

September 2017

ECONOMIC UPDATE

Presented by Cameron Bagrie, Chief Economist

Public

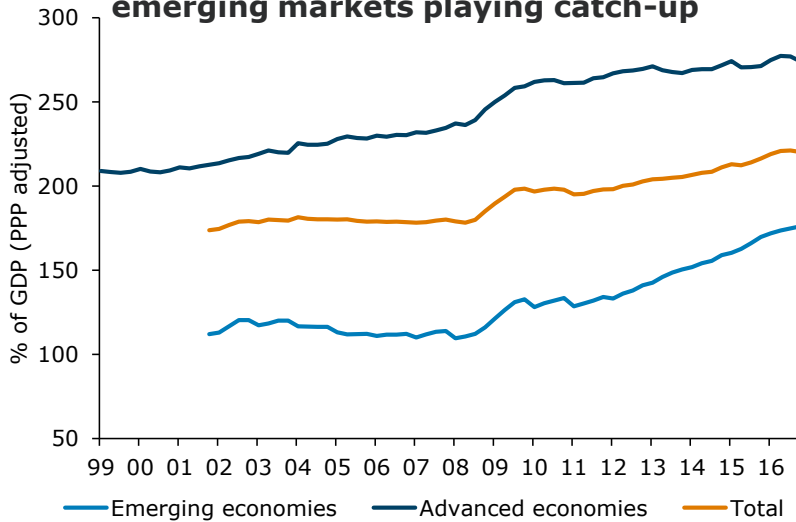


For the “bulls”

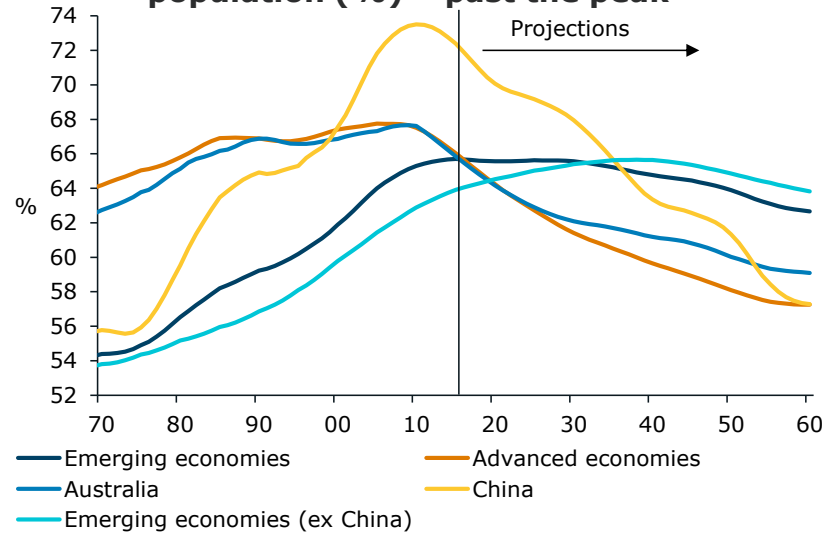
- **Concerted global upswing;** even Europe lifting
- **Unemployment falling** around the globe
- **Interest rates lower for longer**
- **All about liquidity** and it's abundant
- **Low volatility**
- **Greater unity in some regions offsetting Trump**
- **China reins supreme**
- **AI / robotics / technology** is game-changing
- **Fiscal policy slowly moving into gear**
- **Earnings are good**
- **Western world private sector balance sheets have been repaired**

The four horsemen of the apocalypse

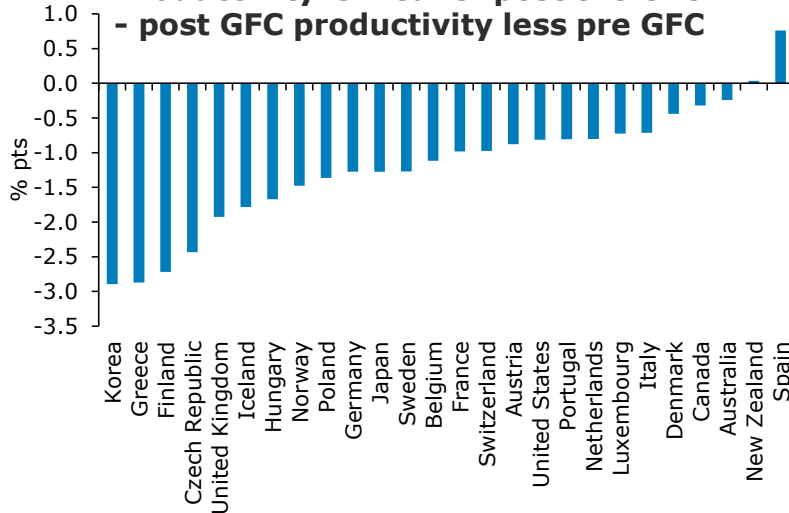
Global debt to GDP – higher highs with emerging markets playing catch-up



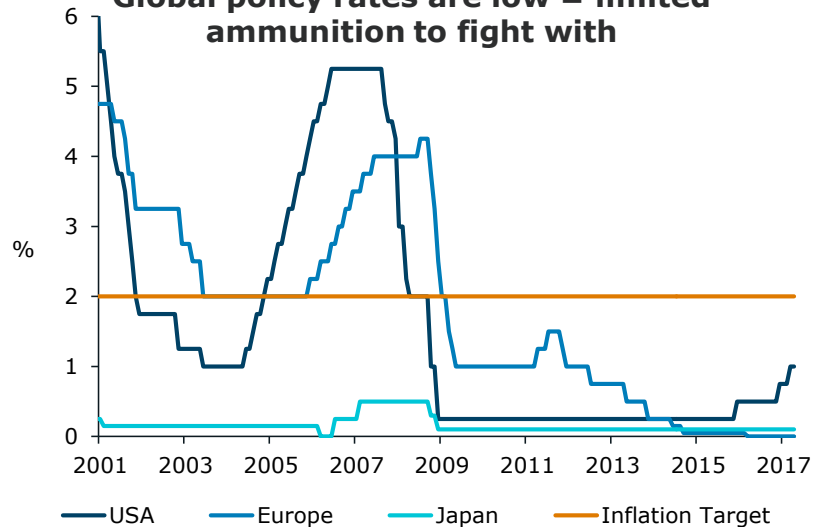
Working age population share of total population (%) – past the peak



