’s consideration and report. A committee should consider inviting the Auditor-General to advise on the key issues it might examine and the method by which the examination could be carried out.

39 Where a committee holds a hearing of evidence with another organisation as part of its examination of a report of the Auditor-General, it may request that the Auditor-General attend the hearing to advise the committee. When this occurs, questions should generally be directed at the organisation under examination as a witness, and not towards the Auditor-General as an adviser.

40 The Auditor-General may provide any assistance requested by a committee in the preparation of its report to the House.
Other inquiries or requests for assistance from the Auditor-General made by members of Parliament

41 The Auditor-General may receive requests, inquiries, or information from members of Parliament. This is considered desirable and appropriate so that the Auditor-General has comprehensive information about concerns and risks regarding the entities being audited.

42 When deciding on the appropriate response to a particular inquiry, the Auditor-General must ensure that the matters raised by the inquirer fall within the mandate, role, and functions of the Office. This involves considering whether proceeding to inquire into the matters raised will be in the wider public interest and will neither compromise the Office’s independence nor be perceived to do so.

43 The Auditor-General must observe the appropriate protocols to ensure that his or her findings are factually correct, and that all parties subjected to, or forming part of, an inquiry are guaranteed natural justice.

44 Further, it is incumbent upon the Auditor-General not only to take full and proper cognisance of the governing rules and regulations that embrace an issue or scenario, but also give due credence to accepted past practices or conventions which have been allowed to build up.

Assistance by the Auditor-General

45 Individual members of Parliament are entitled to bring to the attention of the Auditor-General in a performance audit or inquiry any matters that they believe warrant investigation.

46 Any member of Parliament is entitled to request the Auditor-General’s assistance in interpreting or understanding financial management or accountability matters on which the Auditor-General has knowledge or responsibility.

47 The Auditor-General will make the final determination of the appropriate response to requests made by members of Parliament. This is necessary to protect the statutory independence of the Auditor-General under section 9 of the Public Audit Act.

48 Any requests made to the Auditor-General will be treated as confidential unless it is agreed otherwise between the requestor and the Office.

49 However, where the Auditor-General is concerned about the political or other consequences of his or her response to the request of a member of Parliament, the Auditor-General may discuss the matter with the Speaker before deciding on a course of action.

Standing Orders

50 This code of practice must be interpreted in the light of any changes to the Standing Orders, statutory provisions, or practices and procedures of the House.
Appendix

Committee procedure
The Officers of Parliament Committee met on several occasions to consider this code of practice. The committee consulted the Auditor-General and the Office of the Clerk of the House about this review of the code.

Committee members
Rt Hon David Carter (Chairperson)
David Clendon
Hon Te Ururoa Flavell
Tim Macindoe
Hon Trevor Mallard
Carmel Sepuloni
Barbara Stewart
Code of practice for the provision of assistance by the Parliamentary Commissioner for the Environment to the House, select committees, and members of Parliament

Report of the Officers of Parliament Committee

Fifty-first Parliament
(Rt Hon David Carter, Chairperson)
June 2016

Presented to the House of Representatives
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</tbody>
</table>
Code of practice for the provision of assistance by the Parliamentary Commissioner for the Environment to the House, select committees, and members of Parliament

Recommendation

The Officers of Parliament Committee recommends to the House that it adopt the following revised code of practice for the provision of assistance by the Parliamentary Commissioner for the Environment to the House, select committees, and members of Parliament.

Introduction

1 Under Standing Order 395(2) we conducted a review of the Code of Practice for the Provision of Assistance by the Parliamentary Commissioner for the Environment to the House of Representatives, Select Committees, and Members of Parliament. The code sets out how decisions on the nature and extent of assistance to be provided by the Commissioner are to be taken. Given that the code was implemented in 2007 and has not been reviewed since, we considered a review was necessary to ensure that it reflects accurately current practices. We also wished to ensure that the code establishes a sound framework for deciding the nature and extent of assistance to be provided to the House, its select committees, and members of Parliament by the Commissioner.

Comment

2 While this code of practice is not binding, we intend that it should be used as a guide to best practice. We consider it important that select committees and members of Parliament ensure that their interactions with the Parliamentary Commissioner for the Environment are appropriate to the specific circumstances, and that they respect the Commissioner’s independence. On the other hand the Commissioner must recognise his or her part in assisting Parliament in discharging its functions.

General guidelines

3 The Parliamentary Commissioner for the Environment is an Officer of Parliament appointed under section 4 of the Environment Act 1986. The Commissioner’s role exists to help Parliament to ensure that in the management of natural and physical resources full and balanced account is taken of

- the intrinsic values of ecosystems
- all values placed by individuals and groups on the quality of the environment
- the principles of the Treaty of Waitangi

the sustainability of natural and physical resources
the needs of future generations.

This gives rise to regular interaction between Parliament and the Commissioner.

4 The Commissioner presents reports to the House on the results of his or her reviews of the system of agencies and processes established by the Government to manage the allocation, use, and preservation of natural and physical resources.²

5 The Commissioner may also report to the House on the results of his or her investigations into the effectiveness of environmental planning and management carried out by public authorities, and on matters that may have led to the environment being affected adversely.³

6 The Commissioner may provide assistance to select committees and members of Parliament when they are considering a report of the Commissioner, any petition, bill, inquiry, or other matter the topic of which may impact significantly on the environment.⁴

7 The House may also direct the Commissioner to inquire into any matter that has had or may have a substantial and damaging effect on the environment, and to report the results of the inquiry to the House.⁵

8 The Commissioner collects and disseminates information relating to the environment.

9 As an Officer of Parliament, the Commissioner must be able to act independently in executing the office’s functions, duties, and powers. This means the Commissioner must act without political bias or direction. It is therefore appropriate that a code of practice exists to guide the working relationship between the House, its select committees, and the Commissioner. This means that Parliament’s needs can be effectively and appropriately addressed in a manner that respects the role and status of select committees and the Commissioner’s independence. It also enables the resources of the Commissioner to be managed in an efficient and effective way.

