NEW ZEALAND

Recent strong economic growth is projected to moderate to less than 3% in 2018. Both net migration and expenditure on the Canterbury earthquake rebuild are expected to slow gradually, slowing domestic demand, especially construction activity. The latest earthquake will entail rebuilding investment, but this is not included in the projection because it is too early to judge the economic effects. Growth will continue to be driven by tourism, with dairy price increases providing a further boost to incomes through the terms of trade. Inflation is likely to rise but remain below the mid-point of the official 1-3% target range.

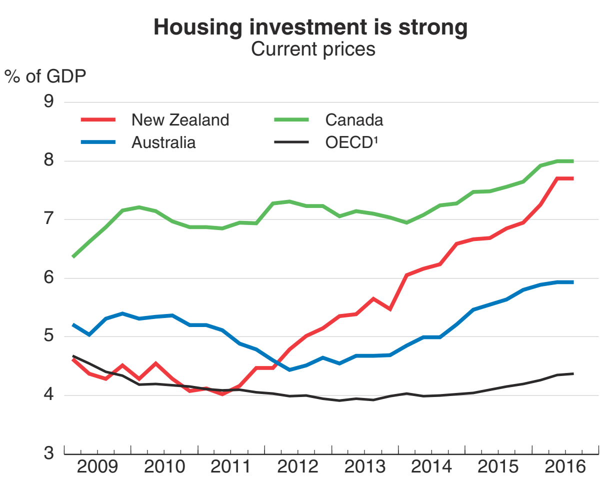
The Reserve Bank has tightened loan-to-value restrictions in order to limit financial stability risks from the high levels of household debt associated with rapid house price increases. These increases have been fuelled by low interest rates, as the Bank has attempted to lift persistently below-target inflation. The fiscal stance is currently neutral to mildly contractionary.

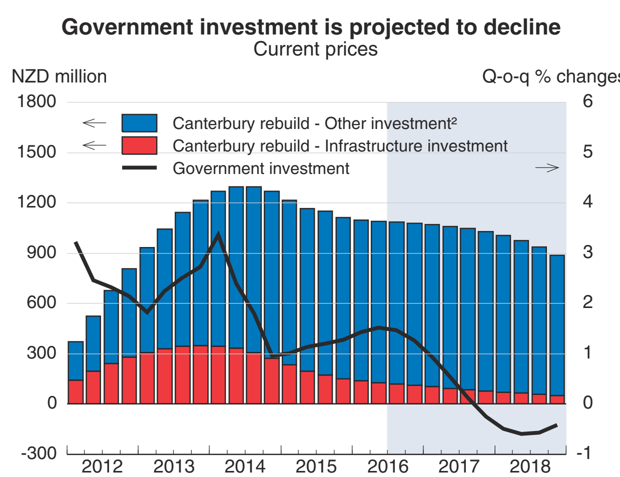
The government has substantial fiscal space, but immediate fiscal stimulus would risk overheating the economy. To the extent that the resources used in the Canterbury earthquake rebuild are freed up in the course of 2017 and beyond, the government should fund infrastructure and increase funding to meet the challenges posed by inequalities and exclusion.

Economic growth remains robust

Economic growth has been buoyed by high net immigration, rapid growth in housing construction and a flourishing tourism sector. Rapid employment growth has pushed the unemployment rate down to near 5%. While wage pressures remain contained in general, median wage growth is strong in construction, finance, health care and public administration. Consumer prices were up only 0.2% in the year to September. Most

New Zealand





1. Unweighted average of available countries.
2. Other investment includes residential and commercial investment.
Source: OECD Economic Outlook 100 database; Reserve Bank of New Zealand (2016), Bulletin, Vol. 79, No. 3, February.