Productivity is weaker post the GFC - post GFC productivity less pre GFC

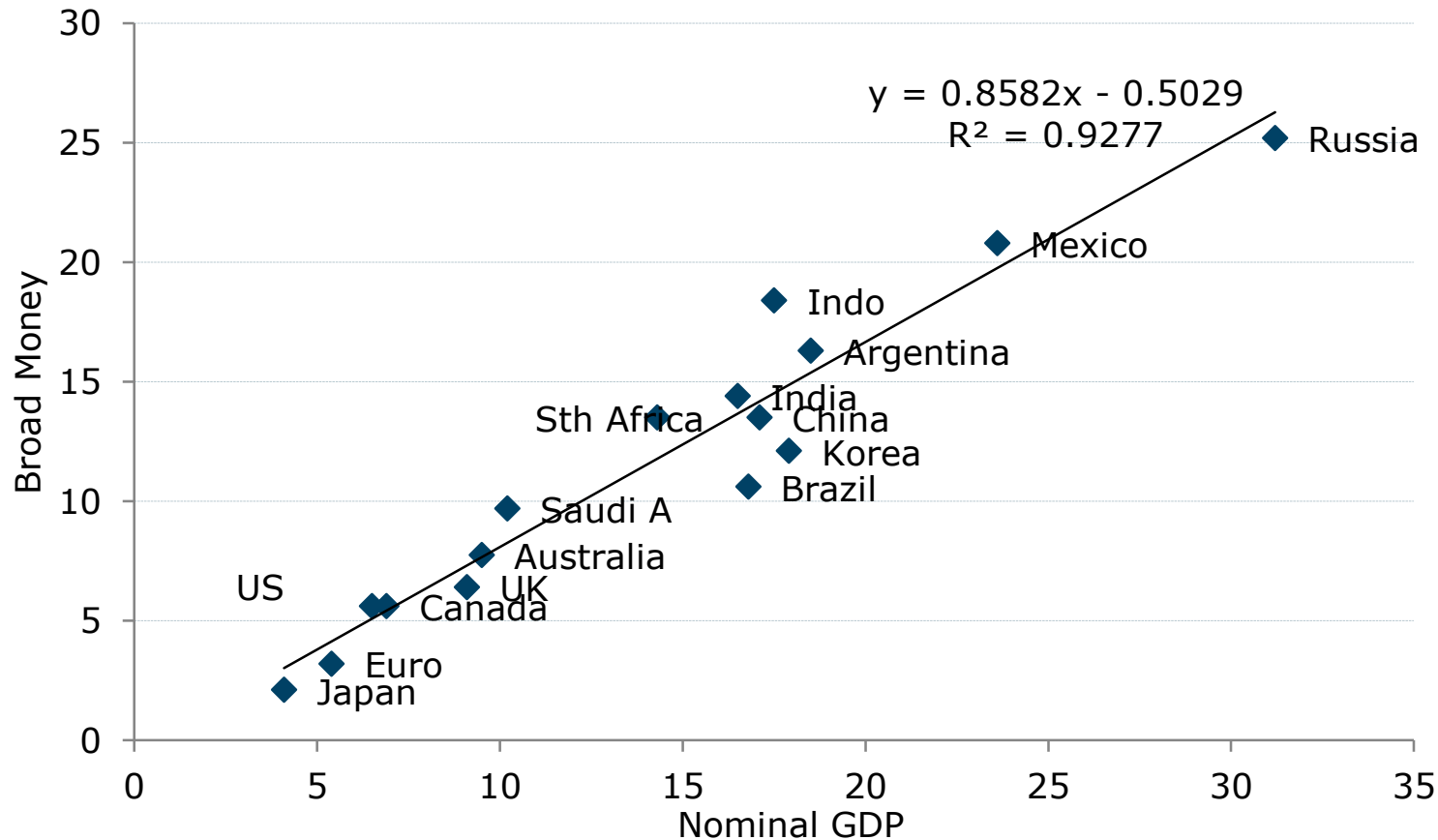


Global policy rates are low = limited ammunition to fight with



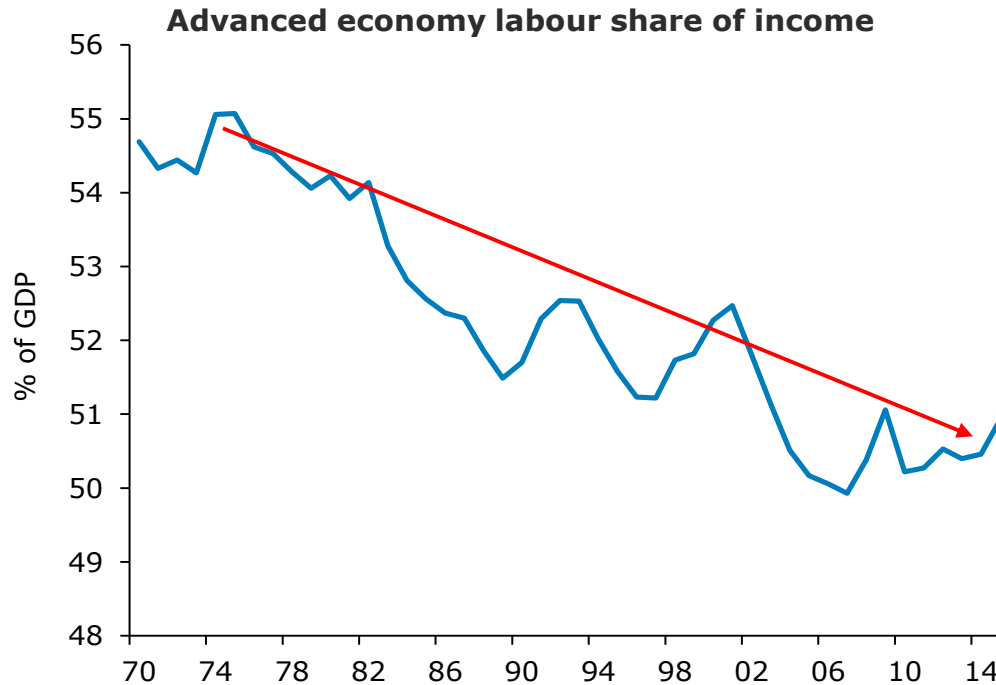
The influence of broad money has been pervasive

Broad money v nominal GDP growth 1980-2013



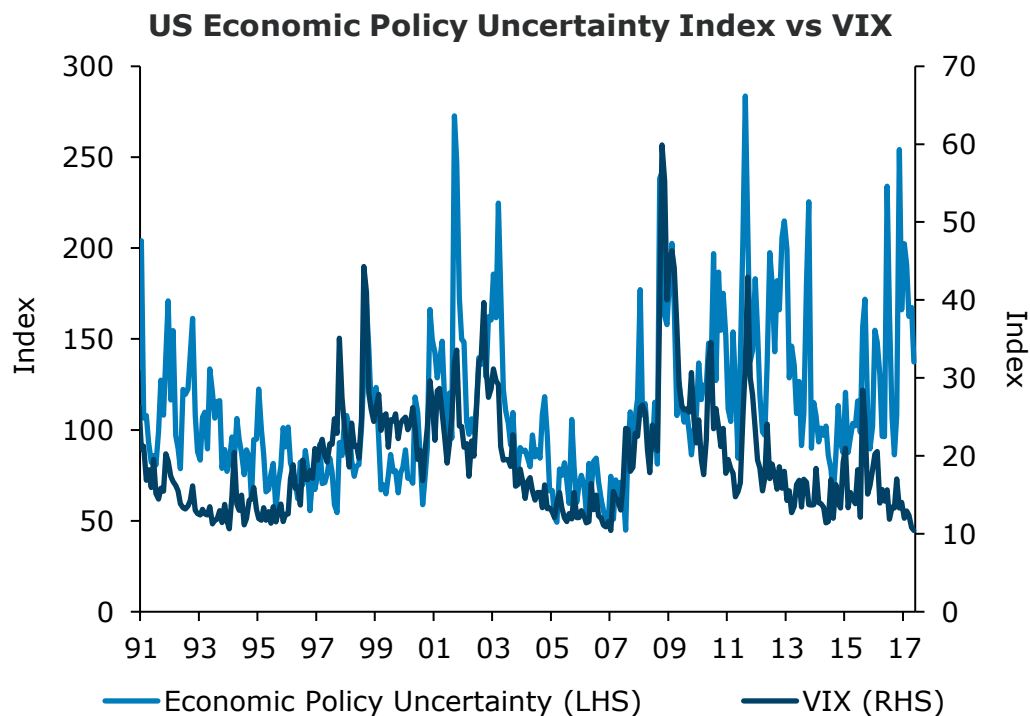
...but more debt is adding less incrementally to GDP and regulation is impeding credit facilitation as financial stability concerns impact