10 To enable the resources of the Commissioner to be managed properly, the Commissioner must consult with the Officers of Parliament Committee before agreeing to provide assistance that may divert significant resources from other functions carried out by the Commissioner.

11 This code of practice therefore provides guidance for managing each of the main ways in which the Commissioner may interact with the House, select committees, and its members.

Definitions

12 Commissioner—For the purposes of this code of practice, references to the Commissioner should be taken to mean the Parliamentary Commissioner for the Environment, and include every person holding any office or appointment under the Parliamentary Commissioner for the Environment.

² Section 16(1)(a) and (b) Environment Act 1986.
³ Section 16(1)(c) Environment Act.
⁴ Section 16(1)(d) Environment Act.
⁵ Section 16(1)(e), (2), and (3) Environment Act.
13 **Public authority**—For the purposes of this code, a public authority is defined to mean a Minister of the Crown, government department, local authority, or any instrument of Executive Government.

**Commissioner’s reports on reviews and investigations**

14 The Commissioner reports regularly to the House in the exercise of his or her functions under the Environment Act and the Environmental Reporting Act 2015. The Commissioner’s reports contain the results of his or her reviews and investigations, and advice that the Commissioner believes warrants the attention of public authorities.

15 The Commissioner may also, where appropriate, ascertain and report to the House on responses made by public authorities to the findings and advice given by the Commissioner as a result of investigations.

16 Reports the Commissioner makes to the House on the results of his or her reviews and investigations stand referred by the House to the Local Government and Environment Committee for examination. That committee may decide to refer the report to another committee (Standing Order 396).

**Consideration of reports by select committees and members**

17 Once a report which contains the findings of a review or investigation carried out by the Commissioner has been presented to the House, the Commissioner may write to the relevant select committee, and members, about the report and offer to brief them on it.

**Assistance by the Commissioner**

18 Where such a report is to be considered by a select committee, the committee may ask the Commissioner to assist it with determining the key issues it might examine, and how such an examination could be carried out.

19 When assisting a select committee with its consideration of a report, the Commissioner will usually have the status of an adviser. The committee will decide this case by case. There may be circumstances where a committee, in reviewing a report of the Commissioner, wishes to take evidence from the Commissioner as a witness. A committee should therefore make it clear to the Commissioner what his or her status is when assisting with the review of a report.

20 Where a committee hears evidence from another organisation in its examination of a report, the select committee may ask the Commissioner to be present to advise it. Where the Commissioner is present as an adviser, the committee should direct its questions to the witness under examination for response, and not to the Commissioner.

21 In preparing advice, the Commissioner may need to consult with other parties to ensure such advice is correct. Unless specifically agreed with the committee, such consultation must not include disclosing the actual advice to be given to the committee (Standing Order 240(1)).

22 While section 20 of the Environment Act requires the Commissioner to withhold certain information from disclosure to other persons and bodies, this does not preclude the Commissioner from providing information to a select committee where the committee considers that the public interest warrants such disclosure.

23 In determining whether to ask the Commissioner to disclose certain information, a select committee will, however, be mindful of the need to ensure that it acts within the law.
24 The Commissioner may also provide such assistance as may be requested by a select committee with the preparation of the committee’s report to the House.

25 The Commissioner will notify relevant Ministers and spokespeople prior to presenting a report to the House.

26 The Commissioner will provide embargoed copies of reports and offer briefings to relevant Ministers and spokespeople prior to the report being presented to the House.

27 Members must regard embargoed reports as confidential and not make any public statements or publicly release a report before it has been presented to the House.

28 The Commissioner will notify the Speaker of the House of Representatives prior to presenting a report to the House.

29 On occasion, the Commissioner may release a report publicly prior to it being presented to the House if there is a good reason to do so (for example, the House being in urgency).

Select committee consideration of petitions

30 Petitions referred by the House to select committees may concern topics that could have significant implications for the environment.

31 A select committee may therefore request the Commissioner to report on any such petition.

Assistance by the Commissioner

32 When assisting a select committee with its consideration of a petition, the Commissioner will usually have the status of an adviser. The committee will decide this case by case. There may be circumstances where a committee, in considering a petition, will wish to take evidence from the Commissioner as a witness. A committee should therefore make it clear to the Commissioner what his or her status is when assisting with the consideration of a petition.

33 In preparing advice, the Commissioner may need to consult with other parties to ensure such advice is correct. Unless specifically agreed with the committee, such consultation must not include disclosing the actual advice to be given to the committee.

34 Where a committee hears evidence from the petitioner and other interested parties, the committee may ask the Commissioner to be present to advise it. Where the Commissioner is present as an adviser, the committee will direct its questions to the witness for response, and not to the Commissioner.

35 The Commissioner may provide such assistance as may be requested by a select committee in the preparation of the committee’s report to the House.

36 Where a committee requests a report from the Commissioner on a petition, the Commissioner will usually be accorded the status of adviser to the committee.

37 The Commissioner, when appearing at a select committee hearing where consideration is being given to a submission from the Commissioner, appears as a witness giving evidence.
Select committee inquiries

38 Select committees are empowered under Standing Orders to initiate inquiries and briefings into matters relating to their respective subject areas.

39 Some inquiries and briefings investigate highly specialised topics for which committees may reasonably wish to procure specialist assistance. Others call for more general investigative skills involving the analysis, evaluation, and synthesis of information. For this purpose, committees may wish to procure some general investigative assistance.

Assistance by the Commissioner

40 In considering options for assistance, a select committee may wish to utilise the specialist expertise of the Commissioner, recognising the Commissioner’s independence, expertise in environmental management matters, and investigative experience.

41 For such inquiries or briefings a committee may invite the Commissioner to

- advise on possible options or terms of reference
- advise on the approach the committee might take to conducting the inquiry or briefing
- act as an independent specialist adviser to the committee.

42 A select committee, in considering whether to conduct an inquiry, may ask that the matter be taken up as a special study by the Commissioner.

