New Zealand: Towards a strong and sustainable recovery

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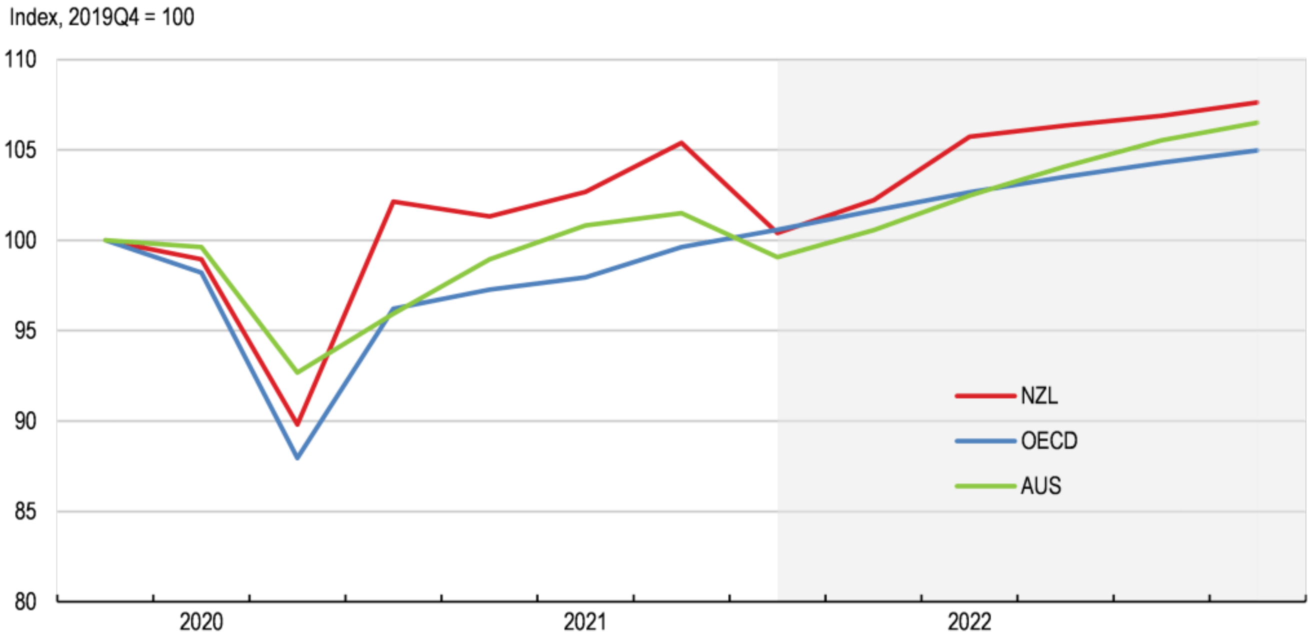
The economy bounced back quickly from the drop caused by COVID-19 in the first half of 2020 thanks to effective virus containment, measures to protect jobs and incomes and highly expansionary macroeconomic policies (Figure 1). Confronted with the highly contagious Delta variant in late 2021 and with high vaccination rates, the government shifted from an elimination strategy, which involved stringent lockdowns and large economic costs, to minimisation and protection. Under the new strategy, virus containment measures are much less strict than before, especially for people with vaccination certificates. The government has also announced plans for re-opening the border in early 2022, although these have been put on hold owing to the spread of the Omicron variant.

Figure 1. The economy is rebounding rapidly

Real GDP



Source: OECD Economic Outlook: Statistics and Projections

(database).
However, macroeconomic stimulus has been so powerful in relation to the already vibrant state of the economy following the bounce back that the economy is now overheating. The labour market is tighter than ever and inflation has soared to 6%.

The OECD Economic Survey 2022 discusses four main priorities for making economic growth strong and socially and environmentally sustainable:

1. Restore price stability and put public finances on a more sustainable path

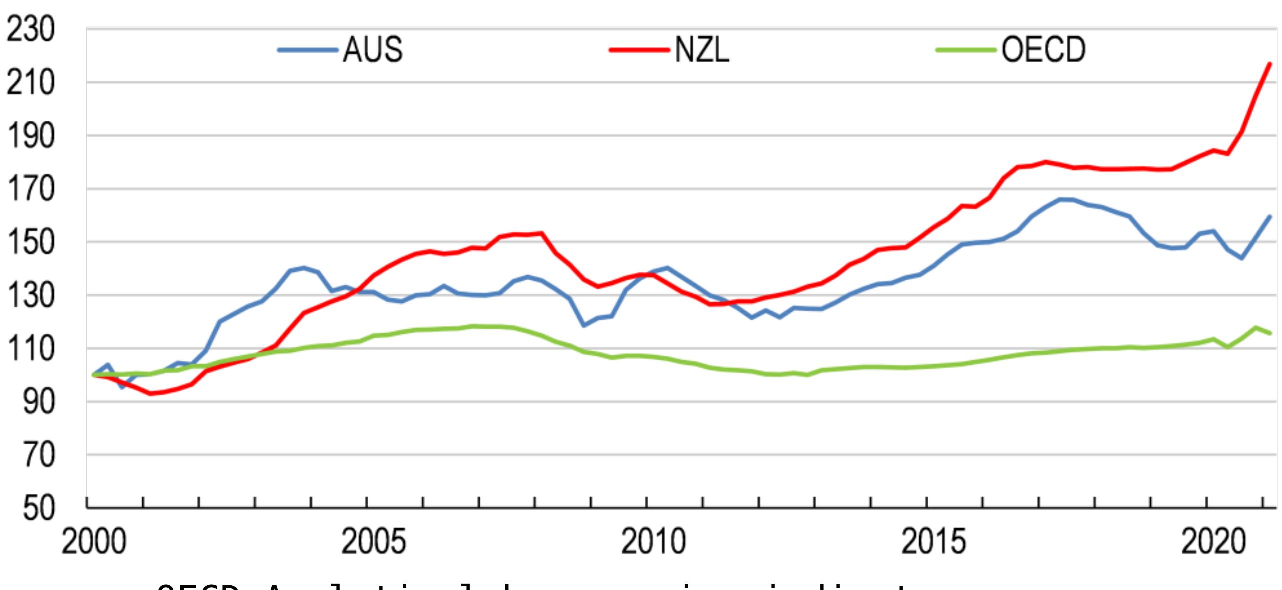
As inflationary pressure built up rapidly on the back of strong economic recovery and supply-side constraints, the Reserve Bank of New Zealand rightly initiated a monetary policy tightening cycle in October 2021. Judging by the stability of business leaders' longer-term inflation expectations at around 2%, the Reserve Bank benefits from high credibility, which will reduce the costs of disinflation. If the government were to accelerate fiscal consolidation, that would reduce the burden on monetary policy of restoring price stability. It would also expand room for manoeuvre to support the economy in future downturns. In the longer term, the government will need to take steps to prevent large increases in public debt caused by population ageing and rising health-care costs, including by increasing the pension eligibility age.

2. Increase housing affordability

Expansionary monetary policies and an initial easing in loan-to-value restrictions underpinned a surge in house prices from already elevated levels (Figure 2). The Reserve Bank rightly judges current house prices to be unsustainable. The ongoing tightening in monetary policy and macro-prudential regulations and the tax changes that made investment in rental properties less attractive are already slowing price increases. Recent urban planning reforms and increased funding for housing-related infrastructure have boosted new housing supply beyond demographic demand for it, progressively reducing housing shortages and laying the ground for durable improvements in housing affordability. To realise the full potential of urban planning reforms, local governments need greater capacity to finance housing-related infrastructure and stronger incentives to do so.

Figure 2. House prices have soared

House price-to-income ratios



Source: OECD Analytical house price indicators.