The economic spoils have accrued more and more to capital



- **Capital share has risen and labour has fallen**
- **We have asset price inflation but no wage inflation**
- **Society is kicking back**
- **Resentment / anger vote shaping policy direction**
- **What exactly is the policy direction** on trade, the environment, fiscal policy?
- **Is NZ immune?** Watch the kick-back vote in September

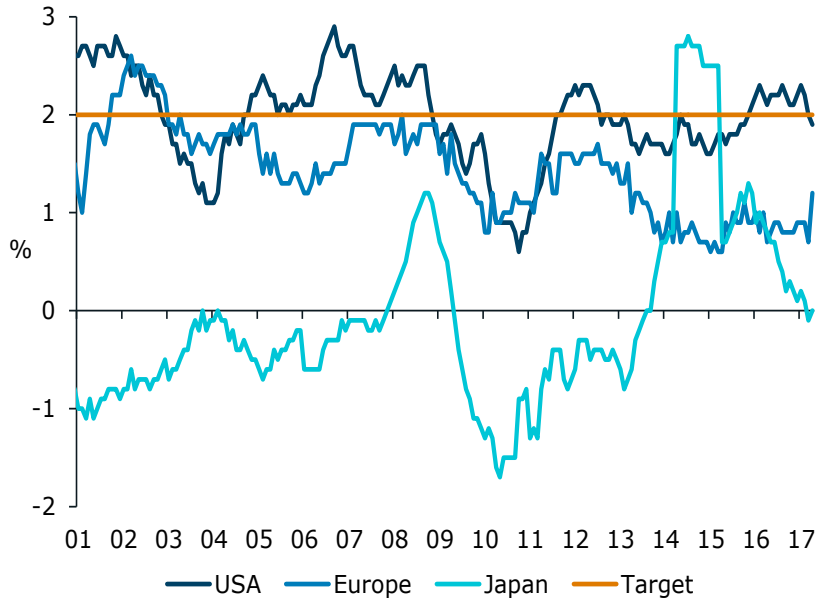
Policy uncertainty versus market volatility