43 Since a select committee’s power of inquiry and the role of the Commissioner are both key mechanisms for holding accountable public organisations responsible for the management of the environment, liaison is desirable between committees (regarding the inquiries they conduct) and the Commissioner (regarding the special studies the Commissioner undertakes).

44 The Commissioner will agree with the select committee the specific terms and conditions of assistance to be provided.

45 A select committee may request the Commissioner to attend during its examination of witnesses. This may be particularly desirable if the committee believes the Commissioner could assist in interpreting and analysing the evidence given.

Select committee consideration of bills

46 Standing Order 288(1) provides that a bill is referred by the House to a select committee for consideration after its first reading.

47 The select committee to which the bill is referred examines the bill, and in accordance with Standing Order 291 determines whether to recommend that the bill be passed, and may recommend amendments in accordance with Standing Order 292.

48 A select committee considering a bill may wish to obtain advice that is independent of the advice given to it by the government officials.

Assistance by the Commissioner

49 Where a bill contains matters in which the Commissioner has responsibilities, knowledge, or expertise, a committee may ask the Commissioner to act as an adviser to it on the bill.
If the Commissioner agrees to provide assistance, then in accordance with Standing Order 211 the committee will appoint the Commissioner as an adviser.

Submissions by the Commissioner

On occasion, the Commissioner may decide to make a submission on a bill which may have a significant effect on the environment. In such cases the Commissioner would if necessary request to appear before the committee as a witness on the same basis as other submitters.

Treatment of submissions

The Commissioner will provide embargoed copies of submissions to relevant Ministers and spokespeople prior to submitting on a bill.

Members must regard embargoed submissions as confidential and not make any public statements or publicly release a submission before it has been made public by the Commissioner.

Other inquiries or requests for assistance by members of Parliament

The Commissioner may receive inquiries or requests for information from members of Parliament about environmental management concerns or risks regarding the system of agencies and processes established by the Government to manage the environment.

Members may request the Commissioner’s assistance in interpreting or understanding any matter of environmental management or accountability regarding which the Commissioner might reasonably be expected to have knowledge or responsibility.

The ability of members to make such inquiries is regarded as desirable and appropriate if the Commissioner is to have access to a comprehensive range of environmental management concerns and risks.

Assistance by the Commissioner

When deciding on the appropriate response to a particular inquiry or request for assistance from a member, the Commissioner must be satisfied that pursuing any inquiry is in the wider public interest and would not compromise the independence of the Commissioner.

The Commissioner will also assess the merits of pursuing a particular inquiry or request for assistance against his or her annual work programme.

The Commissioner will make the final determination of the appropriate response to all members’ inquiries or requests for assistance.

Members should regard their inquiries or requests for assistance to the Commissioner as confidential, and should not make any public statements about such requests until the Commissioner has considered and advised them of a course of action.

Where a member chooses nevertheless to make a public statement about their particular request to the Commissioner, the member should advise the Commissioner in advance of this and provide a copy of the statement to the Commissioner.

Where the Commissioner is concerned about the political or other consequences of the response to a request from a member, the Commissioner may discuss the matter with
the Speaker of the House of Representatives before deciding and advising on a course of action.

**Standing Orders**

63 This code of practice must be interpreted in the light of any changes to the Standing Orders, statutory provisions, or practices and procedures of the House.
Appendix

Committee procedure
The Officers of Parliament Committee met on several occasions to consider the review of this code of practice. The committee consulted with the Parliamentary Commissioner for the Environment and the Office of the Clerk of the House of Representatives about this review.

Committee members
Rt Hon David Carter (Chairperson)
David Clendon
Hon Te Ururoa Flavell
Tim Macindoe
Hon Trevor Mallard
Carmel Sepuloni
Barbara Stewart
Alterations to the 2016/17 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and 2017/18 draft budgets for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment

Report of the Officers of Parliament Committee

Fifty-first Parliament
(Rt Hon David Carter, Chairperson)
March 2017

Presented to the House of Representatives
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Alterations to the 2016/17 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and 2017/18 draft budgets for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment

Recommendation
The Officers of Parliament Committee recommends that the House commend to the Governor-General, by way of an address pursuant to section 26E of the Public Finance Act 1989, alterations to the 2016/17 appropriations for Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and estimates of expenses to be incurred for each appropriation in 2017/18 in Vote Audit, Vote Ombudsmen, and Vote Parliamentary Commissioner for the Environment, and a capital injection to the Office of the Ombudsman, and requests that they be incorporated into an Appropriation Bill.

Introduction
In order to maintain the independence of the Officers of Parliament, the Public Finance Act 1989 provides for funding for the Office of the Controller and Auditor-General, the Office of the Ombudsman, and the Office of the Parliamentary Commissioner for the Environment to be determined by Parliament through the Officers of Parliament Committee.

We received submissions from each officer detailing proposed alterations to their 2016/17 appropriations, and their draft budgets for 2017/18 and out-years. We examined these submissions in conjunction with advice from the Treasury. Our recommended alterations for 2016/17, and estimates for 2017/18 and out-years, are detailed in this report.

We recommend that the House commend these alterations and estimates to the Governor-General for inclusion in the main Appropriation Bill for the coming financial year, or in the Appropriation Bill dealing with the Supplementary Estimates for the current financial year. All figures in this report are GST-exclusive or GST-exempt unless otherwise noted.
Summary of the committee’s recommendations

The following tables give an overview of the changes we support in the 2016/17 appropriations for the Officers of Parliament, and their draft budgets for 2017/18 and subsequent years.

