NEW ZEALAND

The economy is set to expand at only a modest pace with headwinds from weak external demand, a strong currency, high household indebtedness and fiscal consolidation. Post-earthquake rebuilding will provide the main impetus over the coming two years through buoyant investment activity.

The persistence of a heavy net foreign debt burden in an environment of considerable external risks underscores the need for proceeding with fiscal consolidation plans and for implementing structural reforms to raise national saving and improve long-term growth prospects. With the weak projected expansion, monetary policy should remain supportive through 2013.

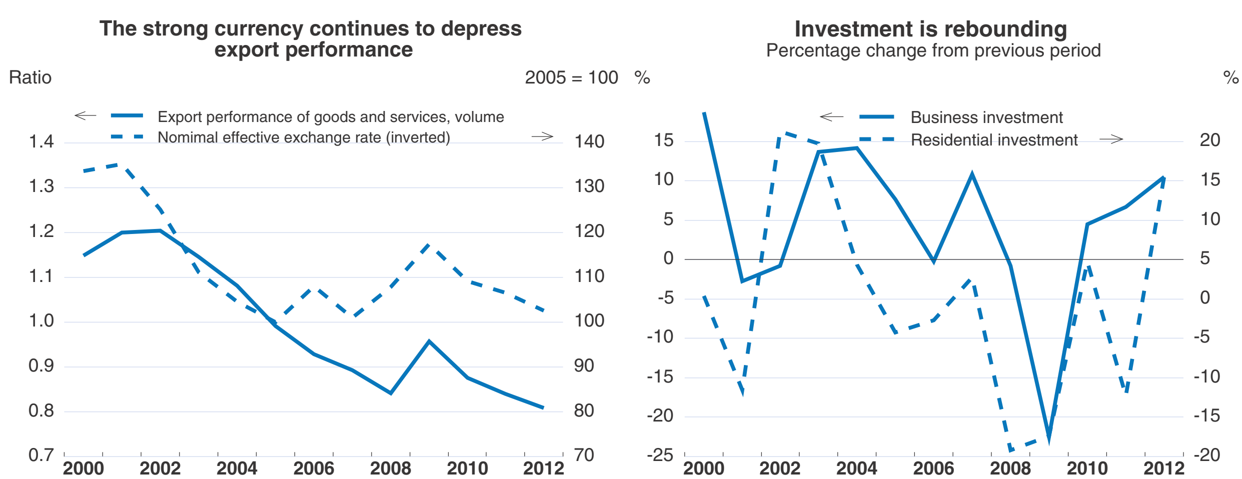
The recovery is patchy

Real GDP growth slowed in 2012 as weak foreign demand and persistent strength in the exchange rate depressed exports. Business confidence has slid, and unemployment has risen. Sluggish real household income growth and high debt loads have pared consumer spending. Currency appreciation and falling world commodity prices have pushed headline and underlying inflation below 1%. Meanwhile, low interest rates have supported business investment and allowed households to deleverage through faster mortgage repayments. Reconstruction from the 2010-11 earthquakes is beginning to gather momentum, and the housing market has shown signs of firming. Credit growth has also risen in the agriculture sector, benefiting from the recent rebound in dairy prices.

Substantial fiscal consolidation will weigh on growth

The planned sizeable fiscal contraction to balance the budget by FY2014-15 will imply cumulative tightening of about 6% of GDP since 2011. This is to be achieved mainly via spending restraint, based on reforms to improve public-sector efficiency and measures to reduce long-term welfare dependency. The partial privatisation of five large state-owned

New Zealand



Source: OECD Economic Outlook 92 database.

StatLink http://dx.doi.org/10.1787/888932743729

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

	2009	2010	2011	2012	2013	2014
	Current prices NZD billion	Percentage changes, volume (1995/1996 prices)				
GDP at market prices	184.9	0.9	0.5	1.6	2.4	2.9
Private consumption	110.1	2.3	1.4	1.5	2.1	2.5
Government consumption	38.1	0.5	0.5	0.2	-0.3	-0.5
Gross fixed capital formation	36.0	2.2	1.6	4.9	7.8	7.4
Final domestic demand	184.2	1.9	1.3	1.9	2.7	2.9
Stockbuilding[1]	- 2.0	0.6	0.5	0.1	-0.3	0.0
Total domestic demand	182.2	2.6	1.8	2.0	2.4	2.9
Exports of goods and services	53.8	3.7	2.7	0.8	4.2	6.2
Imports of goods and services	51.1	11.0	6.7	2.3	4.1	6.1
Net exports[1]	2.7	-2.0	-1.1	-0.4	0.0	0.0
Memorandum items						
GDP deflator	_	4.0	3.1	1.7	2.0	1.9
Consumer price index	_	2.3	4.0	1.1	1.6	2.4
Core consumer price index[2]	_	1.9	2.7	1.1	1.4	2.3
Private consumption deflator	_	1.7	3.4	1.1	1.4	2.1
Unemployment rate	_	6.5	6.5	6.9	6.6	6.0
Household saving ratio[3]	_	0.3	2.3	2.9	3.4	3.2
General government financial balance[4]	_	-3.8	-7.9	-4.3	-3.6	-2.1
General government gross debt[4]	_	39.6	48.3	51.3	54.3	55.6
Current account balance[4]	_	-3.2	-4.1	-5.5	-5.9	-5.9

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 92 database.

StatLink http://dx.doi.org/10.1787/888932745116

enterprises will free up capital to fund public infrastructure and reduce gross public debt.

Monetary policy is supportive

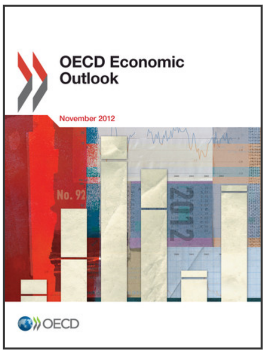
The Reserve Bank has maintained an accommodative stance, keeping its policy rate on hold at 2.5% since early-2011. Under the renewed Policy Targets Agreement, the Bank will take more account of asset prices and financial stability in conducting monetary policy and aim to keep inflation close to the 2% midpoint of the target range. As earthquake rebuilding accelerates, however, supply constraints and skills shortages are likely to boost wage and price pressures, especially in the construction sector. The Bank will need to monitor these developments closely and, as slack is taken up, begin removing monetary stimulus in 2014.

Earthquake rebuilding will drive growth dynamics

Real GDP growth is projected to pick up and exceed potential rates over 2013-14, steadily diminishing economic slack. Growth will be powered by buoyant post-earthquake private investment and strengthening household consumption as balance sheets recover and employment conditions improve. Exports will be curbed by soft global growth prospects over the next year, albeit with some firming in 2014. Price pressures are expected to edge up and peak in late-2013 before inflation returns towards the 2% objective over the course of 2014 as monetary stimulus is withdrawn.

Downside risks loom large

In addition to risks arising from the external environment, the impact of earthquake rebuilding on the economy is uncertain. A faster pickup in reconstruction activity may boost inflation more than projected and force the Reserve Bank to raise interest rates earlier. Such a scenario could squeeze heavily indebted households and increase upward pressures on the already strong currency.



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