

## New Zealand

The pace of activity is cooling as net migration inflows ease, house prices level off and the effects of the exchange rate appreciation spread from the export sector to the economy at large. Together, these factors will reduce pressures on stretched resources and close the output gap, bringing growth onto a more sustainable medium-term path.

With the economy likely to head towards a soft landing, the current “wait and see” stance of monetary policy is appropriate, as is the broadly neutral stance of fiscal policy. With potential growth slowing because of weaker population growth, the policy initiatives currently being developed should aim at encouraging greater labour force participation, thus providing a helpful boost to medium-term growth prospects.

Domestic demand surged in the second half of 2003, with expenditure on GDP expanding by 3 per cent for the year as a whole, and the strong momentum has continued into the early months of 2004. This has been fuelled by net migration inflows, rapidly rising house prices and a residential investment boom. Private consumption growth has outstripped increases in disposable incomes, as households have adjusted upwards their spending plans to reflect increased wealth. With the economy continuing to operate above potential, unemployment at historically low levels and labour shortages increasing, businesses have been expanding productive capacity at a rapid rate. Lower prices for imported capital goods have made such investments more affordable.

*Domestic activity  
has boomed...*

The experience of the tradeables sector stands in sharp contrast to the dynamism of domestic demand. Despite a strong rebound in dairy exports in the last quarter of 2003, losses in competitiveness from the exchange-rate appreciation continue to hit the tradeables sector hard, although the erosion of export earnings has been cushioned by hedging arrangements, and the broader economic impact has been attenuated by improving terms of trade. Domestically-generated inflation has reached around 4½ per cent *per annum*, but falling import prices have kept the annual overall consumer price inflation rate down to around 1½ per cent. Real wage increases have broadly kept pace with productivity gains, a surprisingly modest outcome given reported labour market pressures.

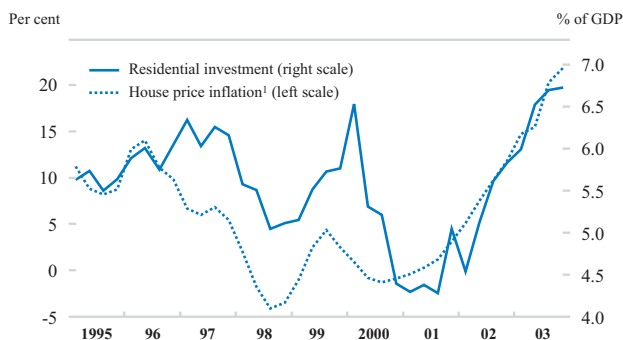
*... but the export sector  
has suffered*

Net migration inflows have peaked and population growth is slowing. This will help to take some of the steam out of the economy, by reducing consumption spending and the demand for housing, although it will also mean a slower expansion of the labour supply. Buoyancy will also be tempered by the lagged flow-through of weak

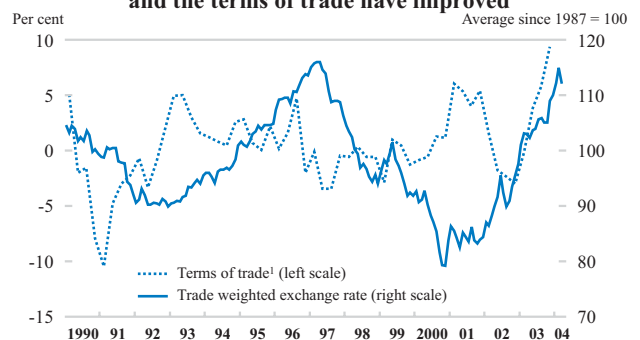
*Exogenous forces and policy  
restraint are slowing  
the economy...*

## New Zealand

**The housing sector has been booming**



**The exchange rate remains high and the terms of trade have improved**



1. Year-on-year change.

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

## New Zealand: Demand, output and prices

	2000	2001	2002	2003	2004	2005
	Current prices billion NZD	Percentage changes, volume				
Private consumption	67.8	2.2	4.2	5.2	4.0	1.9
Government consumption	20.2	4.2	2.6	2.6	6.0	2.6
Gross fixed capital formation	22.2	-0.5	8.9	13.7	7.3	1.6
Final domestic demand	110.1	2.0	4.8	6.4	5.1	2.0
Stockbuilding <sup>a</sup>	0.8	0.3	0.2	-0.3	0.2	0.0
Total domestic demand	110.9	2.3	5.1	6.1	5.4	1.9
Exports of goods and services	39.6	2.4	5.8	1.1	6.7	8.6
Imports of goods and services	38.2	1.6	8.8	10.1	11.7	6.6
Net exports <sup>a</sup>	1.4	0.3	-0.8	-2.8	-1.8	0.4
GDP (expenditure) at market prices	112.2	2.6	4.3	3.0	3.3	2.5
GDP deflator	—	4.7	0.6	2.0	3.0	1.8
<i>Memorandum items</i>						
GDP (production)	—	2.5	4.3	3.5	3.2	2.5
Consumer price index	—	2.6	2.7	1.8	2.1	2.4
Private consumption deflator	—	2.1	2.0	0.5	1.2	1.6
Unemployment rate	—	5.3	5.2	4.7	4.7	4.9
General government financial balance <sup>b</sup>	—	2.0	2.9	3.1	2.9	2.8
Current account balance <sup>b</sup>	—	-2.6	-3.7	-4.5	-4.6	-3.9

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>).

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

b) As a percentage of GDP.