**Vote Audit: alterations for 2016/17**

<table>
<thead>
<tr>
<th>Alterations for 2016/17</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>11,657</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(12)</td>
</tr>
<tr>
<td>Adjustment for audit and assurance deficit</td>
<td>1,392</td>
</tr>
<tr>
<td><strong>New annual appropriation for 2016/17</strong></td>
<td><strong>13,037</strong></td>
</tr>
<tr>
<td>Current PLA</td>
<td>958</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>94</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td><strong>1,052</strong></td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA) for 2016/17</strong></td>
<td><strong>14,089</strong></td>
</tr>
</tbody>
</table>

**Vote Audit: adjustments for 2017/18 and out-years**

<table>
<thead>
<tr>
<th>Adjustments for 2017/18 and out-years</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
<th>2020/21 $000</th>
</tr>
</thead>
<tbody>
<tr>
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<td>10,607</td>
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<td>11,507</td>
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<tr>
<td>Adjustment for capital charge</td>
<td>(16)</td>
<td>(16)</td>
<td>(16)</td>
<td>(16)</td>
</tr>
<tr>
<td>Adjustment for audit and assurance deficits</td>
<td>–</td>
<td>700</td>
<td>427</td>
<td>(1,500)</td>
</tr>
<tr>
<td><strong>New annual appropriation</strong></td>
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<td><strong>11,291</strong></td>
<td><strong>11,918</strong></td>
<td><strong>9,991</strong></td>
</tr>
<tr>
<td>Current PLA</td>
<td>958</td>
<td>958</td>
<td>958</td>
<td>958</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>94</td>
<td>94</td>
<td>94</td>
<td>94</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td><strong>1,052</strong></td>
<td><strong>1,052</strong></td>
<td><strong>1,052</strong></td>
<td><strong>1,052</strong></td>
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<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
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<td><strong>12,343</strong></td>
<td><strong>12,970</strong></td>
<td><strong>11,043</strong></td>
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</table>
### Vote Ombudsmen: alterations for 2016/17

<table>
<thead>
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<th>Alterations for 2016/17</th>
<th>$000</th>
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</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>13,712</td>
</tr>
<tr>
<td>Fiscally neutral adjustment (funded by revenue from MFAT)</td>
<td>8</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(37)</td>
</tr>
<tr>
<td>Christchurch and Wellington accommodation</td>
<td>278</td>
</tr>
<tr>
<td>Expense transfer to 2017/18</td>
<td>(363)</td>
</tr>
<tr>
<td><strong>Total adjustment</strong></td>
<td>(114)</td>
</tr>
</tbody>
</table>

**New appropriation for 2016/17**: 13,598

<table>
<thead>
<tr>
<th>Current PLA</th>
<th>668</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustment for remuneration determination</td>
<td>–</td>
</tr>
<tr>
<td>New PLA</td>
<td>668</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA) for 2016/17</strong></td>
<td>14,266</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Current capital</th>
<th>2,625</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital injection for office accommodation</td>
<td>523</td>
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<tr>
<td><strong>New total capital</strong></td>
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</tbody>
</table>
Vote Ombudsmen: adjustments for 2017/18 and out-years

<table>
<thead>
<tr>
<th>Adjustments for 2017/18 and out-years</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
<th>2020/21 $000</th>
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<tr>
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<td>12,785</td>
</tr>
<tr>
<td>Clearing aged investigations</td>
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<td>(965)</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Monitoring detained people</td>
<td>1,127</td>
<td>1,165</td>
<td>1,165</td>
<td>1,165</td>
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<tr>
<td>Retention of staff</td>
<td>253</td>
<td>686</td>
<td>686</td>
<td>686</td>
</tr>
<tr>
<td>ICT systems</td>
<td>332</td>
<td>269</td>
<td>269</td>
<td>269</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(53)</td>
<td>(53)</td>
<td>(53)</td>
<td>(53)</td>
</tr>
<tr>
<td>Expense transfer</td>
<td>363</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Christchurch and Wellington accommodation</td>
<td>322</td>
<td>322</td>
<td>322</td>
<td>322</td>
</tr>
<tr>
<td><strong>Total adjustment</strong></td>
<td>2,344</td>
<td>1,424</td>
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<td>2,389</td>
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<td>15,155</td>
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<td>668</td>
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<tr>
<td>Adjustment for remuneration determination</td>
<td>–</td>
<td>–</td>
<td>–</td>
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<tr>
<td><strong>New PLA</strong></td>
<td>668</td>
<td>668</td>
<td>668</td>
<td>668</td>
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<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td>16,725</td>
<td>15,823</td>
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<table>
<thead>
<tr>
<th>Current capital</th>
<th>2017/18</th>
<th>2017/18</th>
<th>2018/19</th>
<th>2019/20</th>
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<tbody>
<tr>
<td></td>
<td>3,148</td>
<td>4,442</td>
<td>4,442</td>
<td>4,442</td>
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<tr>
<td>Capital injection comprising:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monitoring detained people</td>
<td>51</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>ICT systems</td>
<td>1,243</td>
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<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>New total capital</strong></td>
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<td>4,442</td>
<td>4,442</td>
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### Vote Parliamentary Commissioner for the Environment: alterations for 2016/17

<table>
<thead>
<tr>
<th>Alterations for 2016/17</th>
<th>$000</th>
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<td>Current annual appropriation</td>
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</tr>
<tr>
<td>Recruitment costs (one-off adjustment)</td>
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</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(9)</td>
</tr>
<tr>
<td><strong>New appropriation for 2016/17</strong></td>
<td><strong>3,041</strong></td>
</tr>
<tr>
<td>Current PLA</td>
<td>323</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>3</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td><strong>326</strong></td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA) for 2016/17</strong></td>
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</table>

### Vote Parliamentary Commissioner for the Environment: adjustments for 2017/18–2020/21

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<tr>
<th>Adjustments for 2017/18 and out-years</th>
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<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
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<tbody>
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<td>Current annual appropriation</td>
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<td>2,990</td>
<td>2,990</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(12)</td>
<td>(12)</td>
<td>(12)</td>
<td>(12)</td>
</tr>
<tr>
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<td><strong>2,978</strong></td>
<td><strong>2,978</strong></td>
<td><strong>2,978</strong></td>
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<tr>
<td>Current PLA</td>
<td>323</td>
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<td>Adjustment for remuneration determination</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td><strong>326</strong></td>
<td><strong>326</strong></td>
<td><strong>326</strong></td>
<td><strong>326</strong></td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
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<td><strong>3,304</strong></td>
<td><strong>3,304</strong></td>
<td><strong>3,304</strong></td>
</tr>
</tbody>
</table>
Office of the Controller and Auditor-General

Alterations to the 2016/17 appropriations for Vote Audit

Adjustment for salaries funded under PLA
The salaries of the Auditor-General and Deputy Auditor-General are revised annually on the basis of determinations by the Remuneration Authority, and are funded under permanent legislative authority (PLA).