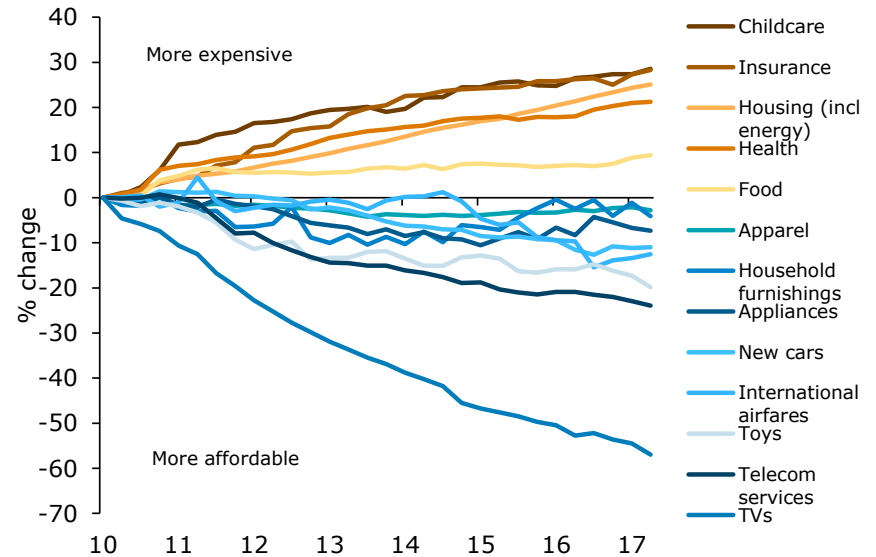
- **Policy uncertainty is elevated.** Market measures of volatility are surprisingly low.
- **When policy uncertainty is high, firms tend to defer investment and “hold back”.**
- **If policy uncertainty remains high, growth will be impacted.**
- **Trump is targeting 4% growth; IMF says 2.3%**

Little inflation but massive financial stability risks and central banks are swinging more to the latter

G3 core inflation



NZ selected CPI components price change (2010-2017)



- **Core inflation is low;** technology is deflationary
- **Some deflation is good**
- **Prices of necessary goods rising;** fun items dropping
- **Forget trying to get inflation up in this world;** worry about asset prices and the next accident
- **Central bank rhetoric is cautious but getting more hawkish**

Secular “shocks” we are dealing with

- **Climate change**
- **Demographics.** Retirees vs millennials battle looming
- **The next empire?**
- Pick your **geopolitical bomb**
- **Liquidity versus fundamental** driven investment mantra
- **Technology:** $1 + 1 = 11$
- **Prudential policy** (taming leverage / credit facilitation)
- **Government policy** shock
- Low inflation + mediocre growth = **low rates and returns** = smaller retirement nest egg
- What is free trade versus **fair and balanced trade**?
- How does the **resentment vote** shape business practices?
- **Social media; tweet risk; politics vs economics**

Interim health-check

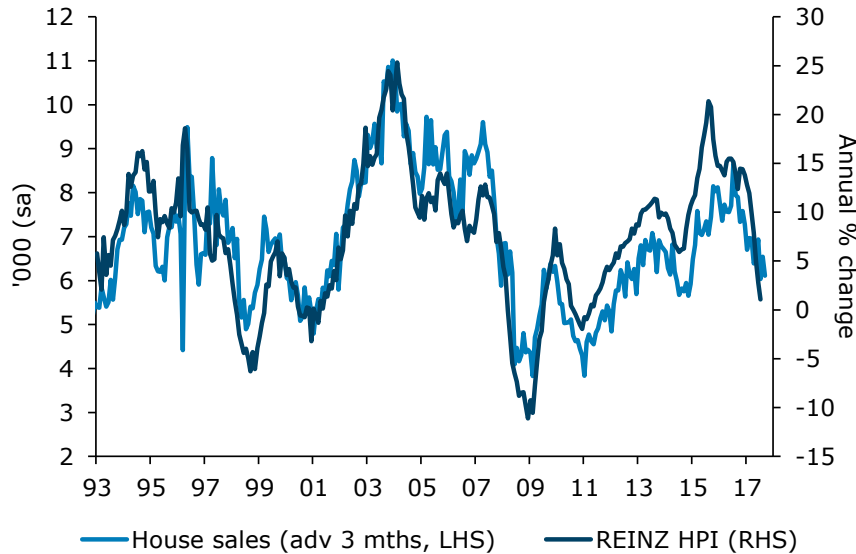
- **Politics now “trumps” economics**
- **We have heaps of candidates for an accident**
- **The foot needs to be taken off the QE / low rate accelerator**
- **Markets like (need?) the liquidity = a fight looms**
- **A lot needs to go right to stop things going wrong**
- **The GFC bought bailouts**, quantitative easing etc, penalised savers, rewarded borrowers and encouraged more speculative risk taking. We protected the zombies
- **Has the piper really be paid?**

