

THE NEW ZEALAND ECONOMY AND INVESTMENT

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Abstract

This paper summarises the current economic situation in New Zealand, using up-to-date statistics and presenting an assessment of the current political environment. The paper discusses the major economic reform measures taken over the past seven years, the current state of the New Zealand economy, New Zealand's Closer Economic Relationship with Australia, projected economic trends, overseas investment in the New Zealand economy, taxation and the political environment.

You've got to stick your neck out to prosper. Risk and reward travel side by side. Avoid the one, and the other will also pass you by. Hide from risk and you hide from its rewards.

Introduction

New Zealand has always been attractive to foreign investors. It is a stable, democratic country; has a western culture and values; and is part of the world's fastest growing economic region, the Pacific Basin. Its people have enjoyed a high standard of living. While its traditional wealth has been built on the export of primary produce, it also has major natural resources that can support industries in horticulture, fishing, forestry, energy, manufacturing and tourism; and has an increasing reputation for the export of services.

Over the past decade, the New Zealand economy has undergone dramatic change, with moves designed to reduce inflation, increase international competitiveness and liberalise the economic environment. A number of policy initiatives were undertaken by successive governments (both National and Labour) to create a more competitive economic environment.

The overall objectives have been to reduce inflation, remove distortions from the local market, liberalise the business environment and increase New Zealand's international competitiveness. The major moves included:

- floating the New Zealand dollar (in March 1985); and the removal of all foreign exchange controls;
- the removal of most tariffs and import controls;
- the signing of the Australia New Zealand Closer Economic Relationship (CER) Treaty and a subsequent acceleration of the free trade arrangements under that treaty;
- major tax reform, including the introduction of a value added type tax known as Goods and Services Tax (GST);
- removal of farming/agricultural/horticultural subsidies; and the gradual removal of most other export subsidies;
- liberalised foreign investment policies;
- intense competition in the financial services sector with the licensing of a number of new banks;
- deregulation of road, rail and air transport and reform of port operations with the projected sale of shares in the country's ports;

- providing statutory independence for the Reserve Bank of New Zealand (the country's central bank) and giving top priority to the bank's role in combating inflation;
- reform of the public service;
- corporatisation and the subsequent privatisation of many state trading departments, including, Telecom and eventually Coalcorp and Electricorp;
- deregulation of the labour market with the introduction of the Employment Contracts Act (providing for greater flexibility in the labour market);
- reform of the Welfare State with restructuring of the over-generous superannuation (GRI) scheme and a determination to stop the growth in numbers of social welfare beneficiaries; and
- tight monetary and fiscal policies combined with commitment to decreases in government spending.

These policies have been accompanied by very tight monetary control for the purpose of achieving the objective of reducing inflation, which has now been largely achieved (the current rate is 2.8 percent per annum), and lowering interest rates.

As in other countries, in the short term (1985-1987) these policies had a number of negative effects including substantial increases in interest rates, inflation and unemployment and an over-valued New Zealand dollar (NZD) - which rose by 33 percent between December 1984 and June 1988. Even in 1991 New Zealand is still suffering from the results of the 1987 sharemarket crash, the recession in Australia, the slowdown in Japan (following the financial scandals and the government pressure to sell overseas assets) and in the United States; as well as the instability of the USSR and the anticipation of problems following the 1992 changes in Europe.

The protective laws and practices of the past have been replaced by policies that seek to provide an environment of maximum flexibility for business in New Zealand and that encourage the development of a truly competitive edge in international markets. This means that New Zealand business is fully exposed to all worldwide economic events.

In the 1980s emigration rose (largely to Australia) with a consequent loss in job skills. However, this trend has been reversed as the full impact of the economic recession in

Australia is felt. In addition, new immigrants from Asia have moved into New Zealand in increasing numbers.

In the mid-1980s, farm values fell very significantly (some by more than half) from levels that were widely regarded as inflated, and some debt-ridden farmers were forced off the land. This trend was marked in the immediate post crash period but, by 1991, has largely stopped.

Significantly, now that all government protections have been removed, the impact of worldwide commodity fluctuations is felt much more quickly - and directly - on individual farmers. Thus, for example, as New Zealand kiwi fruit has lost some of its share of the worldwide market, the number of such farms has diminished and property prices have decreased. Similarly, sheep farmers have been affected by the "wool mountain" presently held in Australia, despite differences in the types of wool produced in both countries.

A number of manufacturers, who had previously operated in a protected domestic environment, also went out of business or transferred some of their activities to importing, or even started manufacturing overseas (notably in Fiji or South East Asia).

Manufacturers are still convinced that they need some form of limited protection (at least in certain industries and from low wage countries); and continue to lobby the government in that regard. Against that, recently one Australian tax consultant suggested that Australian manufacturers would gain considerable advantage by relocating plants in New Zealand because labour costs are lower and productivity is higher in New Zealand. It will be interesting to see whether Australian companies act on this advice. [At least one multinational company recently built a plant in New Zealand after being convinced that the labour component would result in reasonable costs, without conflict and with high productivity. Having recently commenced operations with local customers and an eye to exporting approximately forty percent of its product, the company is apparently very satisfied with the decision to come to New Zealand.]

However, overall, with both primary and secondary producers unable to overcome the disadvantages of an high interest rates and an over-valued dollar, profits in the export/tradeable sector have dropped dramatically. At the same time, it can be anticipated that the increased competitiveness resulting from the new environment will, in the medium term, lead to increased earnings for existing industries that are internationally competitive and to the establishment of new industries (or the re-orientating of existing industries) that are competitive.

Until recently high interest rates were constraining growth in the productive sector (and, indeed, caused many business and farming failures) and imposed real pressure on most other sectors of the economy. Despite the National government's first Budget, which tackled, head-on, the hard issues of government spending, the runaway welfare state and the balancing of New Zealand's financial books, the response of financial markets was mixed. The Budget's underlying assumptions are soundly based; and (despite reactions from individuals affected by the cut-backs) the targeting of social welfare measures appears equitable and well balanced.

The government was understandably disappointed and then frustrated at the lack of interest rate movement following the Budget. However, in recent weeks there has been a break in the banks' stand on interest rates and they have declined.

Over the 1984-1987 period, and despite high interest rates, both the share market and property market entered a growth phase which was marked by rapid corporate expansion, particularly by property and investment companies, numerous mergers and acquisitions and substantial increases in the prices for commercial, industrial and residential properties. Outside of the export/tradeable sector, and away from rural and provincial areas, boom conditions prevailed.

Recession

This boom ended abruptly with the share market crash of October 1987. In the United States, the "C word" was not repeated widely; October 1987 was termed "a break in the market". In New Zealand there was less reluctance to use the word crash. Perhaps this encouraged us to wallow for too long in the recession phase. The Barclays Share Price Index fell to less than half its pre-crash high of nearly 4000; and property values fell dramatically. Substantially "overheated" before the crash, of all sharemarkets in western countries, the New Zealand market was the slowest to recover. It is still going through a very slow recovery phase almost four years after the event.

Inflation Down

By the second half of 1988, inflation had started to fall and interest rates were also tracking downward (although not as fast as many had hoped). In 1989 and 1990 inflation continued moving down slowly with several upward blips. When the newly elected government announced a special Economic Package (17 December 1990) aimed at cutting government spending in social welfare, interest rates once again began a steady move down.