We note that the PLA increases by $94,000 in 2016/17 and out-years as a result of a determination by the Remuneration Authority to increase the remuneration of the Auditor-General and their deputy. Such adjustments are implemented automatically.

Adjustment for reduced capital charge
The rate of capital charge paid by departments and other public sector agencies has reduced from 8 percent to 7 percent for July to December 2016, and to 6 percent from 1 January 2017 onwards. For 2016/17, this change reduces the cost of capital charge to the office by $12,000.

We recommend a reduction of $12,000 in 2016/17 for the reduction in capital charge.

Adjustment for Audit and Assurance Deficit
We recommend an increase of $1,392,000 in the annual appropriation for audit and assurance services in 2016/17.

As we explain later in relation to the budget for 2017/18, the Auditor-General has updated the forecasts of revenue and expenditure associated with the audits required of the office. A deficit of $2,542,000 is expected in 2016/17. At the start of 2016/17, the accumulated surplus in the memorandum account stood at $3,243,000. An increase of $1,392,000 in the annual appropriation is required to provide for the expected deficit, with a small buffer.

The following table shows the effect of the changes for 2016/17.

<table>
<thead>
<tr>
<th>Alterations for 2016/17</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>11,657</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(12)</td>
</tr>
<tr>
<td>Adjustment for audit and assurance deficit</td>
<td>1,392</td>
</tr>
<tr>
<td><strong>New annual appropriation for 2016/17</strong></td>
<td>13,037</td>
</tr>
<tr>
<td>Current PLA</td>
<td>958</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>94</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td>1,052</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA) for 2016/17</strong></td>
<td>14,089</td>
</tr>
</tbody>
</table>
We recommend that these changes be incorporated into the 2016/17 Supplementary Estimates.
2017/18 draft budget for the Office of the Controller and Auditor-General

Adjustment for salaries funded under PLA

We note the increase of $94,000 in the permanent legislative authority for 2017/18 and out-years as a result of a determination by the Remuneration Authority to increase the remuneration of the Auditor-General and Deputy Auditor-General.

Adjustment for reduced capital charge

The rate of capital charge paid by departments and other public sector agencies has reduced to 6 percent from 1 January 2017 onwards. For 2017/18 and out-years, this change reduces the annual cost of capital charge to the office by $16,000.

We recommend a reduction of $16,000 in 2017/18 and out-years for the reduction in capital charge.

Audit and Assurance Services revenue-dependent appropriation (RDA)

The appropriation for Audit and Assurance Services covers the expenses incurred by the Auditor-General in auditing Crown agencies, local authorities, and other entities for which the Auditor-General has auditing responsibility. The appropriation is revenue-dependent. That is, the annual expense that can be incurred under the RDA is limited to the amount of revenue derived from the entities audited. Audit fee forecasts are updated annually according to the expected amount of audit activity.

The Auditor-General has reforecast expenses and revenue for this appropriation. The following changes in expenses are expected:

- an increase in the fees charged to the office by the audit providers (AuditNZ and private providers) of 2.4 percent a year, reflecting increases in the cost of the auditing workforce
- a provision for the cost of auditing local authorities’ long-term plans in 2017/18 and 2020/21 (such audits are required every three years, causing a spike in the office’s budget); the fees for each round are forecast at $7.2 million, based on the 2014/15 round
- increases of 2 percent in personnel costs, 2 percent in accommodation costs, and 1 percent in general operating costs, based on recent historical movements
- a reduction in capital charge rates from the 8 percent previously budgeted to 6 percent from 1 January 2017.

Forecast deficits in the appropriation

The Auditor-General operates a memorandum account for its audits, enabling surpluses in one year to be offset by deficits in another year, and allowing charges to be varied following the accumulation of surpluses or deficits.

An annual appropriation is required for years in which deficits are expected in order to cover expenses in excess of revenue, even though the revenue required to support the deficit is in the office’s bank account from previous years. A buffer of approximately $500,000 is provided to avoid any unappropriated expenditure.

The Auditor-General is forecasting deficits, charged to the memorandum account, of $2,542,000 in 2016/17, $800,000 in 2018/19, and $1,427,000 in 2019/20.
At the start of 2016/17, the accumulated surplus in the memorandum account was $3,243,000.

We recommend the following adjustments in the annual appropriation for Audit and Assurance Services to take account of the revised forecasts:

- 2017/18: no change
- 2018/19: an increase of $700,000
- 2019/20: an increase of $427,000
- 2020/21: a reduction of $1,500,000.

We note that the Treasury has examined and supports the forecast changes.

**Summary of proposed changes**

The following table shows the effect the proposed changes would have on the Vote Audit baseline.

<table>
<thead>
<tr>
<th>Adjustments for 2017/18 and out-years</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
<th>2020/21 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>10,007</td>
<td>10,607</td>
<td>11,507</td>
<td>11,507</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(16)</td>
<td>(16)</td>
<td>(16)</td>
<td>(16)</td>
</tr>
<tr>
<td>Adjustment for audit and assurance deficits</td>
<td>-</td>
<td>700</td>
<td>427</td>
<td>(1,500)</td>
</tr>
</tbody>
</table>

**New annual appropriation**

<table>
<thead>
<tr>
<th></th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
<th>2020/21 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current PLA</td>
<td>958</td>
<td>958</td>
<td>958</td>
<td>958</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>94</td>
<td>94</td>
<td>94</td>
<td>94</td>
</tr>
</tbody>
</table>

**New PLA**

<table>
<thead>
<tr>
<th></th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
<th>2020/21 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>New PLA</td>
<td>1,052</td>
<td>1,052</td>
<td>1,052</td>
<td>1,052</td>
</tr>
</tbody>
</table>

**New baseline (annual and PLA)**

<table>
<thead>
<tr>
<th></th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
<th>2020/21 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>New baseline (annual and PLA)</td>
<td>11,043</td>
<td>12,343</td>
<td>12,970</td>
<td>11,043</td>
</tr>
</tbody>
</table>
Office of the Ombudsman

Alterations to the 2016/17 appropriations for Vote Ombudsmen

We note that, at this stage, no determination has been made by the Remuneration Authority that affects the PLA for the salaries of the Ombudsmen. Any such adjustment would be implemented automatically.

