New Zealand has recently enjoyed strong economic growth, but housing and population ageing pose challenges

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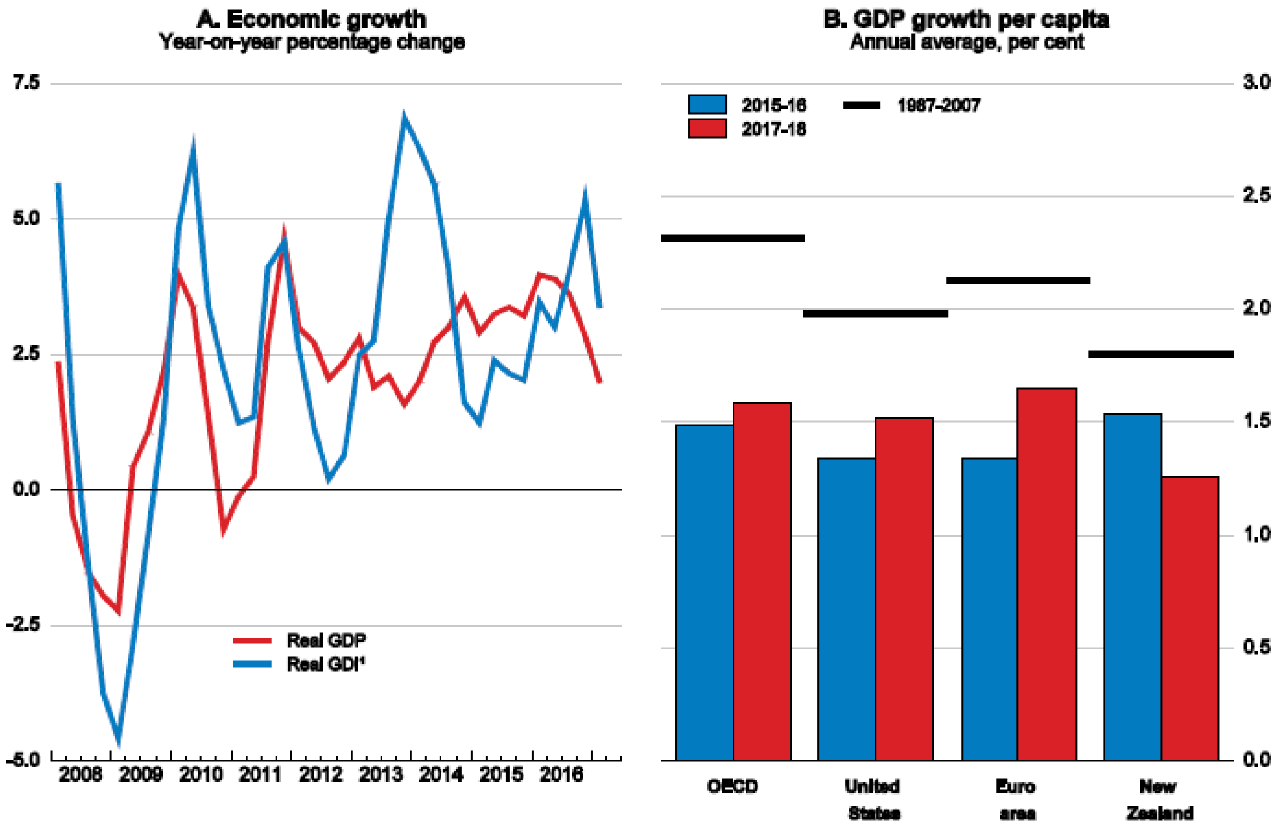
New Zealand enjoyed strong economic growth during 2016, driven by high net inward migration, solid construction activity, booming tourism and supportive monetary policy, although in per capita terms growth has been more in line with that in other advanced economies. The terms of trade have rebounded to near record levels, boosting income growth. Growth eased somewhat during the last quarter of 2016 and the first quarter of 2017, in part due to temporary factors including the impact of unfavourable weather conditions on agricultural output and disruption from the November 2016 Kaikōura earthquake. The OECD projects that growth will return to around 3% in 2017-18, supported by export growth from strong tourism demand and increases in dairy exports. However, slower net immigration is likely to curtail both consumption and residential construction, and the wind-down in the Canterbury earthquake rebuild will curb construction expenditure, more than offsetting the boost from the Kaikōura rebuild and the recently announced increases in infrastructure spending. The unemployment rate is expected to edge down to 4 ½ per cent by the end of 2018 and wage growth to rise moderately. Consumer price inflation should rise sustainably to 2% by the end of 2018, as the effects of oil price falls pass and capacity constraints bite.

While appropriate on the basis of the Reserve Bank of New

Zealand’s inflation projections, current monetary policy settings have the downside of fuelling increases in house prices and household debt. As discussed in the accompanying housing blog, both have reached high levels by historical standards and in comparison with most other countries. Further progress is needed to reduce housing supply restrictions, and macro-prudential policy may need to be tightened further, notably by the implementation of debt-to-income limits to reduce financial stability risks.

The government’s prudent approach to fiscal policy puts New Zealand in good stead to cope with future global shocks and natural disasters. Like other countries, New Zealand also faces large spending pressures from public pensions and health-care costs in the longer term. To this end, the government has announced its intention to increase the age of eligibility for the public pension by six months each year from 2037, reaching 67 by 2040. Budget savings would be larger and inter-generational equity greater if this increase were to be brought forward, the transition period lengthened and the pension age subsequently indexed to life expectancy. The planned focus on increasing public-sector productivity should help to contain long-term increases in health-care outlays.

Economic growth has been strong, less so in per capita terms



1. Real GDI equals real GDP adjusted for changes in the terms of trade.

Source: Statistics New Zealand and OECD, Economic Outlook 101 database.

References

OECD (2017), OECD Economic Surveys: New Zealand, OECD Publishing, Paris.