Most importantly, in the second week of September 1991, the National Bank of New Zealand, which other Banks had accused of holding rates up, finally moved to lower its lending (but not its deposit) rates. This seems to have broken the back of resistance to further interest rate decreases. Several banks have since announced drops in mortgage interest rates and business lending rates. Current 90 Day Bill rates are 8.98 percent; with 5 Year Bonds at 9.03 percent. It is anticipated that these rates will continue a slow downward movement into 1992. Projections suggest that, by the first quarter of 1993 (i.e. in about fifteen months) 90 Day Bill rates will be down as low as 7.75 percent

The New Zealand dollar exchange rate (particularly against the Australian and US dollars and the Japanese Yen - the currencies in which New Zealand conducts most of its trade) has eased back to more realistic levels. From January to June 1991 the exchange rate against the US dollar was down. For some, particularly in the manufacturing sector the exchange rate is still too high and there have been some calls for government intervention.

When the National government was sworn into office in November 1990, it was faced with a predicted 1993-94 budget deficit of \$5.2 billion. However, as a result of all the decisions announced in the 17 December 1990 Economic Package and in the 1991 Budget, the 1993/94 deficit is predicted to fall to about 0.75 percent of GDP. At that level, the ratio of public debt to GDP will be declining. When National took office the debt ratio was projected to rise by ten percentage points between now and 1993/94. This, however, does not mean the government will not be

continuing to borrow. This year over \$5 billion will be borrowed to refinance maturing debt as well as to finance the \$1.7 billion deficit in this financial year. However, it is clear that there is a real commitment to controlling, reducing and then eliminating the deficit over three years. This should result in a better climate for a further lowering of interest rates.

In terms of broad economic objectives and management, the National Government has committed itself to the implementation of policies that achieve:

- expenditure reductions in health, with major structural reforms and the introduction of a system based on ability to pay for the cost of health care;
- reformation of the welfare state with cuts to the Guaranteed Retirement Income (GRI) including raising the qualification age to 65;
- a forecast Budget deficit of \$1.74 billion in 1991/92 falling to \$528 million by 1993/94; and
- restructuring the Accident Compensation scheme with wage earners paying a levy for non-work related accidents and increases in petrol and motor vehicle licenses to pay for the cost of road accidents.

Good Indicators

With the exception of unemployment, all New Zealand's major economic indicators (summarised in Table 1) now point in the right direction:

- inflation is well below that of New Zealand's major trading partners (including Australia). One analyst has predicted that inflation will be between 1.7 and 1.8 percent in 1992-1993¹.
- commercial lending rates are lower than in Australia; and should drop well below the lending rate in Britain;

the lowest rates in the world are the United States and Japan;

- the budget deficit is under control;
- the trade account is improving; and
- the enactment of major labour law reforms designed to give greater labour market flexibility and ultimately to encourage greater productivity.

The situation in the productive sector improved in 1989 and 1990. High commodity prices in some sectors meant that some dairy and wool farms were showing returns of more than ten percent.

However, fluctuations in the wool market resulting from the Australian "wool mountain", the exit of China from the market (and its recent cautious re-entry) as well as the Gulf war has meant greater volatility in commodities. The Reserve Bank forecast an increase in economic output of 1.5 percent in the year to March 1992 and 2.1 percent in the following year. Growth is forecast to come primarily from exports.

In the primary sector:

- wool exports are expected to rise by forty five percent in volume in this financial year; with the Wool Board's move to dispose of its stockpile by next March;
- dairy exports are forecast to increase by nine percent this year; and by four percent in the following year;
- meat exports are expected to rise by eight percent this year; with an increase of four percent in 1993; and
- forestry exports are predicted to increase by seventeen percent in volume this year with a further increase of 7.5 percent in 1992-93.

In 1988, manufacturing improved its competitiveness against Australia (its major market) by one third. Steady improvements followed in 1989 and 1990. In 1991 manufactured exports were forecast to increase by 5 percent with a similar rise in 1992.

The increases in exports can be contrasted with the expected drop in the volume of imports which are forecast to decrease by 2.7 percent in this financial year and expected to increase by one percent in 1992-93.

Unemployment: The One Negative Factor

Unemployment continues to be the glaring negative factor resulting from the restructuring of the New Zealand economy and, more recently, the downsizing of the Welfare State. Aside from a slight improvement in 1988, unemployment steadily rose in 1989 and 1990 and is projected to continue to rise into 1993. In the June 1991 quarter the total number of unemployed was 162,300 or 10.1 percent of the workforce. At the end of August 1991, 198,287 people were registered as unemployed representing 14.8 percent of the work force. In 1991 there were a total of 30,271 newly unemployed.

The GRI changes announced in the 1991 Budget are expected to keep older workers in employment longer and, according to the Reserve Bank, could lead to an unemployment figure of 208,900 by 1993; this is about 12.4 percent of the workforce and compares with a Treasury forecast of 12.1 percent, and other forecasts by private economists of 11.4 percent², 11.8 percent³ and 13.8 percent⁴. This trend toward retention of older workers in the workforce assumes that employers will not resist the need for people to stay in work longer.

Inflation (Consumer Price Index for year ending 31 June 1991)		2.8 percent
Interest Rates (as at 17 September 1991)		
90 day bill rate		8.98 percent
5 year bond rate		9.03 percent
Commercial lending		12.75 percent
Share Market (Barclays Index)		1378.00
Exchange Rates (as at 16 September 1991) against;		
Australian Dollar		.7363
US Dollar		.5864
Japanese Yen		.7869
Pound Sterling		..3389
German Mark		.9909
GDP Forecasts	91/92	92/93
Reserve Bank	1.5	2.1
Treasury	0.8	1.3
Westpac	(0.6)	1.5
NZIER	0.9	1.6
"Consensus"	0.65	1.625

Table 1: New Zealand Key Economic Indicators.

CER

In 1983, New Zealand and Australia signed a Closer Economic Relationship Treaty (CER), a form of free trade agreement. Under CER, trade in goods (and most services) between the two countries have been completely free since 1 July 1990; thereby giving each country a market of 19 million people. Statistics show that, with its slightly lower wage rates and lower valued currency, New Zealand has benefited greatly from CER; which is now attracting foreign investment into manufacturing, thereby giving the investor free access to the Australian market. Moreover, some Australian manufacturers have established operations in New Zealand to take advantage of the complementary aspects of CER.

Many in business and those providing services to the productive and manufacturing sector are urging that the commercial laws in New Zealand be harmonised with Australian commercial law. This is one natural extension of CER that could greatly assist New Zealand companies in their penetration of the Australian market. It could also encourage some Australian companies to relocate in New Zealand.

Recovery

For some time, the New Zealand economy has appeared to be poised for recovery. As early as September 1989 economic commentators, including the Reserve Bank, suggested that a recovery was actually underway. One report⁵ suggested that, by March 1991, investment would be rising by five percent per annum; and that "the rate of growth in domestic demand and activity [was] projected to increase through calendar 1990, and to close in conditions approaching a boom".

Those forecasts were wrong. Today, along with Treasury, the same forecasters are much more cautious predicting very slow growth in the economy over a long period. From August 1990 until October 1990 the National Bank's monthly Business Confidence Index was on a downward slide. In November and December 1990 business confidence tracked up; but began another long slide until April 1991 when confidence shot up to the present high level. However, this sense of confidence could easily be destroyed if the signs of recovery do not continue; or if the Government was seen to waver in its economic policy (which so far, to its credit, it has not done). Looking at the various surveys of business confidence for every year since 1989 the fluctuations make it clear that the business community is still feeling very fragile. Highly public political arguments in which various interest groups (and some politicians) have called for "tinkering" with the direction set by the 1991 Budget could seriously damage the new confidence in the business community that has been evident for some months.