We recommend the following adjustments to the appropriations for, and capital of, the Office of the Ombudsman in 2016/17.

One-off appropriation for fiscally-neutral transfer

We support an increase of $8,000 for a fiscally-neutral transaction to offset costs associated with hosting the Pacific Forum in November 2016. This expense will be reimbursed by the Ministry of Foreign Affairs and Trade.

Adjustment for reduced capital charge

The rate of capital charge paid by departments and other public sector agencies has reduced from 8 percent to 7 percent for July to December 2016, and to 6 percent from 1 January 2017 onwards. For 2016/17, this change reduces the cost of capital charge to the Office of the Ombudsman by $37,000.

We recommend a reduction of $37,000 in 2016/17 for the reduction in capital charge.

Christchurch office accommodation

As we noted last year, the Ombudsman’s Christchurch office was forced to relocate quickly after the 2011 earthquakes, but the new site did not meet a number of critical requirements. A more suitable site has now been located in the central business district.

We support a capital injection of $406,000 to cover the necessary fit-out of the new office space. We also recommend an increase in appropriation of $160,000 in 2016/17 (and $155,000 in out-years) to cover the additional operating expenses for this accommodation.

Wellington office accommodation

Following a restructuring in 2016 involving the recruitment of new staff and contractors, and the establishment of new teams, the Ombudsman’s Wellington premises are under pressure to accommodate all staff. Suitable accommodation is available on an adjacent floor in the same building as the present accommodation.

We support a capital injection of $117,000 for the fit-out of this additional accommodation, and an increase in appropriation of $118,000 in 2016/17 (and $166,000 in out-years) for the ongoing operating expenses.

Expense transfer

We support an expense transfer of $363,000 from 2016/17 to 2017/18 to enable the Office to complete the following projects:

- Intranet redevelopment: $120,000
- Rebuilding website: $80,000
- Learning and development project: $140,000
- Health and safety project: $23,000.

The following tables summarise the alterations for 2016/17.

<table>
<thead>
<tr>
<th>Alterations for 2016/17</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>13,712</td>
</tr>
<tr>
<td>Fiscally neutral adjustment (funded by revenue from MFAT)</td>
<td>8</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(37)</td>
</tr>
<tr>
<td>Christchurch and Wellington accommodation</td>
<td>278</td>
</tr>
<tr>
<td>Expense transfer to 2017/18</td>
<td>(363)</td>
</tr>
<tr>
<td>Total adjustment</td>
<td>(114)</td>
</tr>
</tbody>
</table>

| New appropriation for 2016/17               | 13,598|
| Current PLA                                 | 668  |
| Adjustment for remuneration determination   | –    |
| New PLA                                     | 668  |
| New baseline (annual and PLA) for 2016/17   | 14,266|

| Current capital                             | 2,625 |
| Capital injection for office accommodation  | 523   |
| New total capital                           | 3,148 |

We recommend that the changes for 2016/17 be incorporated into the 2016/17 Supplementary Estimates.
2017/18 draft budget for the Office of the Ombudsman

We note that, at this stage, no determination has been made by the Remuneration Authority that would affect the PLA for remuneration of the Ombudsmen. Any such adjustment would be implemented automatically.

We recommend the following adjustments to the appropriations for, and capital of, the Office of the Ombudsman.

Rapid progress and surplus funding for aged investigations

In Budget 2016 the Office was provided with additional funding over three years to clear a backlog of “aged” investigations (those pending for a year or more) that had reached an unacceptably high level. Progress on this work has been considerably faster than expected. The backlog is now expected to be cleared by 30 June 2018—a year earlier than originally expected. Indeed, the Chief Ombudsman told us he is hopeful that by the end of 2017 the Office will have no cases older than a year.

We consider this an excellent result. We congratulate the Office on the rapid progress it has made in clearing the backlog of investigations. We are also pleased to note that the Office has met, and exceeded, the undertaking it gave last year that 70 percent of all complaints received since 1 July 2016 would be completed within three months of receipt.

In light of this success, the Chief Ombudsman has proposed that the $965,000 proposed for work on aged complaints in 2018/19 be removed from its budget. We note that it is highly unusual for an organisation to offer to return funding. We commend it for doing so.

We recommend that the appropriation for 2018/19 be reduced by $965,000.

Monitoring treatment of detained people

A core part of the Ombudsman’s role is proactive monitoring of how vulnerable people are treated in New Zealand’s places of detention. This is a United Nations inspection role under the Optional Protocol to the Convention against Torture (OPCAT) that New Zealand has committed to since 2003.

The Chief Ombudsman is concerned that, because of underfunding, the Office is unable to fully meet the UN obligations under OPCAT. It is currently funded for only three permanent inspector positions. This means it can carry out only 32 visits and inspections of detention facilities a year—less than a third of the 110 places of detention in New Zealand.

The Chief Ombudsman points out that the situation has been criticised by the United Nations Subcommittee on Prevention of Torture. The subcommittee commented in a 2014 report that if the under-resourcing was not remedied without delay, New Zealand would “inevitably find itself in breach of its OPCAT obligations”.¹ This could trigger significant financial liability for the Crown, as well as undermining public trust and confidence.

We acknowledge the importance of the Office’s role in monitoring New Zealand’s places of detention. This has been highlighted by recent events at the Serco-run Mount Eden prison and, more recently, at the Hawkes Bay prison. We note that in addition to the 110 facilities that clearly fall within the Office’s jurisdiction, there are also court cells and 180 privately operated dementia units that may also fall within its monitoring designation.