Glass half full version

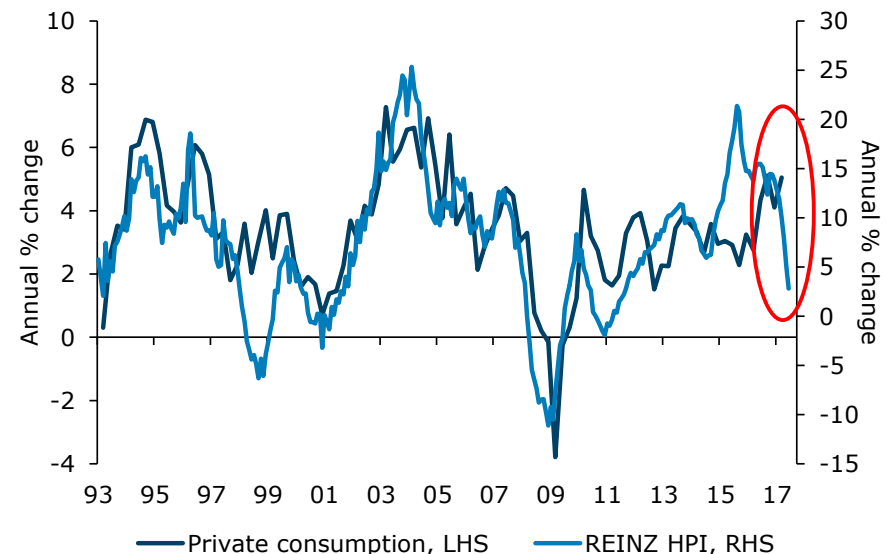
- **China will rebalance** and that’s good for NZ, bad for Oz
- **New leaders will emerge** (i.e. Macron in France though.....)
- **Frameworks will evolve** (i.e. monetary policy)
- **The fourth industrial revolution** brings challenges and opportunities
- **We only need a small portion of the world** to be doing well

NZ: Where house prices go, spending tends to follow

Nationwide house prices and sales



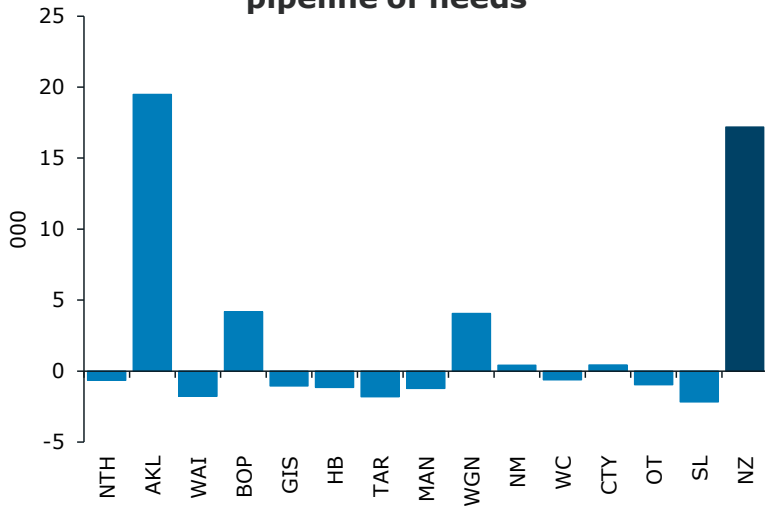
House prices and real consumption growth



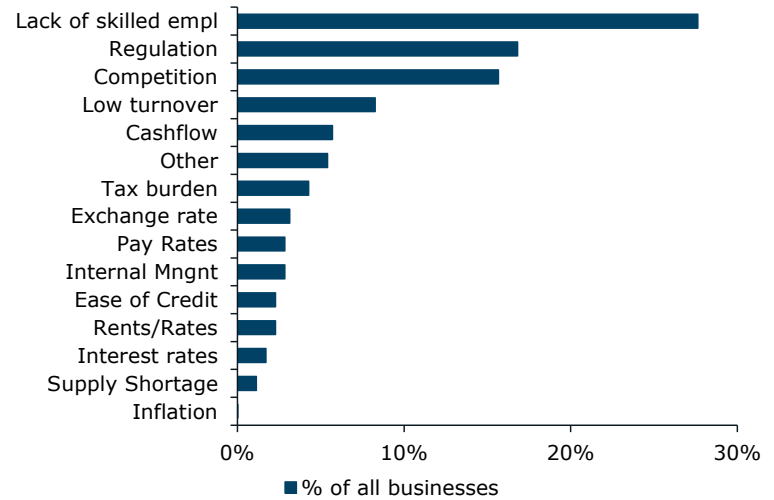
- **Housing cycle has turned**
- **House prices are falling in Auckland**; risk it impacts spending
- **We are at “peak” construction**; capacity constrained
- **Little sign of impact** on the broader economy but...
- **Economy is transitioning** beyond “peak” construction, “peak” tourist and “peak” migrant
- **Fiscal policy, wages** (rising) and **terms of trade** “new” drivers

“Peaking” in the construction sector

Still a shortage of houses and a massive pipeline of needs



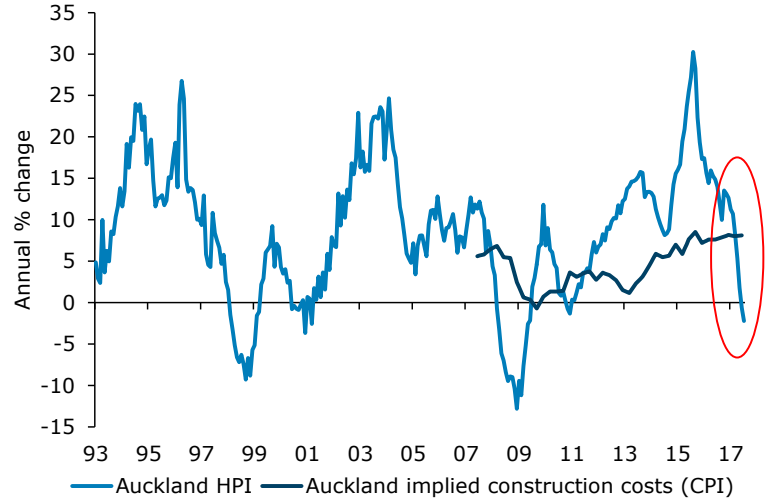
Finding skilled staff is a major issue despite an unemployment rate of 4.8%



