NEW ZEALAND

Growth has slowed thus far in 2010, mainly as high indebtedness and economic uncertainty weigh on households and firms. The major earthquake last September has exacerbated near-term weakness, though providing a boost to activity as reconstruction gathers pace. The recovery will become self-sustaining as businesses hire and invest to meet reviving export and consumer demand.

Monetary and fiscal policies are providing ongoing stimulus and would best continue to do so until around mid-2011. Recent tax reforms will help to reinforce the structural shift, induced by balance-sheet deleveraging, from consumption toward savings and non-residential investment.

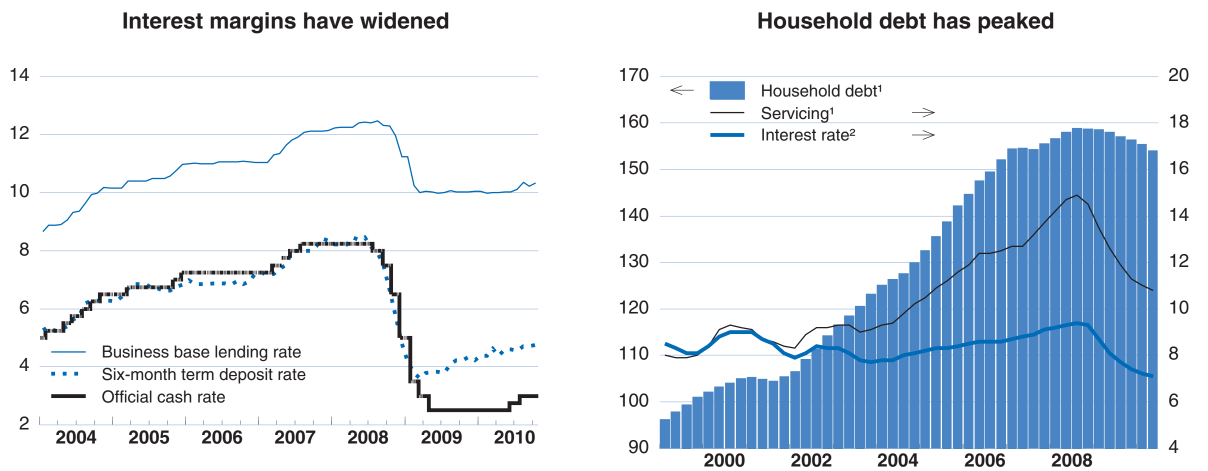
The recovery remains fragile…

The recovery appeared to stall in first half of 2010, mainly as sluggish private consumption resulted from still high debt and unemployment (most recently at 6.4%) and softening housing markets. Against this, business investment began to recover from extremely low levels in late 2009, though business sentiment subsequently worsened. Housing investment surged after muted growth following a long period of decline, but consents are falling. Exports have been a mainstay, notwithstanding competitiveness losses, thanks to robust demand in New Zealand's two main export markets, Australia and China. However, much of this demand has been met from inventory drawdown rather than increased output. The current account has improved, with stronger external than domestic demand and terms-of-trade gains from high dairy prices and currency appreciation.

… reflecting balance-sheet adjustment

A process of financial consolidation is underway in the aftermath of the global crisis. Households have curtailed their appetite for mortgage debt because of declining house prices and less favourable tax treatment