Overseas Investment

Despite fluctuating business confidence in New Zealand, there has been local investment in the New Zealand market. But, having regard to these fluctuations, it is hardly surprising that the message about the availability of attractive investments in New Zealand was heard first by overseas investors rather than by local interests. Initially, overseas investment activity was increased by local reluctance to invest. This held prices at artificially low, and therefore attractive, levels. In just one two year period (1987-1989),

foreign companies invested more than NZ\$ 6 billion in New Zealand⁶. Overseas takeover activity has more than doubled in the past five years; and overall foreign investment in New Zealand had trebled by the end of 1989⁷. The Stock Exchange has estimated that overseas interests were responsible for thirty percent of all buying on the New Zealand market⁸.

A recent example of new overseas investment in New Zealand was the building, by Du Pont (ranked twenty second in the *Fortune* 500 Global Corporations List) of a \$70 million hydrogen peroxide plant at Morrinsville. This provides product to nearby forest product operations and will soon begin exporting a significant portion of its output. Overseas investors into New Zealand have also been attracted by:

- *political stability*, including the fact that the political power base is seen to be supportive of industry and commerce;
- *economic freedom*; New Zealand has one of the world's most open, least regulated economies and free business environments;
- *geographical position*, particularly in financial markets, where New Zealand's is the first market to open each day;
- *resources*; by international standards, New Zealand is endowed with rich resources particularly in the pastoral (agricultural), fishing, forestry, energy, horticulture, foodstuffs and tourism sectors;
- *close links with Australia* under CER;
- *business infrastructure* with good transport, communications, education, availability of labour, and good industrial relations;
- *business environment*, where business is conducted in English (the international business language) and an increasingly sophisticated financial sector;
- *a competitive taxation system*; and
- *a good living environment*.

Attitudes to Foreign Investment

New Zealand welcomes foreign investment. Politically, this attitude is shared by both the previous Labour government (now the Opposition) and the present National government. Furthermore, whereas, in some countries there has been a strong political or public reaction against such investment, particularly from Japan, that is not the case in New Zealand. Although substantial investments by non-residents require some official approval (usually by the Overseas Investment Commission), liberal rules apply in all sectors (other than those involving broadcasting, commercial fishing and rural land). There are no exchange controls; nor are there any restrictions on the repatriation of capital or profits.

Foreign Investment in New Zealand

This section does not set out the law in any detail. Individual transactions must still be considered in light of the relevant legal provisions. Furthermore, because of the wide discretion vested in the approving bodies, the practice is subject to considerable variation; all applications are dealt with on a case-by-case basis. Any person contemplating investment in New Zealand must seek and rely on specific professional advice on the issues involved.

General Policy

A statement of government policy is contained in a 1985 Department of Trade and Industry publication: *The New Zealand government welcomes foreign investment that contributes to New Zealand's social and economic well-being.*

This general statement must be read subject to the detailed comment below and also subject to more recent developments in government policy. For instance, overseas ownership of radio stations is restricted to 15 percent (increasable to 25 percent) and that of television broadcasters is restricted to 15 percent.

Overseas Investment Regulations 1985

The rules relating to business investment in New Zealand by overseas persons are found in the Overseas Investment Regulations 1985 as amended in 1989 (made under the Overseas Investment Act 1973). The regulations are administered by the Overseas Investment Commission ("OIC") whose secretariat is attached to the Reserve Bank of New Zealand.

Definition of an overseas person: Under the regulations an overseas person is defined as:

- any body corporate that is incorporated outside New Zealand; or
- any company (as defined by the New Zealand Companies Act) in which 25 percent or more of any class of share is held by an overseas person(s) (in other words a 24.9 percent investment does not require approval); or
- any person not ordinarily resident in New Zealand ("ordinarily resident" meaning either domiciled in New Zealand, or who has resided in New Zealand as his/her "usual place of residence" for the preceding twelve months).

[It should be noted that, although it can be the trigger for determining whether a corporate investor is an overseas person, the level of equity participation is only a minor factor in the actual assessment of any investment proposal.] No distinction is made between different countries of origin; these rules apply to overseas persons from whatever country.

Overseas Investment Commission: An "overseas person" wishing to invest in New Zealand need only obtain the consent of the Overseas Investment Commission for the following transactions:

- investments by overseas persons to establish a new business (other than in the specified sensitive areas) where the total expenditure to be incurred in setting up the business exceeds NZ\$ 10 million); or
- investments by way of takeover or acquisition (other than in the sensitive areas) where either the total consideration payable or the total assets of the business exceed NZ\$ 10 million; or
- investments by overseas persons, regardless of value, in any of the specified sensitive areas.

The commission applies liberal criteria; and considers factors such as whether the proposal would:

- create additional employment; or
- contribute to the balance of payments; or
- promote economic growth; or
- where a sale is involved, would enable the vendor to realise the best possible price for his/her investment.

In general terms, investment in New Zealand by overseas persons is regarded as much more acceptable than it was in

the past, and this is particularly reflected in the 1989 amendment to the regulations. The commission deals with applications on a case-by-case basis and gives priority to those applications that show some net benefit to New Zealand. Where an overseas person seeks permission to commence business in New Zealand (including the ownership of income earning real property), only one such application is required (i.e. when the business is first commenced). Approval is invariably granted and appears to be required for monitoring and statistical purposes rather than for regulation.

Purchase of Land

The procedure in relation to the purchase of land (other than where the land is owned by a company whose shares are being sold) differs somewhat from the above. Again, individual transactions must still be considered in light of the relevant legal provisions. Furthermore, because of the wide discretion vested in the approving bodies, the practice relating to approval of sales to overseas persons is subject to considerable variation; and each application for approval, particularly in respect of commercial and rural land, must be dealt with on a case-by-case basis.

The Land Settlement Promotion and Land Acquisition Act: The rules relating to investment in New Zealand land by overseas persons are found in the Overseas Investment Regulations (see above) and the Land Settlement Promotion and Land Acquisition Act 1952. The Act is administered by the Valuation Tribunal which is attached to the Department of Lands.

Residential land: Following the 1989 amendment to the Regulations, unless residential land is being sold/purchased for more than NZ\$ 10 million, OIC approval is not now required.

Farm land: Purchases of farm land by overseas persons are the most politically and emotionally sensitive (attracting particular attention from both farming and environmental lobbies); and therefore receive close scrutiny. Nonetheless, the attitude is now more relaxed than in the past.

For overseas investment purposes, farm land is either:

- all land designated as such under an operative District Scheme; or
- any land that is likely to be zoned in a District Scheme for reserve purposes; or
- any land on an island.

Purchases of farm land require the approval of both the Valuation Tribunal and the OIC.

Under the Land Settlement Promotion and Land Acquisition Act, an overseas person is somewhat differently defined, as one who is not a New Zealand citizen and who is not ordinarily resident in New Zealand (i.e. who has not resided in the country for two and one half of the preceding three years). To obtain approval for a purchase of farm land, such a person must satisfy the Tribunal that either:

- if the rural land is to be used for rural (i.e. farming) purposes by an overseas person who does not intend living in New Zealand, that New Zealand agriculture will gain a significant positive/net benefit from the activities to be undertaken; and that he/she has the finance and ability to undertake the operation; or
- if the rural land is to be used for non farming purposes (e.g. tourism), that the use is, in some way, unique; and that the benefits accruing from that use would exceed those from normal farming operations.