3. Increase productivity through greater diffusion of digital technologies

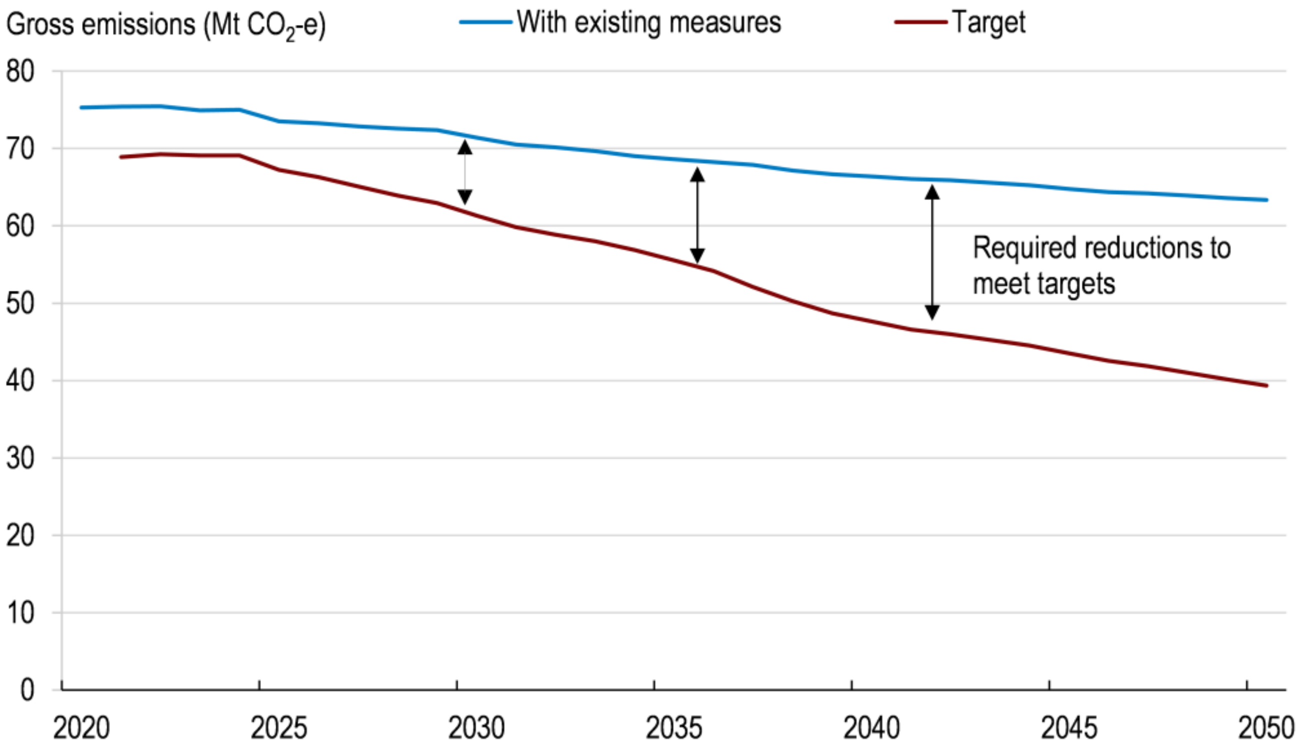
New Zealand's productivity has been lagging behind other advanced economies, despite its good institutional settings. One way to boost productivity is to enhance the diffusion of digital technologies. New Zealand has good digital infrastructure and New Zealanders already have a well-rounded skills set to thrive in the digital workplace. Despite these good bases for digital transformation, the digital sector is small and New Zealand makes little use of digital technologies to boost its export performance. Implementing the national digitalisation strategy is essential for advancing New Zealand’s digital transformation. Specialised ICT skills run short, in part owing to COVID-19 related border restrictions. To build a strong domestic pipeline of ICT skills, students’ maths skills should be improved, digital apprenticeships developed and help provided for women, Māori and Pacific Peoples to pursue digital careers. Stronger coordination between export promotion and innovation support would help boost the export expansion by firms that leverage digital technologies.

4. Implement measures to achieve greenhouse emissions abatement objectives

New Zealand is not on track to meet either its Nationally Determined Contribution (a 41% reduction in emissions from the 2005 level by 2030) or its 2050 targets – net zero carbon emissions and a reduction in biogenic methane emissions from agriculture of 24-47% from the 2017 level (Figure 3). To meet these targets at least cost, substantial increases in carbon prices from progressively tightening the supply of emissions permits will be needed, complemented by further measures that address market failures not corrected by carbon pricing alone. Examples of such measures include accelerating the uptake of electric vehicles and creating options to decarbonise heavy transport and freight, which would promote a shift to sustainable transport.

Figure 3. Emission reductions need to be accelerated

Greenhouse gas emissions



Note: The red line shows the target path for gross emissions consistent with achieving both the 2030 Nationally Determined Contribution and, for non-agricultural sectors, the 2050 net zero emissions target. This line includes agricultural emissions with existing measures. The difference between the red line and zero in 2050 reflects gross emissions in non-agricultural sectors to be offset by carbon sinks, such as forestry, and agricultural emissions.
Source: Ministry for the Environment (2021), New Zealand's Projected Greenhouse Gas Emissions to 2050.

Reference

OECD (2022), *OECD Economic Surveys: New Zealand*, OECD Publishing, Paris, https://doi.org/10.1787/a4fd214c-en