New Zealand



1. As a percentage of disposable income.
2. Weighted average interest rate on total household debt.

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

StatLink http://dx.doi.org/10.1787/888932345964

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

	2007	2008	2009	2010	2011	2012
	Current prices NZD billion	Percentage changes, volume (1995/1996 prices)				
Private consumption	104.6	-0.4	-0.6	1.7	2.0	2.2
Government consumption	33.1	5.0	1.4	2.9	0.6	0.5
Gross fixed capital formation	41.4	-3.5	-12.0	4.1	11.6	7.0
Final domestic demand	179.0	-0.1	-2.7	2.4	3.6	2.9
Stockbuilding[1]	0.0	0.0	-0.6	0.2	0.2	0.0
Total domestic demand	180.0	0.4	-5.1	2.9	3.6	2.9
Exports of goods and services	49.8	-1.1	0.4	3.4	4.0	6.0
Imports of goods and services	51.9	2.3	-14.8	7.2	7.7	7.4
Net exports[1]	- 2.1	-1.0	5.0	-1.0	-0.9	-0.3
GDP at market prices	178.0	-0.5	-0.4	2.2	2.7	2.5
GDP deflator	_	3.6	1.6	3.0	4.3	2.1
Memorandum items						
GDP (production)	_	-0.2	-1.7	1.7	2.6	2.5
Consumer price index	_	4.0	2.1	2.4	4.3	2.3
Core consumer price index[2]	_	2.0	2.2	2.0	3.8	2.3
Private consumption deflator	_	3.6	2.5	2.0	3.9	1.8
Unemployment rate	_	4.2	6.2	6.5	5.9	5.3
General government financial balance[3]	_	0.4	-3.7	-5.3	-4.5	-3.4
Current account balance[3]	_	-8.8	-2.9	-3.2	-5.3	-6.0

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/sources-and-methods).*

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. Consumer price index excluding food and energy.
3. As a percentage of GDP.

Source: OECD Economic Outlook 88 database.

StatLink http://dx.doi.org/10.1787/888932347712

of investment property. Farmers are paying down debt rather than increasing spending, as both they and their bank lenders are being cautious. Business borrowing is falling at a 7% annual rate. The cost of credit has declined much less than policy rates because of increased risk aversion and tighter bank wholesale funding regulations, while deposit rates have actually risen somewhat, contributing to a growing wedge between policy and retail rates.

The earthquake will have important effects

In September, a devastating earthquake struck Christchurch, the second largest city. The damage to homes, business capacity (mainly buildings) and local infrastructure (water and sewage systems) is estimated at around 2% of GDP. This disrupted economic activity in the third quarter but will subsequently boost activity as reconstruction gets underway. The destruction of capital stock and pressure on resources from rebuilding could add to near-term inflation, however. Businesses may face higher insurance premiums, and the public insurer of households (the Earthquake Commission) will need to be recapitalised once it sells assets in order to cover present losses.

Monetary tightening has been postponed…

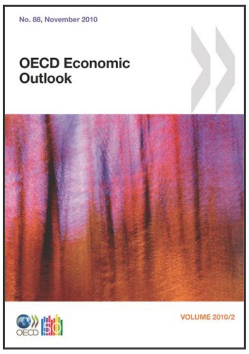
After raising its policy rate by 25 basis points in both June and July, the Reserve Bank decided to pause at its September and October reviews, citing weaker economic data and increased uncertainty associated with global developments. Inflation has remained around or below the mid-point of the Bank's 1-3% target range but will spike in late 2010 due to policy measures, notably an increase of the Goods and Services Tax rate from 12.5 to 15%. A concurrent reduction in personal income tax rates should boost disposable incomes and thereby restrain any wage response, as will the still soft labour market. In accordance with its mandate, the Bank has said it will "look through" temporary inflation increases arising from one-off tax increases and natural disasters. The projections embody a resumption of policy tightening only in mid-2011.

… as has fiscal consolidation

According to the May 2010 Budget, fiscal policy will remain expansionary in 2010, turn roughly neutral in 2011, and then tighten by some 1.5% of GDP in 2012. This consolidation will take place through expenditure restraint. The "operating allowance" on new discretionary current spending is set at NZD 1.1 billion per year over the medium term (in effect, growing only 60% as fast as GDP), though taking into account excluded benefit, pension and finance costs, the cumulative spending increase is roughly twice as great. The projection assumes the government's fiscal plans are implemented and reduce the deficit to 3.4% of GDP in 2012, below its 2009 level. Reconstruction of earthquake-damaged public infrastructure will apparently now cost less than the initially estimated NZD 1 billion, and thus should be mostly covered within existing budgets.

The growth outlook is subdued

Although policy stimulus is about to be withdrawn, reconstruction should provide support to GDP over the next year or so. Private consumption should also be boosted by the rugby World Cup in 2011 though decelerating thereafter, even as job creation and optimism return, with ongoing deleveraging. Business confidence seems to be turning the corner, and investment should bounce back as diminishing slack in the labour market increases the cost of further substitution of capital by labour. Export growth should benefit from a waning of adverse exchange-rate appreciation effects while market growth moderates. A risk may stem from possible wage demands following the temporary spike in inflation, which would oblige the Bank to tighten more rapidly.



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