NEW ZEALAND

Economic growth is projected to ease to around 3% in 2017-18. A strong recovery in business investment, ongoing strength in tourism and the recent increase in dairy prices should support growth. Net immigration is assumed to fall, slowing both household consumption and, together with the wind-down in the Canterbury earthquake rebuild, construction expenditure, despite a planned boost to government infrastructure spending. Inflation is projected to rise sustainably to around the mid-point of the official 1-3% target range.

The Reserve Bank has tightened loan-to-value restrictions to limit financial stability risks from high household debt and increasing house prices. A debt-to-income limit should be added to the Bank's macro-prudential instruments with attention to benefits exceeding costs. The Bank should begin to increase the policy rate from late-2018. The fiscal stance underlying these projections is mildly contractionary - the cyclically-adjusted budget balance is projected to rise by 0.6 percentage point of GDP between 2016 and 2018. Since the projections were finalised, the 2017 budget has been delivered. The fiscal stance is now neutral, which is appropriate.

New Zealand's flexible labour market facilitates adjustment to globalisation. Such adjustment would be enhanced and costs to workers reduced by strengthening the education and training system to help people acquire skills in demand. To reduce costs to displaced workers, the government should consider introducing unemployment insurance and expanding training and job-search assistance.

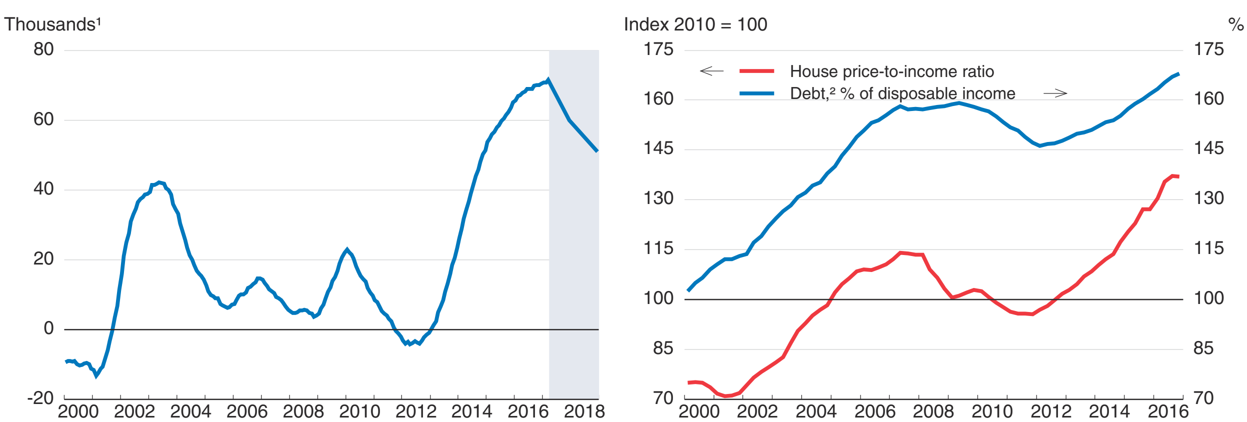
Economic growth remains solid

Robust economic growth has been buoyed by a rise in net immigration to record levels and large housing wealth gains, boosting private consumption and construction, and

New Zealand

Net immigration is strong

House prices and household debt are high



1. Cumulative data for the past 12 months. Statistics New Zealand projections.
2. Including debt on rental properties.

Source: Statistics New Zealand, National population projections, 2016 (base)-2068; Reserve Bank of New Zealand, Statistics on Households; and OECD Analytical House Price database.