In special cases, where the Tribunal cannot approve the application, there is provision for joint approval by the Ministers of Finance and Lands.

Commercial land: All land that (under the above definitions) is not classified as either residential or farm land, is dealt with as commercial land. In this instance, purchases by overseas persons only require the approval of the OIC if being sold/purchased for more than NZ\$ 10 million. The commission deals with applications on a case-by-case basis and gives priority to those purchases that show some net benefit arising to New Zealand. Increasingly however, approval is also being given to passive investments (i.e. those that promise no improvement and represent nothing more than an intention to purchase the land and/or its buildings and hold same as an income earning and/or capital appreciating asset). As with farm land, the OIC now acknowledges the need for a vendor to get the best possible price for his/her investment.

Business Immigration

Under its Business Immigration Policy, New Zealand welcomes immigrants with proven business skills who intend to establish and operate business enterprises in the country. Applicants are assessed according to their potential contribution to the New Zealand economy and society. Regard is had to the applicant's business background and credit worthiness as well as the nature of the intended business venture.

In addition to the capital necessary for investment in business enterprise in New Zealand, applicants must also have a minimum of NZ\$ 200,000 to meet initial housing, living and personal establishment costs. As a general rule, a business migrant would normally be expected to have a minimum of around NZ\$ 400,000 available for transfer to New Zealand.

If the application is favourably recommended on business grounds, the applicant must then still comply with the normal immigration requirements including facility with the English language, medical and character checks; and will normally be expected to take up residence within six months of approval. Once resident in New Zealand, the applicant may apply for a Returning Visa allowing him or her to leave and re-enter New Zealand.

It should be noted that this policy is presently under review; and that some changes may result.

Approval For Overseas Investment

The current regulations regarding foreign investment establish a threshold of NZ\$ 10 million; below this level approval is not required. These rules are contained in an amendment to the Overseas Investment Regulations 1985 that was gazetted on 27 July 1989 (and took effect from 25 August 1989). Certain sensitive areas (broadcasting, commercial fishing and rural land) remain subject to tighter surveillance.

In summary, the effect of the regulations is that an "overseas person" wishing to invest in New Zealand only needs to obtain the consent of the Overseas Investment Commission for the following transactions:

- investments by overseas persons to establish a new business (other than in the specified sensitive areas) where the total expenditure to be incurred in setting up the business exceeds NZ\$ 10 million); or

- investments by way of takeover or acquisition (other than in the sensitive areas mentioned above) where either the total consideration payable or the total assets of the business exceed NZ\$ 10 million; or
- investments by overseas persons, regardless of value, in any of the specified sensitive areas.

The effect of the regulations is that, while an infrastructure is maintained to monitor significant overseas investment proposals (and all investments in the sensitive areas), less significant proposals can now proceed unimpeded.

For those investments that do require approval, this is given if the proposal shows a net benefit to New Zealand as a consequence of any one of:

- added competition;
- lower prices;
- greater efficiency;
- introduction of new technology, or managerial or technical skills;
- development of new export markets or the earning of overseas funds;
- creation of new jobs; or
- the promotion of New Zealand's economic growth. (Details of the procedures and criteria for approving foreign investment are set out below.)

These criteria (which are considerably more liberal than those that apply in many other countries, for instance Australia) can be applied to either active or passive investments.

The one area that still creates some controversy and requires scrutiny by the appropriate Minister involves the sale of farmland or offshore islands.

The Sectors that Drive the New Zealand Economy

It is useful for the overseas investor to understand the areas of major strength in the New Zealand economy; as these can differ quite significantly from other western/developed countries (thus affording an opportunity for investment in these sectors without the risks sometimes associated with third world countries).

Agriculture and Horticulture

New Zealand is one of the most efficient and successful producers and exporters of agricultural products in the world. Operating now without subsidies, it is the world's largest exporter of coarse wools (accounting for 40 percent of the world total) and lamb and mutton, and holds one quarter of the world's dairy trade. A full 66 percent of the country's GDP comes from the agricultural sector. In the year ended June 1990 the three largest agricultural exports were meat (\$2138 million), dairy (\$2066 million) and wool (\$1316 million).⁹

Because it produces a wide range of horticultural products in the northern hemisphere's "off-season", New Zealand has built important markets for many fruits and vegetables, most notably kiwifruit (half the world's production, although this share is reducing) and apples.

Internationally, of course, agricultural markets are plagued by subsidies and protection of inefficient producers, resulting in unfair barriers in many markets, including those of the European Community, Japan and even the United States. Therefore, under successive governments, much of

New Zealand's diplomacy has been directed towards resolving these issues and liberalising agricultural access. Perhaps more than any other nation, New Zealand stands to gain the most from a more liberal international agricultural trade regime; and particularly from the outcome of the GATT Uruguay Trade Round. The delays in achieving a satisfactory conclusion to the Uruguay Round have had an adverse impact on New Zealand which will be exacerbated if no settlement is finally reached.

The agricultural sector is therefore very attractive to investors; and opportunities exist for the vertical integration of local production and processing into wholesale and retail markets in other countries. Investors would be wise to seek expert advice; and to stick to mainstream farming activities such as meat, wool and dairy and avoid smaller niche markets (such as goats, deer etc.) unless their expertise in these smaller markets is considerable.

Moreover, investors contemplating this area must be prepared to "ride out" variations in return caused by the inevitable fluctuations in world commodity prices. Farming, while a rewarding investment, is not for the short-term investor. Interestingly, this characteristic fits in with the personality of many Asian investors who are well known for their patience in exploring and developing business relationships and new markets.

Also attractive is investment in infrastructure facilities such as processing plants (other than meat-killing/processing works), ports and cool stores.

Fishing

With an area of 1.2 million square nautical miles New Zealand has the fifth largest Exclusive Economic (Two Hundred Mile/Fishing) Zone in the world. With improved management techniques, the resource is now much better controlled than in the past. It has enormous potential; and offers an exciting range of products, from the internationally recognised orange roughy through squid to all forms of shellfish.

The top five export earners accounting for export receipts totalling \$409 million in 1990 were orange roughy, rock lobster, squid, hoki and snapper. Orange roughy alone brought in \$166.4 million in 1990. Recent discoveries of a large new orange roughy fishing grounds will greatly extend the quality and quantity of that resource. The most important export markets for New Zealand fish are Japan, the United States, Australia and South Korea. Other important markets with high growth expected are Hong Kong, Singapore, Taiwan, the U.K. and France.

A number of overseas interests are licensed to fish in the zone; and others operate in joint venture with New Zealand companies.

In addition to these fish exports are the newly created and expanding markets for farmed species of fish and shell fish. New Zealand has made major strides in the development of fish farming, particularly salmon. This industry has had some shaky times in the past; but in recent years has gained greater stability and (with that stability) the interest of overseas investors. In 1989 total export earnings from aquaculture was \$45.1 million. Receipts rose 21 percent in 1990 to a total of \$54.6 million. Greenshell mussels, salmon and oysters are the most important export earners in this sector.

The sector continues to be attractive to overseas investors, and again offers opportunities for vertical integration into wholesale and retail markets in other countries.

