OPENING STATEMENT DELIVERED TO THE FINANCE & EXPENDITURE SELECT COMMITTEE BY THE TREASURY'S CHIEF ECONOMIST, DR. GIROL KARACOAGLU, 29 JANUARY 2014

Good morning. I'll keep my comments brief today – I'd just like to recap a few key themes from the *Half Year Economic and Fiscal Update* in light of recent public discussions about New Zealand's economic outlook.

It's no secret that New Zealand is in an enviable position. Our economic outlook is very good compared to most other countries we benchmark ourselves against. "Rock Star Economy" seems to be the phrase on everyone's lips. That makes great headlines, but it only really reflects our short-term outlook. It's true that we expect to see a period of higher growth over the next few years, but the *Half Year Economic and Fiscal Update* forecasts growth to be more moderate after that.

We've already seen some of the risks identified in the *Update* start to materialise. Domestic demand has been stronger than originally forecast, and the reality is that the global environment will continue to be volatile. It will be important to be responsive to these factors.

If we want to achieve the kind of long-term, sustainable economic growth that will consistently raise living standards for New Zealanders, we need to:

1. Learn the lessons of the last decade
2. Show restraint as the economy hits a new gear, and
3. Use the opportunity of higher growth in the short-term to expand the economy, and create a platform for sustained growth over the long-term

The lessons of the last decade

The developed world went into the 2000s with a belief that in many respects we'd answered the question of how to achieve stable, long-term economic growth, with steadily rising incomes. We were wrong. Governments and households overextended themselves, asset markets became overvalued, and extra revenue wasn't sufficiently used to pay off debt. Then it all came tumbling down. For the last five or six years everyone's had to take their medicine. New Zealand was better placed than many other countries, but has still felt the impact of the Great Recession.

With things now looking up, this is the time to show we've learned. The question is, what path will we take this time?

Showing restraint as we hit a new gear

Over the next few years we expect the Crown's day-to-day finances to improve as the economy picks up. The temptation might be to spend more.

With the economy operating at or above capacity over the next year or so, too great an increase in government spending risks driving interest rates up higher than they would naturally rise at this point in the cycle. In turn this will put more upward pressure on the exchange rate, and undermine the very export-oriented sectors we want to support higher living standards over the long-term.

Instead, the Treasury's view is that we need to stay restrained in our spending.

In particular, we need to tightly manage the Crown's investments in the Christchurch rebuild, to avoid log jams, cost escalations and extra spending. We need to keep pursuing efficiencies in the public sector. We can tighten government spending if household spending is higher than expected. And we can keep steadily reducing debt over time – having room to move on the Crown's balance sheet was crucial to New Zealand's ability to support demand in the economy during the downturn. It also meant we could deal with the costs of a large earthquake. We need to rebuild the buffer against future crises.

Use this opportunity

But while short-term choices about how we manage the government's finances are important, the real prize is long-term economic growth. As the economy shifts into a new gear we have a golden opportunity to pursue lasting gains by lifting productivity.

In this context, the Treasury welcomes the recent public discussions around how to improve educational outcomes. Other areas we see as priorities include:

- Strengthening our international connections – so that New Zealand businesses have better access to emerging markets;

- Encouraging companies to invest in productivity improvements. For example there are some signs of a lift in productivity in the construction sector that could make a real difference to how we manage the economic cycle if they can be sustained; and

- Pursuing productivity gains in the public sector.

To make headway in some of these areas we'll need to address some complex and persistent challenges. That will require innovation, and within reason, we can afford to take some educated risks. We just have to be measured, and invest wisely, with an eye on the long-term. We might be a rock star, but we don't want to be a one-hit wonder.

Thank you.