StatLink http://dx.doi.org/10.1787/888933437843

New Zealand: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices NZD billion	Percentage changes, volume (2009/2010 prices)				
GDP at market prices	226.7	3.0	3.0	3.5	3.4	2.6
Private consumption	132.6	2.7	2.3	3.6	3.4	2.8
Government consumption	43.0	2.7	2.0	1.9	2.0	1.8
Gross fixed capital formation	47.3	10.9	3.0	6.4	6.3	3.7
Final domestic demand	222.8	4.4	2.4	3.9	3.9	2.9
Stockbuilding[1]	1.7	0.1	-0.4	-0.3	0.0	0.0
Total domestic demand	224.6	4.4	2.0	3.6	3.8	2.9
Exports of goods and services	64.8	3.1	6.8	3.8	3.5	2.8
Imports of goods and services	62.6	7.9	3.6	3.5	5.1	3.8
Net exports[1]	2.2	-1.3	1.0	0.1	-0.4	-0.3
Memorandum items						
GDP deflator	_	2.0	0.2	1.9	2.0	2.0
Consumer price index	_	1.2	0.3	0.5	1.0	1.5
Core consumer price index[2]	_	1.4	1.1	1.3	1.2	1.5
Private consumption deflator	_	1.1	1.1	1.1	1.1	1.1
Unemployment rate	_	5.4	5.4	5.0	4.5	4.4
Household saving ratio, net[3]	_	-0.7	-1.1	-0.2	0.4	0.6
General government financial balance[4]	_	-0.1	-0.3	-0.2	0.1	0.9
General government gross debt[4]	_	40.9	41.0	39.9	39.5	38.4
Current account balance[4]	_	-3.2	-3.3	-2.8	-2.9	-2.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. As a percentage of disposable income.
4. As a percentage of GDP.

Source: OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933439144

measures of underlying inflation are at, or just above, the bottom end of the Reserve Bank's inflation target range.

Expansionary monetary policy is exacerbating housing market pressures

The official interest rate is at a record low, and interest rates have encouraged borrowing to buy houses. House prices and household debt have risen to very high levels, raising economic and financial stability risks. The Reserve Bank has attempted to limit financial stability risks by tightening loan-to-value restrictions. Additional macro-prudential measures, such as debt-to-income restrictions, may be required if rapid price increases persist. In addition to initiatives underway to address restrictive land-use rules, notably the Auckland Unitary Plan, more social housing and/or higher targeted housing subsidies are needed to attenuate the effects of high housing costs on low-income households.

The effects of such stimulative monetary policy suggest that rebalancing should be considered, although tighter monetary policy and looser fiscal policy would risk an unwanted exchange rate appreciation. The government has substantial fiscal space: net general government debt is currently 5% of GDP and projected to fall further, and the deficit is near zero. The fiscal policy stance is neutral to mildly contractionary in 2016-17, which is appropriate to forestall overheating. Although subject to future changes in spending in response to the November 2016 Kaikoura earthquake, the fiscal stance is set to become more contractionary as government investment declines through 2017. This is despite considerable scope to improve infrastructure. Government planning should begin now to establish a pipeline of good quality projects, including to promote productivity-enhancing urban densification and to service the rapidly expanding housing stock. As such investment would occur when the Canterbury rebuild is winding down, such spending would support growth and the construction industry would be better placed to meet this demand than at present. Spending should also be increased on measures to reduce poverty rates amongst welfare beneficiaries with children, Maori and Pasifika. Such spending should be on measures to enhance education and health outcomes, and to activate welfare beneficiaries.

Economic growth is projected to moderate

Growth is projected to moderate by 2018, as net migration falls from an annual rate of 70 000 to 28 000 and construction activity eases. Export growth is expected to slow but will continue to be driven by strong tourism demand from Asia and increases in dairy exports. Recent dairy price increases have raised pay-outs above the breakeven rate for the median dairy farm and are expected to drive a recovery in herd sizes following declines in 2015.

High house prices and associated levels of household debt are the biggest downside risks, as private consumption and housing investment would suffer if house prices fell. The economic effects of the Kaikoura earthquake are still unclear, but are likely to include some short-term curtailment of activity coupled with medium-term fiscal stimulus from reconstruction work. External risks centre on China, directly through demand for agricultural exports and indirectly through Chinese demand for exports from New Zealand's key trading partners. There are upside risks if dairy price increases continue or if net immigration does not decline to the assumed extent.