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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	227.7	2.8	3.1	3.9	3.1	3.1
Private consumption	132.8	3.1	2.9	4.3	4.1	3.3
Government consumption	42.8	3.3	2.6	2.3	2.7	1.9
Gross fixed capital formation	48.1	8.4	2.1	5.6	5.9	4.9
Final domestic demand	223.7	4.3	2.6	4.2	4.3	3.4
Stockbuilding[1]	1.8	0.0	-0.5	0.6	0.2	-0.1
Total domestic demand	225.6	4.2	2.2	4.7	4.5	3.3
Exports of goods and services	64.8	3.1	6.8	1.6	0.7	3.6
Imports of goods and services	62.6	7.9	3.6	4.2	6.1	4.5
Net exports[1]	2.2	-1.3	1.0	-0.7	-1.4	-0.2
Memorandum items						
GDP deflator	_	2.3	0.2	1.6	2.7	2.1
Consumer price index	_	1.2	0.3	0.6	2.4	1.8
Core consumer price index[2]	_	1.4	1.1	1.3	1.7	1.8
Private consumption deflator	_	1.1	1.1	1.1	1.1	1.1
Unemployment rate	_	5.4	5.4	5.1	4.7	4.5
Household saving ratio, net[3]	_	-1.5	-2.2	-0.7	-0.6	-0.6
General government financial balance[4]	_	0.3	0.0	0.0	0.3	0.8
General government gross debt[4]	_	40.7	40.8	39.7	39.1	38.2
Current account balance[4]	_	-3.2	-3.3	-2.7	-3.4	-3.4

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 101 database.

StatLink http://dx.doi.org/10.1787/888933506018

surging tourism. Activity temporarily slowed in late 2016 owing to adverse weather conditions that depressed dairy production. Rapid employment gains have lowered the unemployment rate to around 5%, but wage pressures have remained subdued. Capacity constraints are tightening, and labour is becoming more difficult to find. Inflation is therefore edging up.

Expansionary monetary policy is exacerbating housing market pressures

Expansionary monetary policy has pushed down mortgage interest rates, boosting housing demand and household debt. Moreover, housing supply has not kept pace with demographic expansion, despite housing construction rising to a record 7% of GDP. Increases in infrastructure investment and changes to urban planning in Auckland should facilitate greater supply, while an expected decline in annual net immigration from 70 000 to 51 000 in 2018, mainly owing to improvement in the labour market in Australia relative to New Zealand and to some recent immigrants on temporary visas leaving, should slow demand growth. Following tightening in loan-to-value limits, a rise in mortgage rates and expectations of further increases, house price increases have moderated. If housing credit and house price increases do not continue to slow, debt-to-income restrictions should be introduced with attention to benefits exceeding costs. The policy interest rate, which is at a record low, is projected to begin to rise in late-2018 to stabilise annual inflation at around 2%.

Fiscal policy settings assumed for these projections are mildly contractionary. The cyclically-adjusted budget balance is projected to rise by 0.6 percentage point of GDP between 2016 and 2018. Since the projections were finalised, the 2017 budget has been delivered. Updating for the budget would eliminate the increase in the structural budget balance, leaving a modest cyclical increase in the budget balance to a small surplus. The government is aiming to reduce net core Crown debt as a share of GDP from 24% in 2016-17 to 10-15% by 2025 to help cope with future periodic global shocks and natural disasters. Nevertheless, it should be possible to finance some high-priority tax reductions or expenditure increases without compromising its fiscal strategy.

Economic growth should moderate

Growth is projected to ease to around 3% in 2017-18, as lower net immigration and smaller house prices increases curtail growth in both consumption and residential construction, and the wind-down in the Canterbury earthquake rebuild curbs growth in construction. Even so, growth will remain solid, supported by a sharp recovery in business investment to ease capacity constraints, ongoing strength in tourism and the recent boost to incomes from higher global dairy prices. The unemployment rate is projected to edge down to 4½ per cent by late 2018 and wage growth to rise moderately. Consumer price inflation is projected to rise to almost 2% by end-2018.

The biggest downside risk to these projections is a disorderly housing market correction. House prices and household debt are high, and most mortgages have interest rates that are floating or fixed for less than two years. Shocks that reduce households' ability to service their mortgages could cause a sharp property price decline, depressing household consumption and housing investment, and raise financial stability concerns. Growing protectionism abroad or a sharp slowdown in China are also potential downside risks. The main upside risks are that net immigration does not drop as much as assumed, sustaining robust growth in consumption and construction, and that dairy price rises continue, strengthening exports and disposable incomes.