Forestry

A unique combination of soil and climate, combined with some of the most sophisticated silviculture techniques available anywhere, means that New Zealand can grow radiata pine in 30 years (or less if intended for pulp); much quicker than most other countries. With a well developed infrastructure, New Zealand forestry products are internationally competitive and a substantial export earner. It is significant that four of New Zealand's largest companies—Fletcher Challenge, Brierley Investments, Carter Holt Harvey-NZFP and Corporate Investments (through its Newmans subsidiary)—are involved in this sector. Exports of forest products in the year ended June 1989 totalled \$1235 million. Australia is the largest customer purchasing sawn timber and pulp and paper. Japan is the second biggest customer with purchases largely confined to wood pulp, logs and wood chips.

Overseas investors should particularly note the National government's policy to sell off part of the state forestry assets. This will provide access to some of the world's most efficient producers of exotic softwoods. Local forestry companies are seeking international partners to bid for these assets. New Zealand expertise in forestry could be attractive for investors wishing to penetrate new markets (such as Russia, the Baltic States and the former Eastern Block nations) in joint ventures. In addition, investors should consider investment in forest product manufacturing facilities in New Zealand. Already a few Japanese companies have invested in existing forest product manufacturing operations. And there is room for expansion into greenfields operations.

Energy

In recent years, the energy sector (along with forestry and fishing) has attracted some of the largest investment into the New Zealand economy. In the early 1980s, New Zealand was assessed as the fourth most energy rich country in the world *per capita*. The United States Department of Energy consistently ranks New Zealand among the top in energy rich countries in the world. New Zealand's geography and abundance of water allows for widespread and efficient use of hydro-electric power.

The country was a pioneer in the generation of geothermal power; and its experts have been increasingly called on to assist in the development of overseas geothermal energy resources. A study in 1977⁶ concluded that, in the foreseeable future, the country had no need for nuclear power generation.

New Zealand has a one thousand year reserve of coal; and (while not self-sufficient) also has significant oil reserves. There are three natural gas fields in production, including the large offshore Maui field.

The energy sector in general and petroleum in particular have made a significant contribution to the New Zealand economy. Caltex, Mobil, BP and Shell (along with, until recently, the local company Europa) have operated in the New Zealand petrol supply market for many years. Although oil resources were identified, particularly in the Taranaki region, more than a century ago, serious exploration did not begin until the 1960s, with the Shell-BP-Todd consortium

leading the way. Since then there has been extensive overseas involvement in New Zealand oil and gas exploration—particularly offshore (the Great South Basin etc.). By the late 1970s extensive gas and lesser oil resources had been found.

The second oil shock of 1979 brought home to New Zealand (and of course other countries) the danger of relying on oil supplies from politically vulnerable sources: in 1978 about seventy percent of our imported oil came from Iran; in 1979—nothing. Had the Saudis not moved to fill some of the production void, New Zealand would have been even harder hit.

This prompted the then National government to institute a major programme to make the country fifty percent self-sufficient in transport fuels by the mid-1980s. The measures, which involved very substantial investment, included:

- conversion of large numbers of vehicles to operate on CNG or LPG;
- building what is still the world's only commercial synthetic petroleum (gas-to-gasoline) plant; and
- expansion of the Marsden Point refinery (including a hydrocracker).

More recently (with a lower price of crude than prevailed when these projects were implemented) this programme has attracted political criticism. However, its strategic purpose - to reduce New Zealand's dependence on vulnerable imported oil supplies - has been achieved. It is interesting to note that the cynical view held by some local commentators regarding this strategy has been viewed (overseas, and particularly by other governments) as one of the few international success stories in achieving transport fuels independence.

With its extensive resources, the energy sector remains very attractive to investors. According to the Statistics Department, the Crude Petroleum and Natural Gas Industry has the highest level of profitability as measured by the Annual Enterprise Survey. The survey found that profitability for the industry reached 21.1 percent for the 1988-89 period. (The survey measures profitability as the ratio of net profit to total sales and other income. In previous years the industry had profitability figures at 30.9 percent (1986-87) and 26.1 percent (1987-88). Key Statistics August 1991, Department of Statistics, GPO at p. 98).

Exploration rights continue to be granted.

The previous Labour government sold Petrocorp (to the New Zealand company Fletcher Challenge).

Manufacturing

As indicated, in the mid- and late-1980s the New Zealand manufacturing sector suffered considerably from high interest rates and an over-valued dollar. Those who survived this period are now much more efficient and internationally competitive. Unfortunately, those who continue to "sing the blues" are the ones we all too often hear about. There are many who are hard at work and re-tooling for the competitive domestic and local market.

A number of New Zealand companies have established niche export markets in particular products (for example specialised electronics). Such companies represent the best avenue for investment in this sector, along with those manufacturers that have a dominant position in the local market and/or those who are taking advantage of preferential access to Australia under CER.

One of the most successful New Zealand manufacturing companies, that is taking full advantage of the CER environment, is the whiteware manufacturer, Fisher and Paykel. Once a manufacturer or assembler of a wide range of household appliances and electronics, F&P has moved to concentrate its manufacturing activities only on those areas (basically whiteware) in which it can be truly competitive on the international stage; and imports those products that it cannot competitively manufacture. It has recently spent \$84 million on new plants in Queensland, Australia and in East Tamaki in Auckland. F&P has also launched a major whiteware marketing initiative; and plans to service the entire spectrum of the whiteware market by penetrating the budget price sector with the reintroduction of its own *Whiteway* brand, and servicing the mid-level and top-of-the-line sectors with imported German *Blanco* products. F&P is entering the global whiteware market with a good measure of "guts and gusto". It is companies such as this that will be attractive for investors.

New Zealand products, with at least fifty percent local content, have tariff-free entry into Australia under CER. As a result, overseas (i.e. non-Australian/NZ) investors are now considering the opportunities offered by manufacturing in New Zealand and exporting to Australia.

New Zealand is even more attractive for such investors following the enactment of the Employment Contracts Act and the resulting creation of a much more flexible labour environment. For some products this is more competitive than the alternatives of exporting direct to Australia from a third country and/or manufacturing in Australia itself.

Tourism

With its magnificent and diverse scenery New Zealand has much to gain from tourism which, overall, is the fastest-growing industry in the world. About half a million tourists visit each year; of which just under fifty percent come from Australia. Visitors from Japan, North America and the UK (and increasingly Germany and Scandinavia) are also visiting in increasing numbers. The opening of new air routes (the latest being links to Bangkok and Taipei) and competition in air fares has done much to encourage new visitors to the South Pacific. The industry is heavily reliant on Australia (from which it is seeking to diversify). Despite the recession in Australia and the recent financial scandals in Japan, tourist numbers from these countries have increased.

Another new area for investment is the staging of major musicals in Auckland following the completion of the Aotea Centre. *Les Miserables* attracted more than 32,000 visitors to Auckland spending an estimated \$5.8 million excluding the cost of the tickets¹¹. It is likely that the success of this venture will lead to the staging of further "musical extravaganzas".

Overall projected annual growth in tourism is 10 percent. However, tourism costs are still too high. This has been driven by two major factors:

- labour costs; although the new Employment Contracts Act will enable more realistic overheads in this area.
- capital costs; because of the high capital cost of tourism properties. This problem will remain until tourism property values fall back to more realistic levels. This sector is yet to face up to the sort of "shake-out" in property values that occurred in the rural sector in the mid-1980s.

The Tourism industry is in need of considerable further investment; and overseas investors - particularly those already associated with the industry - have been active in recent times, particularly in Christchurch. Japanese investors have purchased the Wairakei golf course which is being upgraded to international standards. In addition, a major Japanese investor in developing an international golf resort near Arrowtown. A recent big investment in tourism came from a group of Hawaiian investors in a joint venture with the Maori Development Corporation. This type of investment is particularly important as the Hawaiian partners are not only brought important funding into the deal but also the knowledge of the highly sophisticated Hawaiian tourism industry.