¹ Report on the visit of the United Nations Subcommittee on Prevention of Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment in New Zealand, 28 July 2014, p.4.
We therefore support the Chief Ombudsman’s request for funding to provide for five additional OPCAT inspectors and one information analyst. This would allow it to have at least one fully-resourced, multi-disciplinary permanent inspection team.

We recommend an increase in appropriations of $1,127,000 in 2017/18, and $1,165,000 in 2018/19 and out-years. We also recommend a capital injection of $51,000 in 2017/18 for the establishment costs associated with the additional staff.

**Staff remuneration and retention**

Over several years we have noted the Office’s concern that remuneration rates for its staff are below those of other agencies, and that paying market salaries to attract suitable staff creates anomalies for existing staff. Last year, we accepted that turnover, at 20 percent, had reached an unacceptable level. We recommended an additional appropriation of $341,000 in 2016/17, increasing by 5 percent a year in out-years, to correct such anomalies and promote the retention of staff.

This year we were pleased to note that voluntary staff turnover has fallen to 6 percent. Nevertheless, the Chief Ombudsman remains concerned that he is unable to compete within the current market, and risks losing trained, experienced staff. He notes that the Office’s workload continues to expand. He expects strong demand in the current year for the completion of Official Information Act investigations prior to the general election. In addition, the recent Kaikōura earthquakes are likely to generate a significant increase in complaints. The loss of any experienced staff could reverse the progress that the Office has made in carrying out its role and functions, and getting on top of its workload.

The Chief Ombudsman notes that his staff’s remuneration is currently based on the 2013 “All Orgs” market rates. He would like to update it to the 2016 All Orgs rates, but recognises that the expense of doing so would be significant, with an immediate cost of $953,000. He therefore suggests aligning salaries with the public sector rates for 2016, and seeks additional funding of $253,000 for this in 2017/18. In subsequent years, the Chief Ombudsman proposes further increases of 5 percent a year from 2018/19 in order to recognise performance and maintain market relativities.

We have considered the Chief Ombudsman’s proposal carefully. We are mindful of fiscal constraints—although we note that the Officers of Parliament, and this committee, are not subject to Government direction in this regard.

We appreciate that the Office’s staff fulfil an important and demanding role. We also recognise that the Office has achieved impressive gains in carrying out its functions effectively and in a timely way. We are aware that the Office’s workload is increasing, and would not wish to see its productivity jeopardised by the loss of trained and experienced staff.

A particular consideration for us has been the Office’s excellent performance in getting on top of its backlog of aged cases. It is to the Office’s credit that it is doing so more quickly than expected (in 2 years, rather than the predicted 3), and that it has taken the unusual step of offering back a substantial amount of funding earmarked for 2018/19. We believe it is appropriate that some of this saving should be made available for the Office to reward its staff and continue the improvement in performance into the future.

On balance, therefore, we support the requested baseline increase of $253,000 in 2017/18 to align salaries with current public sector market rates. We also support increasing this amount by a further 5 percent ($433,000) in 2018/19, to $686,000, to allow for the
recognition of performance and to maintain market relativities. We recommend holding it at this level in 2019/20 and 2020/21. We will assess in two years’ time whether further adjustments are warranted to maintain relativities and retain experienced staff.

**ICT systems and capability**

The Office has been updating its electronic systems, which were considerably behind the times. In 2014/15, resources were made available for the development and implementation of an Electronic Content Management System (ECMS). Last year we accepted the case for additional funding, noting that this would allow it to make the best use of the ICT capital already agreed to, and go a good way to meeting its future needs. We noted that some further funding might still be sought for the replacement of the office’s complaints management system, which is over two decades old.

The Office has now developed a business case to update this case management system (CMS) so that it can integrate into the new ECMS. We accept that this is needed, and support the request.

We recommend a capital injection of $1,243,000 for development of a new CMS, and increases in appropriations of $332,000 in 2017/18, and $269,000 in out-years, for the associated operating expenses.

**Adjustment for reduced capital charge**

The rate of capital charge paid by departments and other public sector agencies has reduced to 6 percent from 1 January 2017 onwards. For 2017/18 and out-years, this change reduces the annual cost of capital charge to the Office by $53,000.

We recommend a reduction of $53,000 in 2017/18 and out-years for the reduction in capital charge.

**Expense transfer from 2016/17**

As noted earlier in this report, we support an expense transfer of $363,000 from 2016/17 to 2017/18 to enable the Office to complete four projects currently under way.

**Christchurch and Wellington office accommodation**

Again, as noted in our discussion of the 2016/17 appropriations, we support an increase of $322,000 in 2017/18 and out-years to cover operating expenses associated with the Office’s move to more permanent premises in Christchurch, and additional office space in Wellington.
Summary of proposed changes

The following table shows the effect of our recommended changes on the 2016/17 appropriation for Vote Ombudsmen and the baseline for subsequent years.

<table>
<thead>
<tr>
<th>Adjustments for 2017/18 and out-years</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
<th>2020/21 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>13,713</td>
<td>13,731</td>
<td>12,785</td>
<td>12,785</td>
</tr>
<tr>
<td>Clearing aged investigations</td>
<td>–</td>
<td>(965)</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Monitoring detained people</td>
<td>1,127</td>
<td>1,165</td>
<td>1,165</td>
<td>1,165</td>
</tr>
<tr>
<td>Retention of staff</td>
<td>253</td>
<td>686</td>
<td>686</td>
<td>686</td>
</tr>
<tr>
<td>ICT systems</td>
<td>332</td>
<td>269</td>
<td>269</td>
<td>269</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(53)</td>
<td>(53)</td>
<td>(53)</td>
<td>(53)</td>
</tr>
<tr>
<td>Expense transfer</td>
<td>363</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Christchurch and Wellington accommodation</td>
<td>322</td>
<td>322</td>
<td>322</td>
<td>322</td>
</tr>
<tr>
<td><strong>Total adjustment</strong></td>
<td>2,344</td>
<td>1,424</td>
<td>2,389</td>
<td>2,389</td>
</tr>
<tr>
<td><strong>New annual appropriation</strong></td>
<td>16,057</td>
<td>15,155</td>
<td>15,174</td>
<td>15,174</td>
</tr>
<tr>
<td>Current PLA</td>
<td>668</td>
<td>668</td>
<td>668</td>
<td>668</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td>668</td>
<td>668</td>
<td>668</td>
<td>668</td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA)</strong></td>
<td>16,725</td>
<td>15,823</td>
<td>15,842</td>
<td>15,842</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current capital</th>
<th>2017/18</th>
<th>2017/18</th>
<th>2018/19</th>
<th>2019/20</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3,148</td>
<td>4,442</td>
<td>4,442</td>
<td>4,442</td>
</tr>
<tr>
<td>Capital injection comprising:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monitoring detained people</td>
<td>51</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>ICT systems</td>
<td>1,243</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>New total capital</strong></td>
<td>4,442</td>
<td>4,442</td>
<td>4,442</td>
<td>4,442</td>
</tr>
</tbody>
</table>
Parliamentary Commissioner for the Environment

