NEW ZEALAND

Economic growth continues to be strong, boosted by post-earthquake rebuilding, recovery from a drought and enormous terms of trade gains. Economic slack is being taken up, but so far inflation pressures have remained muted, thanks to renewed currency strength and moderate wage increases. But with growth projected to stay robust, such pressures are beginning to become manifest.

If export prices remain favourable and global demand picks up as projected, the Reserve Bank will have to continue to increase its policy rate to prevent overheating. Fiscal consolidation should continue as planned, eliminating the budget deficit in 2014 and putting public debt on a firm downward path before longer-term ageing pressures take hold.

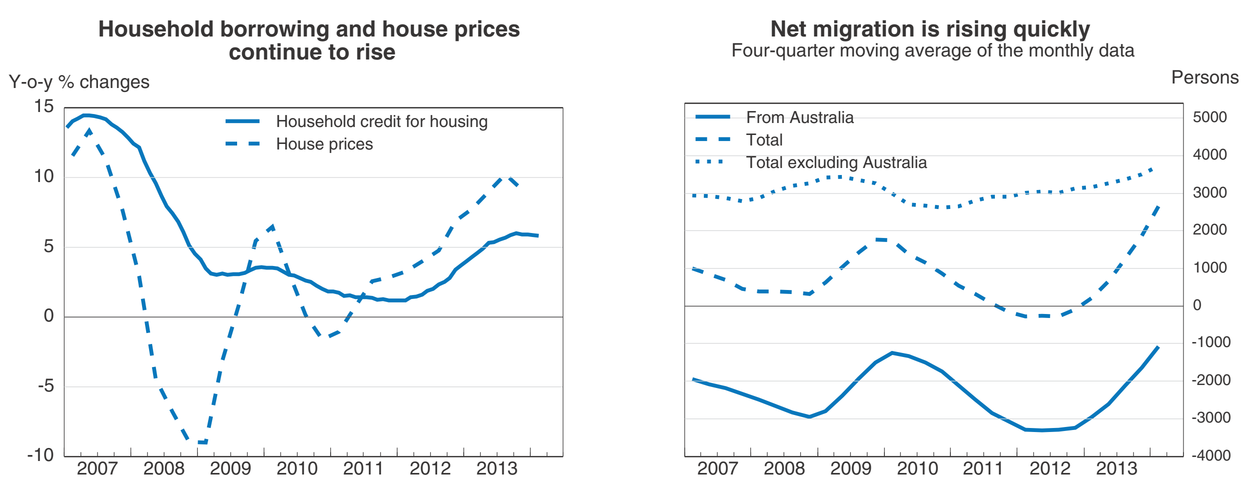
Output is growing rapidly

The economy is benefiting from post-earthquake reconstruction and a surge in immigration, both of which are supporting investment. Agriculture is a strong point, as production and export volumes have recovered from last year's drought, and the terms of trade have reached a 40-year high, spreading income gains to the household sector. Along with considerable capital appreciation in housing and ample job growth, consumers have the wherewithal to spend freely despite already high debt levels. Unemployment is still falling and wage and price inflation, while still modest, have begun to move up. Demand is being constrained by ongoing fiscal contraction and by the recent rise in official interest rates and expectations of further increases to come, which are putting upward pressure on the currency.

Monetary tightening should continue

As output continues to grow robustly, policy rates will need to rise further to head off overheating. The projections assume a peak rate of 4.5% by early 2015, although the actual path of rates will of course depend on economic developments. Last October's implementation of

New Zealand



Source: Reserve Bank of New Zealand; and Statistics New Zealand.

StatLink http://dx.doi.org/10.1787/888933049648

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

	2010	2011	2012	2013	2014	2015
	Current prices NZD billion	Percentage changes, volume (1995/1996 prices)				
GDP at market prices	197.3	1.2	2.9	2.5	3.5	3.3
Private consumption	115.0	2.5	2.9	3.4	3.7	3.4
Government consumption	39.5	0.9	-1.0	0.8	1.0	0.7
Gross fixed capital formation	36.7	4.8	7.2	9.5	9.6	7.3
Final domestic demand	191.2	2.6	2.9	4.1	4.4	3.8
Stockbuilding[1]	1.3	0.0	0.1	-0.1	-0.2	0.0
Total domestic demand	192.6	2.6	3.0	3.9	4.4	3.8
Exports of goods and services	60.0	2.5	2.2	1.0	3.3	3.6
Imports of goods and services	55.3	6.9	2.6	6.3	6.9	5.4
Net exports[1]	4.7	-1.2	-0.1	-1.5	-1.0	-0.4
Memorandum items						
GDP deflator	_	3.0	-0.6	2.6	3.6	1.2
Consumer price index	_	4.0	1.1	1.1	1.7	2.3
Core consumer price index[2]	_	2.7	1.0	1.2	1.8	2.3
Private consumption deflator	_	2.8	0.5	0.5	1.3	1.6
Unemployment rate	_	6.5	6.9	6.2	5.9	5.6
Household saving ratio, net[3]	_	0.4	-0.7	-0.2	0.2	-0.2
General government financial balance[4]	_	-4.4	-2.1	-0.3	0.1	0.7
General government gross debt[5]	_	41.3	42.4	40.6	39.3	38.1
Current account balance[4]	_	-2.9	-4.1	-3.3	-2.7	-3.7

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.
5. As a percentage of GDP at market value.

Source: OECD Economic Outlook 95 database.

StatLink http://dx.doi.org/10.1787/888933051320

macro-prudential limits on banks' mortgage loans has been surprisingly successful in limiting such lending.

Fiscal consolidation is on track

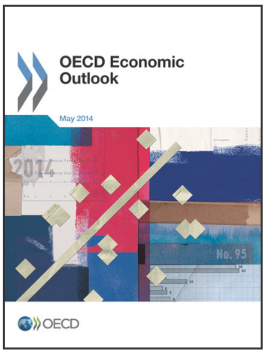
The general government deficit is projected to move into a small surplus this year, thanks to revenue surprises from strong activity. This will be enough to begin to reduce public debt. This counter-cyclical policy is appropriate given the projected business cycle developments and to strengthen sustainability to face the costs of population ageing. The government intends to proceed mainly by expenditure restraint, structural reforms to reduce welfare dependency and excise tax increases.

A number of factors will drive strong but easing growth

Real GDP is projected to advance at a brisk, if slowing, pace as the effects of immigration, rebuilding and terms-of-trade only gradually wear off, and as monetary tightening begins to bite. Domestic demand will be underpinned by healthy business conditions and heightened confidence from wealth gains and steadily declining unemployment. Although external demand is projected to strengthen progressively, the strong currency will remain a drag on export performance.

Risks are broadly balanced

The increasing momentum of demand could prove stronger than projected. On the other hand, high house prices, relative to incomes and rents, and household indebtedness pose risks to financial stability in the event of a negative shock. A deterioration in the global outlook, especially in China, would weaken export volumes and prices, slowing growth.



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