Share Market

The New Zealand share market is very small by world standards; and has taken much longer than others to recover from the October 1987 crash. Trading volumes are low; which particularly affects the attractiveness and viability of smaller stocks (no matter how good their earnings). Therefore, smaller local companies, even those with good earnings prospects, do not attract overseas investors.

However, those larger New Zealand companies that do attract international attention are well regarded and include: *Brierley Investments, Carter Holt Harvey, Corporate Investments, Countrywide Bank, FERNZ, Fisher and Paykel, Fletcher Challenge, Goodman Fielder Wattie, INL, Lion Nathan, Mair Astley, Magnum, PDL, Sandfords, Wilson and Horton*. Most of these companies are involved in multi-national business and some of their stocks are traded on overseas exchanges. Some (but certainly not all) reported good results for the financial year ending 31 March 1991, with profit recovery from the previous year. International fund managers have been gradually increasing their exposure to such investments. For the larger or institutional investor, opportunities also exist for direct placements into New Zealand listed (and even unlisted) companies that are seeking further capital.

Privatisation of State Owned Enterprises

The privatisation of State-owned assets offers potentially very rewarding area for investors. The previous Labour government sold all of the Crown interests in the Tourist Hotel Corporation, Air NZ, NZ Steel, Development Finance Corporation, NZ Shipping Corporation, Health Computing Systems, Postbank, Petrocorp, Communicate NZ, Travel Offices of the Tourist and Publicity Department, National Film Unit, Government Printing Office and Telecom; and partially sold its interests in the Bank of New Zealand and some non-core Railways assets and forestry assets.

The present Government has made it clear that it will continue this privatisation process. However, recognising the criticism of both the pace and management of these sales under the previous Government, the process is likely to be more managed and deliberate than in the past. Unlike its predecessor (which included sale proceeds as part of its Budget estimates) the Government refuses to be tied down to a narrow fiscal timetable. Furthermore, unlike its predecessor, the present Government has declined to speculate publicly on the expected net outcome of these sales.

In its 1991 Budget, the Government foreshadowed three other sales:

- the Housing Corporation's prime mortgage portfolio;
- the Crown's interests in on-shore Taranaki Petroleum Mining Licences; and
- New Zealand Timberlands Limited, in addition to the previously announced proposed sale of Supplycorp.

The proceeds of these sales will be applied only to the retirement of Government overseas debt (whereas the previous Government used these moneys for budgetary purposes). Therefore, the domestic borrowing programme will be unaffected by the level and timing of asset sales. Other assets that could also be privatised include: Electricorp (it is possible that Transpower, ECNZ's distribution subsidiary, will be separated from its parent), Coalcorp, the government's shares in the three international airport companies NZ Post and parts of Landcorp. All these represent very attractive investments, either for those who already operate in these areas or (for smaller investors) in the public float of privatised companies - as was the case with Air New Zealand and Telecom.

The New Zealand Property Market

As in most other countries, the property market is cyclical in character. In New Zealand, all three major sectors of that market - commercial, residential and residential - are currently at the bottom of such a cycle. This is attracting the attention of some overseas investors, particularly those interested in counter-cyclical investment.

Commercial

The recession has led to a flight to quality property investments. CBD investments in Auckland and Wellington (and, to a lesser degree, Christchurch) have held to their values much more than fringe properties. Quite apart from the shortcomings of their location, non-CBD properties and those of lesser quality tend to be smaller buildings, often reliant for their income on single major tenants who, in turn, tend to be more vulnerable to economic downturn. At the height of the property boom, in the mid 1980s, yields on CBD commercial properties fell to as low as 5 percent, but normally (depending on precise location) ranged from 6.5 to 7.5 percent.

The downturn in the property market, and particularly the lack of activity by the major institutional investors (who have traditionally been strong players in this market) has had several effects which are briefly discussed below.

Despite the downturn, according a recent survey by a leading property consultant, demand for office space has "continued at a significant level". The same survey concluded that investors who have good quality buildings coming on stream at the right time should have a good investment.

A number of properties that might otherwise have been sold have been removed from the market, the vendors being under no pressure to sell and being unwilling to accept a lower price.

Some properties have been sold at lower prices and consequently higher yields, particularly where the vendor has been under some pressure.

Local financiers will usually not allow a developer to commence construction of a new office building until there is a sixty to seventy percent precommitment of tenancies - sufficient to provide debt coverage. [This contrasts with

some other markets, notably the United States, where many buildings start with no precommitments and do not achieve a positive cash flow until Year Two or Three.]

Therefore most of the commercial buildings presently under construction in the Auckland and Wellington CBD's should, when completed, be occupied at least on a break-even basis. This will, however, impose pressure on older and less attractive buildings that will lose occupants to the new buildings and may not be able to attract replacement tenants.

Recently a small number of CBD office building developments have been undertaken, financed from the developers own resources or from general rather than specific lines of credit, and without any precommitments as to tenancies. Despite their quality and location, some of these properties have proved very hard to lease. One newly completed building, so far largely untenanted, recently sold to a speculative investor for NZ\$ 22 million, a loss of at least NZ\$ 5.6 million.

Overall, sales of CBD office buildings have shown a lengthening of yields by between 0.5 and 1.75 percent (averaging about 0.75 for quality Queen Street Auckland properties and higher for fringe CBD); with the precise level of charge depending on some or all of the above circumstances. Average yields are now about 7 percent (or slightly higher) for Queen Street and 8 to 8.5 percent for fringe CBD.

Beyond these considerations, some excellent individual bargains can be obtained. For instance, recently an older CBD office building was sold at a mortgagees sale to the only bidder for just NZ\$ 1.75 million, which (even with two floors untenanted and previously occupied by the now defunct owning company) showed a yield of fourteen percent!

In New Zealand, office tenancies tend to be for longer periods (sometimes as long as twelve to fifteen years), with regular rent reviews and rights of renewal. Items such as rates (property taxes) and Land Tax are usually paid by lessees/tenants.

The down-turn in demand for office space has been the most marked in Auckland, with new space vacancies at around 5.33 percent and total space vacancies of around 10.2 percent (reported as at April 1989). It is anticipated that this market will be in oversupply for at least another twelve to twenty four months which (other than for purely speculative investments, which must be priced accordingly) reinforces the importance of acquiring well located buildings with good tenants and long term tenancies. Recently, agents have reported "a definite lift in commercial leasing activity"; and that "new buildings are now filling quite rapidly" although at the expense of older buildings.

Moreover, since early April 1989, there has been a reported upswing of interest in Auckland commercial property, partly fuelled by a Taiwanese buying "spree", particularly in the fringe CBD areas. So far this does not appear to have led to a significant raising of prices and/or a shortening of yields; although there have been reports of owners refusing low offers that, six months earlier, might have been accepted. It should also be noted that there may still be a significant "gap" between a vendor's asking price on the one hand and the price at which they are prepared to sell on the other. Prospective buyers should be ready to bargain!

In Wellington, while there is some projected oversupply, the market is maintained by the large number of government

departments, state owned enterprises and corporate head offices. New space vacancies, at around 4.88 percent and total space vacancies of around 9.16 percent, are lower than in Auckland (again, reported as at April 1989). As a result, rental rates tend to be higher, with slightly lower yields than in Auckland.

