Executive summary

Even before the latest severe earthquake in Christchurch, the expected gradual economic recovery in New Zealand was being held back by efforts by the private sector to reduce debt as well as a persistently strong currency. Active monetary stimulus and a significant fiscal expansion resulting from decisions taken prior to the global downturn supported the economy through the recession, as has buoyancy in Australia and Asia and large terms-of-trade gains. Households, businesses and farmers are attempting to repair over-extended balance sheets in the aftermath of a property boom. The balance sheets of the non-financial private sector deteriorated markedly as the increase in property prices and perceived wealth prompted additional household spending. The associated widening in the current account deficit was largely financed by bank-intermediated foreign credit, adding to already high external debt. Weak business investment and low national saving have for some time contributed to poor growth performance. Achieving faster growth will require progress across a broad policy front. This includes bolder fiscal consolidation in the form of spending restraint, coupled with tax and pension reforms to boost national saving. These measures would allow interest rates to stay low for longer and create room for the exchange rate to ease, thereby facilitating the needed rebalancing of the economy, boosting output of tradable goods and services.

Favourable tax treatment of housing and inefficient regulatory constraints on supply should be removed. These distortions exaggerated the surge in house prices, giving rise to wider wealth inequalities and a heavy dependence of households' long-term financial positions on volatile property values. The shallowness of capital markets that results from low national saving also contributes to the attractiveness of housing as a savings vehicle relative to financial assets. Despite the slump in housing demand, property prices remain at high levels relative to rents and average incomes, keeping affordability low for less affluent households and intensifying pressures on the social housing sector. While the government has made progress in addressing some tax distortions and inefficiencies in social housing delivery, policy priorities should include further tax reforms to level the playing field for saving and investment decisions, while improving the efficiency of land-use policies and the overall urban planning system.

Regaining regulatory best practice and improving management of the government's considerable asset holdings could help boost productivity growth. OECD indicators suggest that New Zealand's long-standing front-runner status in product market regulation has been eroded away over the past decade or so. Regulatory quality has deteriorated somewhat, and government ownership of economic assets has increased, in contrast to OECD-wide trends. Consequently, New Zealand is falling further behind in its ambition to catch up with OECD living standards, in particular Australia's, by 2025. Encouragingly, the government has taken action to strengthen the regulatory management system, and a Regulatory Responsibility Bill designed to improve accountability and transparency is before Parliament. In addition, the government is considering, if re-elected, to partially privatise some key SOEs. Further steps should seek to fortify the regulatory governance framework in order to improve the overall investment environment. Continuing to enhance co-operation and regulatory harmonisation with Australian counterparts where appropriate would also reduce impediments to trade and competition.

Green growth would help to consolidate New Zealand's long-run growth potential. As an exporter of resource-based goods and services, notably dairy products and tourism, its "brand" relies on the environmental integrity of its output and policies. To this end, the country has begun to put in place one of the world's first and most comprehensive emissions trading schemes to fulfil its Kyoto obligations. However, mitigation possibilities are limited by the high share of hydro in its power generation and of agriculture in its overall GHG emissions. The carbon-price signal will need to be bolstered in order to encourage the greater uptake and discovery of clean technologies, although moves in this direction should be conditioned on progress towards a comprehensive international agreement. Market-based instruments to give natural assets a value should be used more broadly, notably to allocate water efficiently.

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