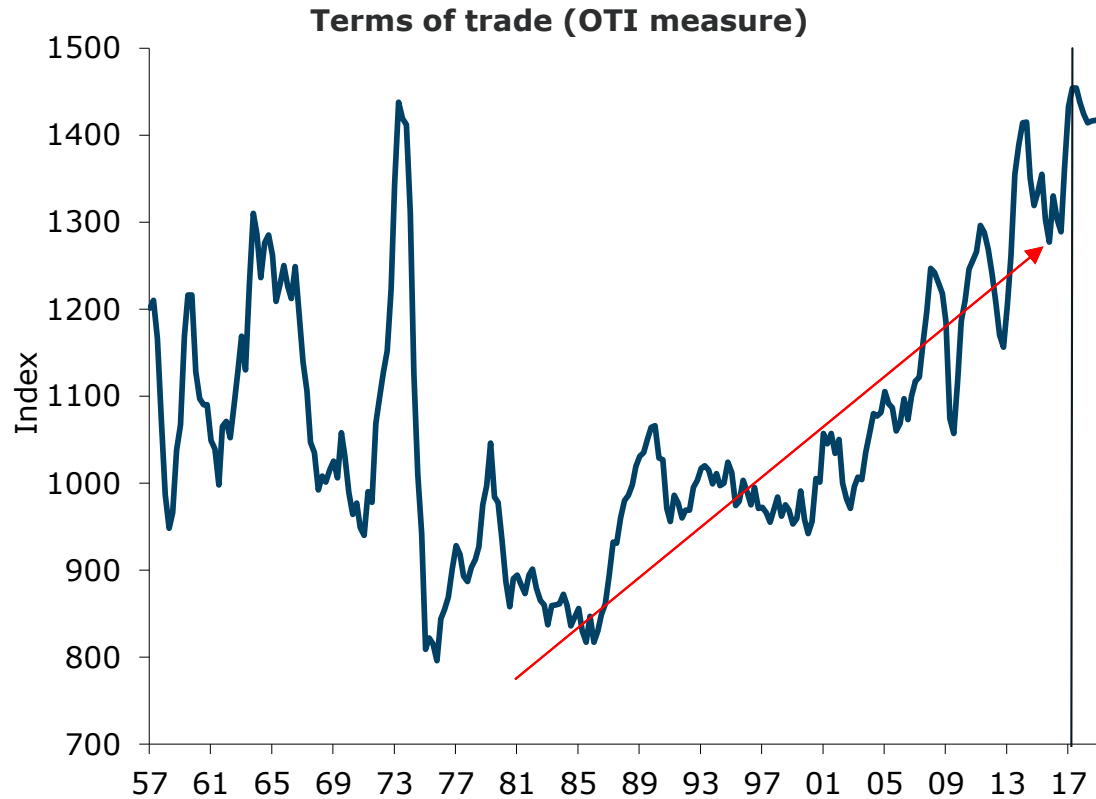
If you can't find a builder consents stabilise; we are at peak construction



House prices easing and construction costs rising is a bad combination for the development market



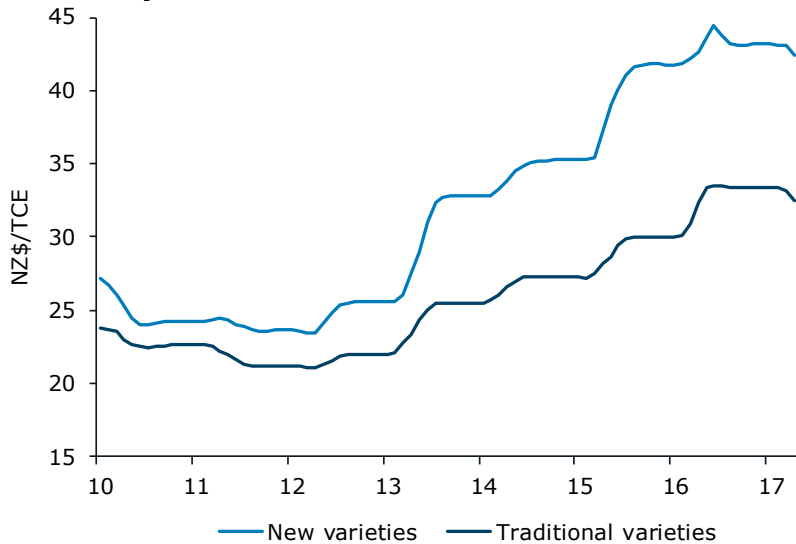
NZ terms of trade – a secular story.....



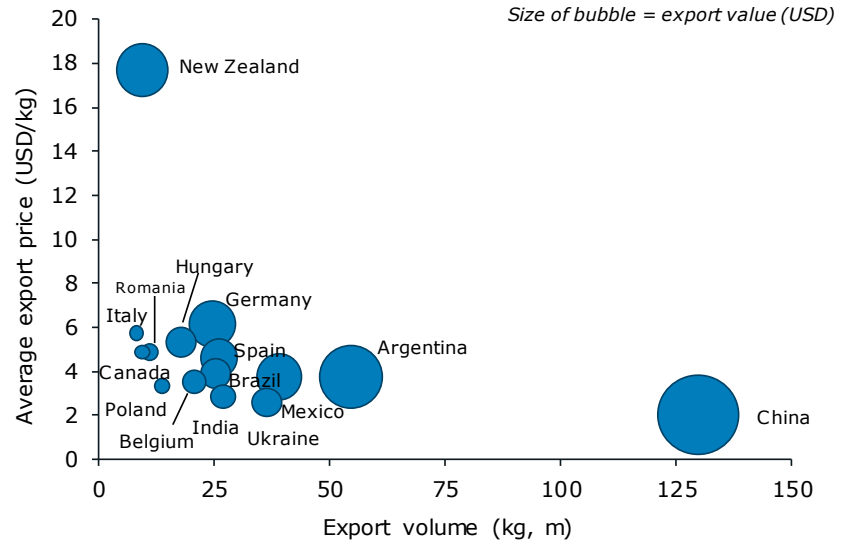
- **We sell milk, import technology**
- **We sell steak, import cars**
- **We sell seafood, import clothing**
- **We sell wood, import oil**