With a much smaller population than in the major North Island centres, Christchurch has a correspondingly lesser degree of CBD property activity. While there are some good investments, they do not compare favourably (particularly as to potential for capital growth) with those that are currently available in Auckland and Wellington. However, there has been recent Japanese interest in hotel and motel properties; probably because, with direct airlinks to Australia and the United States (and, in the near future, also Japan), the city is the "gateway" to major scenic and skiing destinations in the South Island.

Industrial

With the decline in manufacturing, and the consequent reduction in the number of available tenants and the uncertain financial strength of those remaining, industrial properties have shown a decline in value and a lengthening of yields. There is a shortage of well located properties with good tenants, which presently show a yield of around 10 to 10.5 percent; but for others (many being untenanted or not fully occupied, but also including properties of only average quality that are fully tenanted) the figure is much higher - with a reported (June 1989) median of 11.7 percent. At present, with few exceptions (again, well located properties with good tenants, or keenly priced speculative investments), industrial properties do not represent a good investment. However, this situation could change. One large realtor has reported that, with little speculative building since mid-1988, there is a shortage of quality buildings, particularly in the NZ\$ 200,000 to NZ\$ 2 million range.

Residential

In the mid 1980s there were dramatic increases in the values of well placed residential properties, particularly in Auckland's Eastern suburbs. These values have slumped badly in the last eighteen months along with overall market activity. For buyers who are in a position to make cash/unconditional offers, very real bargains can be secured. However, in the past few months there have been reports of a gradual revival in this market; but it is still too early to say whether this will be confirmed by statistics. At the same time, despite the recession, the house building market has remained reasonably active, particularly at the lower end.

It is anticipated that, if the America's Cup is sailed in Auckland, waterfront properties (and those on Auckland's North Shore and Hibiscus Coast, adjacent to the sailing area) will again increase in value.

Rural

As indicated earlier, farm properties, having undergone dramatic reductions in value, and reflecting good commodity prices, can now show returns of in excess of ten percent, or even higher, without any subsidies or tariff support. However, investors contemplating this area should probably aim for a more realistic and modest yield (between ten and fifteen percent) and must be prepared to "ride out" variations in return caused by the inevitable fluctuations in world

commodity prices. Farming, while a rewarding investment, is not for the short term investor.

Investors would be wise to seek expert advice; and to stick to mainstream sectors such as meat, wool and dairy (fringe activities including everything from goats to nashi pears can be profitable in the short term but are risky investments).

[The 1 July 1989 increase in the GST rate from 10 to 12.5 percent will have an effect on inflation over the next twelve months (and specifically on the mid-1988 quarterly increases in the Consumer Price Index). However, even so, inflation is not expected to rise much above 6.5 percent (on a one-off basis) and should then revert to its downward trend, with the Reserve Bank still predicting a rate of between zero and two percent by the early 1990s.]

Taxation

The following taxation rates have applied in New Zealand since 1 April 1989:

Personal

Income up to NZ\$ 30,875	24 percent
above NZ\$ 30,875	33 percent

Corporate

Resident Companies	33 percent
Non Resident Companies	38 percent

These rates are lower than in Australia. It is not difficult to obtain registration as a resident company. Non-resident withholding tax on interest was removed in the 1991 Budget; this should attract more overseas investment. From 1 April 1988, a dividend imputation scheme has operated, thus preventing the double taxation of company profits.

Indirect Taxes

With the exception of special taxes imposed on tobacco, liquor, petroleum products and motor vehicles, the only general sales tax is GST, which is imposed on all goods and services at the consistent rate of 12.5 percent. Only financial services are excluded from GST; and that is only for technical reasons; export goods, although subject to the tax, are zero

rated. In effect, by a series of refunds (Table 2), GST is only finally paid by the end-user of the goods or services. A registered taxpayer can claim refunds on all other GST payments.

There is no Capital Gains Tax. Such a tax was specifically opposed by the National Party when it was in opposition.

Political Climate

The National Government has given a very clear commitment to a non-regulated economy with decreased government spending. Despite this, and despite the responsible fiscal stance of its first Budget (which should help to maintain New Zealand's credit rating), that Budget did not meet with widespread approval according to the national pollsters. This was largely for two reasons:

- attention focused on moves to decrease social welfare spending with protests from those affected by the changes (and their political supporters); rather than on the need for a responsible fiscal stance. The government has remained firm in its commitment to the Budget.
- financial markets had anticipated the Budget's fiscal stance (which had been well proclaimed by the Government); and had reacted by lowering interest rates before the Budget. Therefore, the Budget did not itself result in an immediate further lowering of rates; although this has started to occur in the ensuing months.

Summary of Present Market Position

Overall, the present position of the various New Zealand markets can be summarised in the following terms. *Agriculture* is New Zealand's great strength; with more realistic values than in the past, it represents a very good long-term investment both directly and in the supporting infrastructure. *Fishing* is another important niche sector that also offers good returns. New Zealand's *forestry industry* is among the most efficient in the world; the sale of more of the government's forestry assets offers excellent investment opportunities - possibly in partnership with local forestry companies. On a population basis, New Zealand is *energy* rich. Exploration opportunities abound; and the projected sale of Coalcorp (once the Tainui land claim is settled) and (in the longer term the *possible* sale of Electricorp, is an excellent chance to buy into a major resource. Selected *manufacturing* opportunities exist, but only in go-ahead companies with a very strong domestic position and/or niche export markets and/or those that take advantage of the freer access to Australia under CER. *Tourism*, which requires substantial further investment, has considerable potential and is attracting overseas investors; although property values need to fall to make such investment really attractive. The *property* market is at the bottom of a downturn. The *share* market has recently been under priced, both as to NTA and PE ratios. Because of small trading volumes, secondary stocks should be avoided even if they have attractive earnings. Major stocks in companies with international earnings and/or which are traded on world sharemarkets can be good long-term investments. Opportunities exist for placements by larger or institutional investors.

With the exception of the property market, which is included because of the attraction to counter-cyclical investors, it is significant that, because of New Zealand's size, every one of these areas for investment is either:

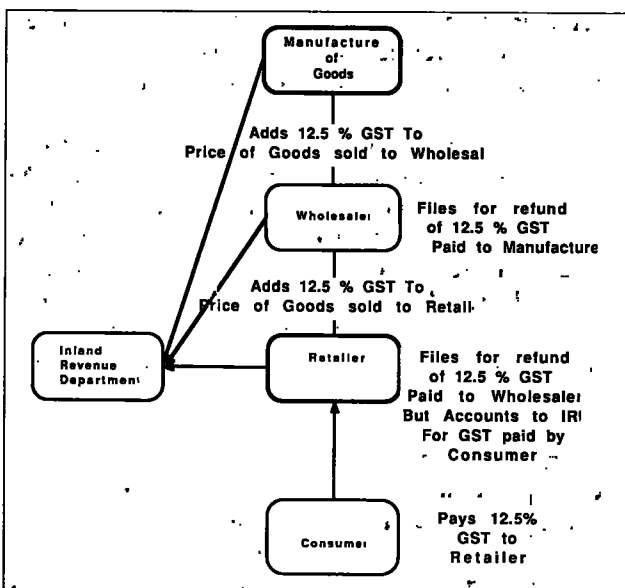


Table 2: New Zealand Goods and Services Tax (VAT type) flow chart.

- export-driven (e.g. agriculture);
- one that produces added-value export products based on New Zealand primary products (e.g. the public manufacturing companies listed as sound stocks for investment);
- an earner of overseas funds (e.g. tourism);
- has substantial overseas operations (e.g. the listed companies) and/or,
- by import substitution, is a saver of overseas funds (e.g. energy).