Alterations to the 2016/17 appropriations for Vote Parliamentary Commissioner for the Environment

Adjustment for salaries funded under PLA

The salary of the Parliamentary Commissioner for the Environment is revised annually on the basis of determinations by the Remuneration Authority, and funded under permanent legislative authority (PLA).

We note an increase in the PLA of $3,000 in 2016/17 and out-years as a result of a determination by the Remuneration Authority. Such adjustments are implemented automatically.

Recruitment costs for new Commissioner

The Commissioner is due to retire at the end of June 2017. Arrangements are in hand to recruit a new Commissioner and the cost of this process has been estimated. As no provision is made in baselines for the recruitment process, we recommend an increase in appropriation of $60,000 for 2016/17 to cover the estimated cost of recruiting a new Commissioner.

Adjustment for reduced capital charge

The rate of capital charge paid by departments and other public sector agencies has reduced from 8 percent to 7 percent for July to December 2016 (and to 6 percent from 1 January 2017 onwards). For 2016/17, this change reduces the cost of capital charge to the Parliamentary Commissioner for the Environment by $9,000.

We recommend a reduction of $9,000 in the baseline for 2016/17 for the reduction in capital charge.

The following table shows the effect of these changes on the Vote’s baseline.

<table>
<thead>
<tr>
<th>Alterations for 2016/17</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>2,990</td>
</tr>
<tr>
<td>Recruitment costs (one-off adjustment)</td>
<td>60</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(9)</td>
</tr>
<tr>
<td><strong>New appropriation for 2016/17</strong></td>
<td><strong>3,041</strong></td>
</tr>
<tr>
<td>Current PLA</td>
<td>323</td>
</tr>
<tr>
<td>Adjustment for remuneration determination</td>
<td>3</td>
</tr>
<tr>
<td><strong>New PLA</strong></td>
<td><strong>326</strong></td>
</tr>
<tr>
<td><strong>New baseline (annual and PLA) for 2016/17</strong></td>
<td><strong>2,984</strong></td>
</tr>
</tbody>
</table>
We recommend that the changes for 2016/17 be incorporated into the 2016/17 Supplementary Estimates.
2017/18 draft budget for the Office of the Parliamentary Commissioner for the Environment

We note the increase of $3,000 in the PLA for 2017/18 and out-years as a result of a determination by the Remuneration Authority to increase the Commissioner’s remuneration.

Adjustment for reduced capital charge

The rate of capital charge paid by departments and other public sector agencies has reduced to 6 percent from 1 January 2017 onwards. For 2017/18 and out-years, this change reduces the annual cost of capital charge to the Parliamentary Commissioner for the Environment by $12,000.

We recommend a reduction of $12,000 in 2017/18 and out-years for the reduction in capital charge.

Summary of proposed changes

The following table shows the effect of the proposed changes on the 2017/18 appropriation for Vote Parliamentary Commissioner for the Environment, and the baseline for subsequent years.

<table>
<thead>
<tr>
<th>Adjustments for 2017/18 and out-years</th>
<th>2017/18 $000</th>
<th>2017/18 $000</th>
<th>2018/19 $000</th>
<th>2019/20 $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current annual appropriation</td>
<td>2,990</td>
<td>2,990</td>
<td>2,990</td>
<td>2,990</td>
</tr>
<tr>
<td>Adjustment for capital charge</td>
<td>(12)</td>
<td>(12)</td>
<td>(12)</td>
<td>(12)</td>
</tr>
<tr>
<td>New annual appropriation</td>
<td>2,978</td>
<td>2,978</td>
<td>2,978</td>
<td>2,978</td>
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<tr>
<td>Current PLA</td>
<td>323</td>
<td>323</td>
<td>323</td>
<td>323</td>
</tr>
<tr>
<td>Adjustment for remuneration</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>New PLA</td>
<td>326</td>
<td>326</td>
<td>326</td>
<td>326</td>
</tr>
<tr>
<td>New baseline (annual and PLA)</td>
<td>3,304</td>
<td>3,304</td>
<td>3,304</td>
<td>3,304</td>
</tr>
</tbody>
</table>
Appendix

Committee procedure
We met on 9 and 23 March 2017 to consider the alterations to the 2016/17 appropriations and the draft budgets for 2017/18 for the Officers of Parliament. We heard evidence from the Chief Ombudsman, the Controller and Auditor-General, and the Parliamentary Commissioner for the Environment, and received advice from the Treasury.

Committee members
Rt Hon David Carter (Chairperson)
David Clendon
Hon Te Ururoa Flavell
Tim Macindoe
Hon Trevor Mallard
Carmel Sepuloni
Barbara Stewart

Ron Mark and Clayton Mitchell participated in the consideration of this item of business.

Evidence and advice received
The documents that we received as advice and evidence are listed below:


Office of the Ombudsman, Supplementary papers tabled at meeting on 9 March 2017.


The Treasury, Assessment of 2017 Budget and Baseline Submissions for the Officers of Parliament.