.....and signs of a value added one (finally)

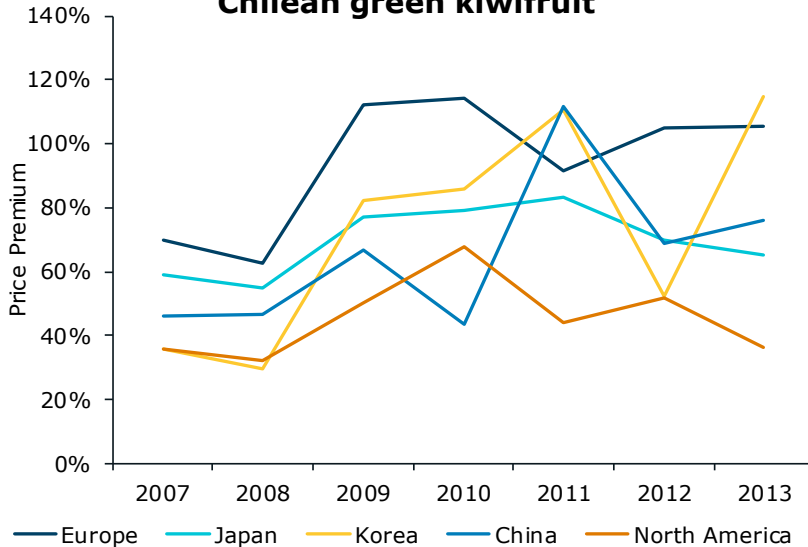
Pipfruit returns – traditional vs new



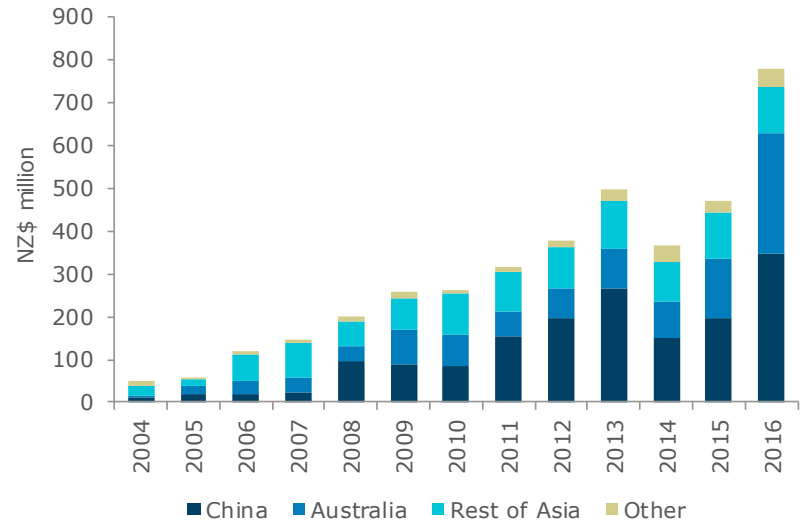
International honey returns by country



Price premium between NZ & Chilean green kiwifruit



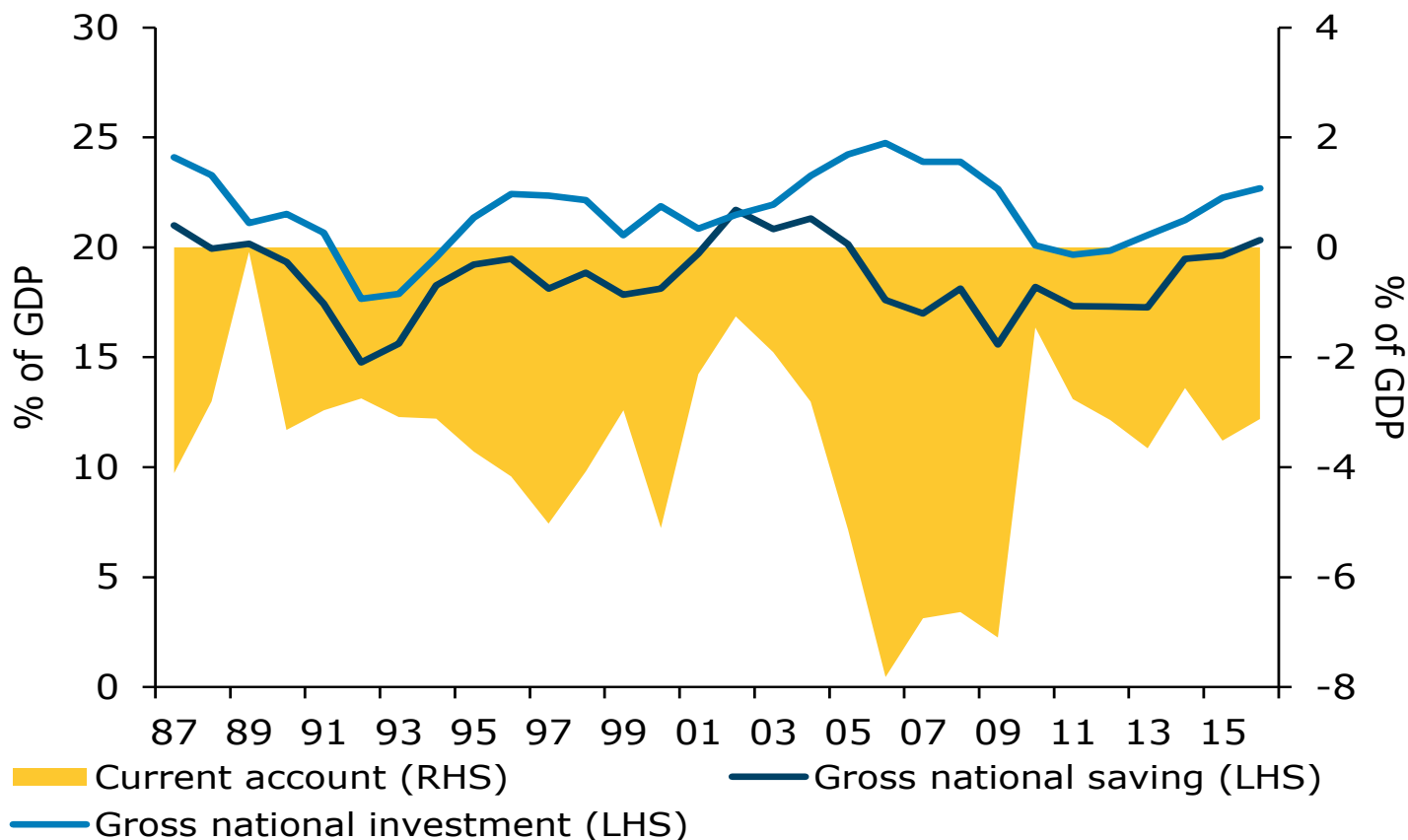
Infant formula exports



Source: ANZ, Comtrade, Statistics NZ, Zespri



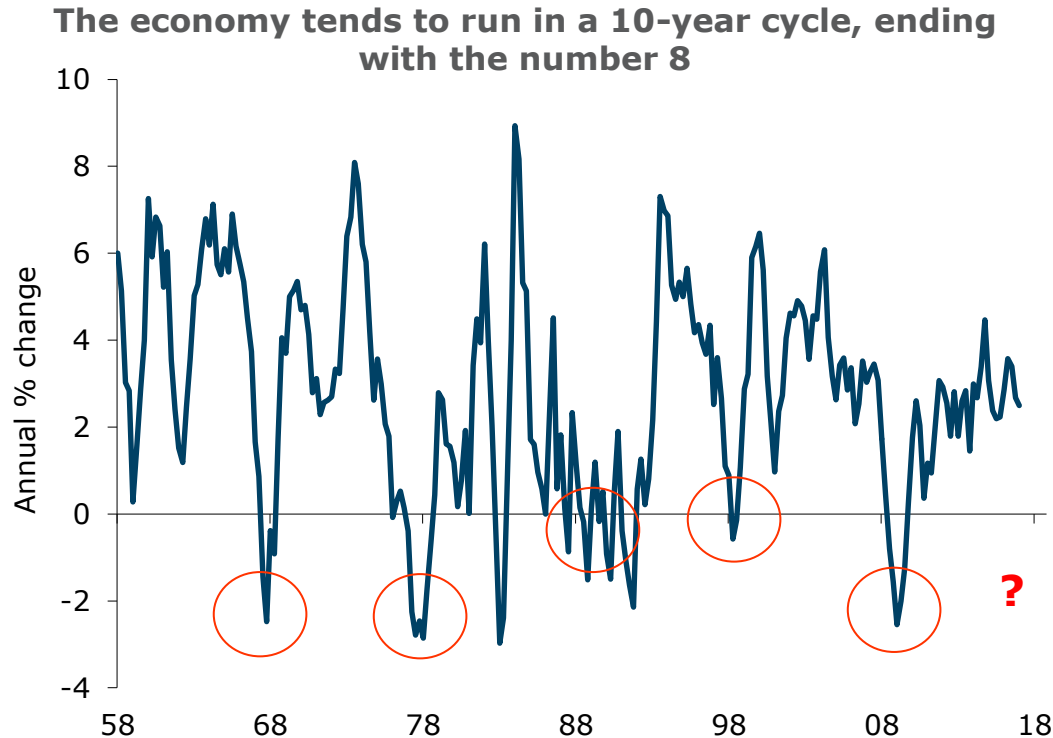
Realigning national saving and investment



Source: ANZ, Statistics NZ

If we are being told not to borrow as much overseas we need to lift domestic savings....or investment has to fall

All the 8s: saving us from ourselves



- **Housing boom + consumption boom = excesses build = inflation = higher rates and the Grim Reaper (recession) hits**
- **We have the housing boom and some excesses**
- **But low inflation = rates lower for longer**
- **Banks' curbing credit growth and RBNZ using prudential policy**
- **So this time it's different ... we hope ...**

The upshot

- **Global economy is muddling through; growth is ok**
- **But we have the four horseman of the apocalypse**
- **And a donkey;** the globe is lacking economic leadership
- **Society wants change** but doesn't really know what change they want
- **Capitalism is being redesigned** into a social justice version
- **Central banks are erring more towards financial stability risks =** a turn in the liquidity cycle
- **A lot needs to go right to stop things going wrong**
- **It's not one way traffic;** the world will evolve
- **Business cycle + secular change = you need a good micro story**
- **NZ's housing cycle has turned;** broader economy is fine
- **Value added story finally starting to appear** for NZ.Inc
- **We need to save more**
- **Beware years ending in "8"....but this time it looks different**

THANK YOU

Presented by Cameron Bagrie



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