The fact that these investments do not depend on a small local market for their long-term viability provides a substantial measure of comfort for overseas investors.

Future Direction

The New Zealand economy is poised for a gradual economic recovery. The immediate future direction of the economy will depend on:

- the inflationary (probably negative) and trade and investment (probably positive) implications of any downward movement of the New Zealand dollar;
- the willingness of the Government and Reserve Bank to maintain tight monetary policy;
- the ability of the Government to continue to reduce its expenditure; and to deliver on its promises regarding the budget deficit/surplus;
- the extent to which consumption grows over the next twelve months;
- continued, and rising, business confidence; and
- international events, including the recession in Australia (New Zealand's largest market).

Assuming that the government delivers on its promised "fiscal responsibility", it is reasonable to assume that:

- recovery from the recession should be export led
- the Reserve Bank should be able to accommodate interest rate declines provided they do not produce more than a slow decline in the value of the New Zealand dollar
- there is still some downside potential in the value of the NZ dollar
- unemployment will continue to rise
- export earnings should increase moderately over the next two years
- repayments of overseas debt will help to contribute to a reduction in New Zealand's country risk premium.

Overseas Advisors Bullish on NZ

This interest has been compounded by recent favourable reports by overseas (mostly Australian) investment advisors regarding the New Zealand economy and its current suitability for investment.

For instance, improving economic fundamentals recently prompted Merrill Lynch (USA) to describe the New Zealand bond market as "one of the most attractive for United States institutions"¹². With the exception of Canada, New Zealand was described as having the best fundamentals of a number of countries including Australia and Britain. And, in the same article, Salomon Brothers described the New Zealand sharemarket as being "very strong" and said that they expected it to "go up".

A major firm of Sydney (Australia) brokers¹³ reported on the recent bullish run on the New Zealand stock market which it attributed to:

- the policy stance outlined in the 1991 Budget Statement;
- increasing reports of a recovery in the economy; and
- a perception that, in relative terms, the NZ market was undervalued not having yet recovered from the October 1987.

A June 1989 report¹⁴ by another Sydney firm concluded that New Zealand is "slowly emerging from a deep recession" ("the worst" they said "is over"); that "(t)here is a significant "window of opportunity" to invest in New Zealand now" (their emphasis); and that this window could close "given continuing improvement of economic fundamentals". That report said that, despite restructuring, New Zealand, which, in its own right, is a small market, remained primarily an agricultural exporter; this sector and natural resources were the country's "natural advantage". Noting that the market has most probably seen the worst of the corporate collapses which marked 1987 and 1988, the report recommended that certain basic investment principles should be observed, including recognition of short-term risk and adoption of a long-term investment horizon.

Similarly, a paper by Mr. D. Chan (Managing Director of Fidelity International in Taiwan)¹⁵ identified a number of reasons why overseas interests should consider investment in New Zealand. Overall, Chan predicted that "as the economic performance of New Zealand improves there will be a substantial increase in foreign investment"; and concluded that it "provide(s) some perfect investment opportunities for foreigners". His final comment: "I genuinely believe that New Zealand is one of the best places in the world to invest in if one takes a long-term view".

Earlier this year¹⁶ the then Prime Minister, David Lange, said that, unlike some other countries, New Zealand welcomed Japanese investment¹⁷; similar but more general statements are contained in official publications outlining government policy on foreign investment.

A factor that could attract certain foreign investors is the government's business immigration policy.

The interest of overseas brokers in the local market has already been noted—and it is understandable. In the twelve weeks from 16 June to 8 September 1989, the Barclays Share Index rose by 23.3 percent (from 1929.24 to 2378.45); the rise in the first 21 days of August alone was "a massive 400 points or 20.1 percent"¹⁸. One reputable broker has forecast a "healthy" eleven percent growth in earnings per share in 1989-90; another expects the New Zealand equities market "to post a solid twenty percent rise over the next twelve months, underpinned by a continued recovery in economic activity and a more stable economic sector"¹⁹. The New Zealand sharemarket was recently described as "the hottest in the world for most of August"²⁰. [Overseas investors, particularly from the United States, should not be concerned at the relatively low quotes—even for quality stocks (often only a few dollars per share). This is a feature of both Australian and New Zealand stocks where investors prefer to deal in lower valued units.]

Recent Events

Some recent events of significance to the New Zealand economy are outlined below. Since the Government's annual Budget Statement delivered in late August, interest rates have eased. The present projection is for rates to continue to fall gradually. The economy is projected to grow slowly.

With the strengthening of the US dollar, in mid-year the New Zealand dollar dropped to its lowest levels for nearly three years. Since then, the dollar has settled at a level of around 58 to 59 cents to the US dollar (trading last week at around 58.9). This will have a further positive effect on overseas trade (making New Zealand products more competitive internationally) and investment (making local prices even more attractive to overseas investors); but could have a slightly negative effect on inflation (by increasing the price of imports).

New Zealand's trade account has moved into surplus; although there is still a deficit on movements of cash, reflecting debt service and other payments.

Quality, well tenanted CBD commercial properties in Auckland and Wellington can be purchased at lower prices and higher yields than in the past; and represent good a buy to those attracted to counter-cyclical investment. Industrial properties should be generally avoided. Residential property offers some excellent bargains to cash buyers; and suitable Auckland waterside properties should increase in value, at least over the period of any America's Cup Regatta. Farming property investment should only be undertaken with expert advice.

The extent to which the government can contain inflationary wage demands, particularly resulting from the recent increase in GST from 10 to 12.5 percent. [As indicated, both the government and the Reserve Bank have set an inflation target of between zero and two percent by the early 1990s, suggesting the likelihood of a continued tight money supply.]

Depreciation in the NZ dollar since June 1988 (particularly over the past month), and the increase in GST (which will be a one-off effect), will result in a temporary increase in inflation in 1989. However, inflation is then expected to continue its downward trend in 1990-91. With inflation in the four to five percent range, and possible moves by the Government moves to discourage wage increases, a further reduction in inflationary expectations can be expected.

One prominent analyst's "most likely scenario" suggests rates of 11.5 percent by the March 1990 quarter; the Government decision, announced in the July Budget Statement, to utilise moneys from the sale of State assets to retire domestic (rather than foreign) debt - and therefore not to borrow on the domestic market for that purpose - has already had a positive effect and could take that figure even lower. Firming of monetary policy is expected with the recent passing of the Reserve Bank Act.

Growth will be around three percent in 1989-90²¹. With growth in the economy, the Government's accounts are projected to move into a real surplus in the 1990-91 financial year.

In addition, present low prices, moderate non-inflationary growth in 1989 and future prospects (including activity directly related to the America's Cup) should attract international investors.

One can do no better than adopt the views of those who have described New Zealand as "one of the best places in the world to invest in if one takes a long-term view"; and those who have concluded that "(t)here is a significant "window of opportunity" to invest in New Zealand now".

Conclusion

New Zealand offers to the selective investor an excellent opportunity to invest in a stable, democratic country with a western culture and values and which is part of the world's fastest growing economic region, the Pacific Basin. In short, the opportunities are there to be taken.

Please note: The material in this paper is not intended to provide formal advice nor should it be used as the basis of any investment decision. It is intended only as background information. While every care has been taken in the preparation of the contents, no responsibility can be accepted for any errors. Any person contemplating investment or other action in the areas dealt with in this document must conduct his, her or its own inquiries and/or due diligence.

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