Source: OECD.

export earnings to the rest of the economy. Overall, these factors should play a large role in bringing the economy back to a more sustainable growth path. In addition, the Reserve Bank raised interest rates by ¼ per cent at the end of January, thereby shifting towards a more neutral monetary stance. Monetary policy judgements will depend crucially on the pace at which domestic pressures unwind, and the Bank is assumed to keep interest rates steady over the projection period. Overall expenditure restraint has allowed the general government cyclically-adjusted primary surplus to rise to around 2¼ per cent of GDP in 2003. It is projected to remain steady in 2004 and 2005, even as the government puts in place infrastructure spending and additional measures for low-income families, within the envelope already indicated for the May budget.

... and a soft landing is within reach

Prospects point to a soft landing, with activity decelerating as the current year progresses, and GDP growth of 2½ per cent in 2005. Households are expected to boost their savings rate as house prices level off, while residential investment shrinks. The outlook should brighten for exporters who will benefit from strengthening foreign markets, especially around the Pacific Rim. Overall, GDP is projected to grow more slowly than its potential rate, and the output gap will gradually close, allowing the economy to proceed on a steadier track, without inflationary pressure. But the potential growth rate is also projected to moderate as a result of a slower expansion of the labour supply.

Risks are associated with net migration and the housing market

The main risks surround the orderly unwinding of excess domestic demand. The risks of a full-blown housing market bubble have diminished, but not entirely disappeared. A sharper slowdown in net migration could, however, feed through into a substantial decline in residential construction and fears of falling house prices. With the savings rate already low and indebtedness high, this could lead households to retrench.

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### Conventional signs

\$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mbd	Million barrels per day	Trillion	Thousand billion
..	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		

## Summary of projections

	2003	2004	2005	2003		2004		2005		Fourth quarter			
				Q4	Q1	Q2	Q3	Q4	Q1	Q2	2003	2004	2005
Per cent													
<b>Real GDP growth</b>													
United States	3.1	4.7	3.7	4.1	4.6	4.3	3.8	3.9	3.6	3.6	4.3	4.2	3.6
Japan	2.7	3.0	2.8	6.4	1.7	2.2	2.5	2.7	2.8	3.0	3.6	2.3	2.9
Euro area	0.5	1.6	2.4	1.4	1.4	1.9	2.3	2.3	2.5	2.5	0.7	2.0	2.6
Total OECD	2.2	3.4	3.3	4.0	3.1	3.2	3.2	3.2	3.2	3.3	2.9	3.2	3.3
<b>Inflation</b>													
United States	1.7	1.7	1.6	1.5	2.1	2.0	1.3	1.3	1.8	1.5	1.6	1.7	1.6
Japan	-2.5	-1.8	-1.1	-4.4	-0.8	-1.4	-1.2	-1.1	-1.1	-1.0	-2.7	-1.1	-0.9
Euro area	2.0	1.7	1.7	1.6	1.5	1.6	1.8	1.8	1.6	1.7	2.0	1.7	1.7
Total OECD	2.0	1.7	1.6	1.1	2.1	1.8	1.6	1.6	1.6	1.5	1.6	1.8	1.6
<b>Unemployment rate</b>													
United States	6.0	5.5	5.2	5.9	5.6	5.6	5.5	5.4	5.3	5.3	5.9	5.4	5.1
Japan	5.3	5.0	4.6	5.1	5.0	5.0	4.9	4.9	4.8	4.7	5.1	4.9	4.3
Euro area	8.8	8.8	8.5	8.8	8.8	8.8	8.8	8.8	8.7	8.6	8.8	8.8	8.3
Total OECD	7.1	6.9	6.7	7.1	7.0	7.0	6.9	6.9	6.8	6.7	7.1	6.9	6.5
<b>World trade growth</b>	4.5	8.6	10.2	11.5	6.9	8.9	9.6	10.0	10.5	10.5	5.8	8.8	10.5
<b>Current account balance</b>													
United States	-4.9	-4.7	-4.8										
Japan	3.1	3.8	4.4										
Euro area	0.4	0.5	0.6										
Total OECD	-1.2	-1.0	-1.0										
<b>Cyclically-adjusted fiscal balance</b>													
United States	-4.2	-4.6	-3.9										
Japan	-7.5	-7.0	-7.0										
Euro area	-1.7	-1.6	-1.8										
Total OECD	-3.4	-3.5	-3.2										
<b>Short-term interest rate</b>													
United States	1.2	1.3	2.9	1.1	1.2	1.2	1.4	1.6	2.1	2.6	1.1	1.6	3.6
Japan	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Euro area	2.3	1.7	1.8	2.2	2.1	1.7	1.5	1.5	1.5	1.5	2.2	1.5	2.3

Note: Real GDP growth, inflation (measured by the increase in the GDP deflator) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day-adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate. The unemployment rate is in per cent of the labour force while the current account balance is in per cent of GDP. The cyclically-adjusted fiscal balance is in per cent of potential GDP. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month CD; euro area: 3-month interbank rate.

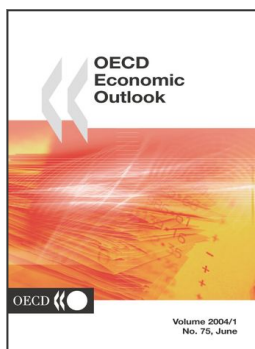
Assumptions underlying the projections include:

- no change in actual and announced fiscal policies;

- unchanged exchange rates as from 14 April 2004; in particular 1\$ = 108.50 yen and 0.836 euros;

The cut-off date for other information used in the compilation of the projections is 21 April 2004.

Source: OECD.



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