The Birds-Eye View

September 2016
incorporating *BERL Forecasts (Vol LIX No 3)*

SUMMARY FOR RELEASE

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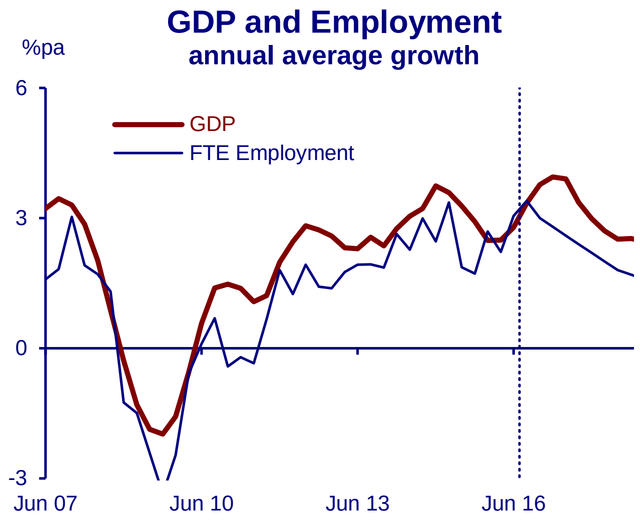
The front page

As has been widely reported – it appears the Rock Star has returned. Strong GDP growth figures for the June quarter – recorded at a per annum 3.6% – reinforce New Zealand's position at the head of the OECD pack. And with

- strong employment growth and declining unemployment
- an improving external account on the back of robust export income shored up by tourism activity
- recovering dairy prices
- the government books back in the black
- inflation well and truly tamed
- positive business and consumer confidence

there would seem little to be concerned about.



Statistics NZ

But there is a nagging feeling that is difficult to shake for many.

Without doubt, much of the risk to New Zealand's rock star status comes from abroad. The global economy remains precarious, with the impact of BREXIT still in front of us. And when the IMF points to "unresolved legacy issues in (the) European banking system" and "continued reliance on credit as growth driver is heightening risk of an eventual disruptive adjustment in China" then one's ground feels less secure.

We should not underestimate the vulnerability of the global economy. Clearly, the financial system continues to grapple with a range of monetary measures to support demand in the wake of the GFC. Negative interest rates and quantitative easing have not been greatly successful, so the flight to safety continues – as reflected in minimal long-term yields on Treasury bonds. Growing concerns about the fragile credit foundation of growth in China, as well as renewed worries around the Balance Sheet of the German Deutsche Bank so not engender confidence.

US Federal Reserve

Nevertheless, there are also domestically-sourced concerns – primarily around the asset price bubble that threatens the stability of the financial system. The RBNZ states “house price inflation remains excessive, posing concerns for financial stability”, while further reiterating (again) that “a decline in the (NZ$) exchange rate is needed”.

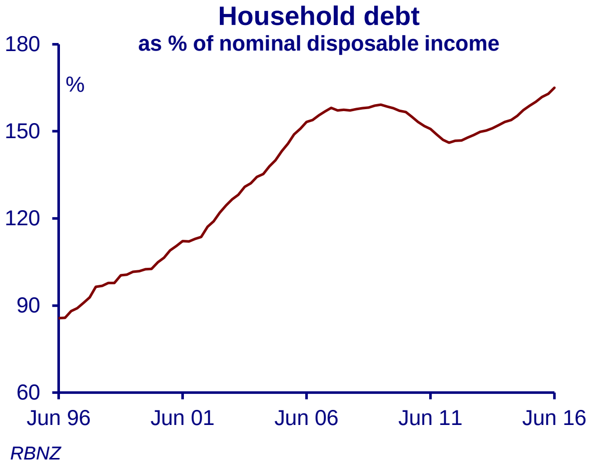
In addition, some consider the drivers of the current growth story to be transitory rather than sustainable.

However, the tourism surge (annual visitor numbers up 11%) is not transitory and is set to remains a feature of the New Zealand economic scene for some time. Whether the sector and the country have the capacity (or is prepared to make the necessary investments) to sustain and profit from this surge remains moot. The surge is a prime opportunity to continue to move the tourism from a volume focussed, low-skill/wage to a value-based, high skill/wage business model.

Historically large migration net inflows are also a considerable driver of current growth. Elements of this driver (in particular, students from some markets) are likely to be transitory. In addition, trans-Tasman flows could also ease depending on relative job prospects in Australia. Overall though, the attractiveness of New Zealand as a safe haven (both financially and economically) suggests migration inflows will remain relatively buoyant over the forecast horizon.

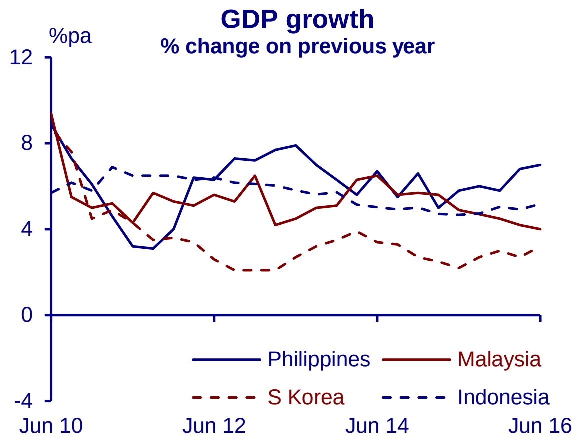
The third driver of current growth is construction sector activity; in particular, residential building. There are no signs that this is transitory, as house building catches up from several years of slump. And at close to 30,000 consents in the past year, which is also spread across many regions, it is clear that this activity is set to drive growth for some time. However, capacity limitations in this sector could stifle wider growth, as is reflected in lacklustre non-residential building and investment activity.

The missing element in this growth story is the merchandise export sector. While there are several success stories – e.g. wine, kiwifruit, fish – the overall picture is of a sector treading water. Consequently, the government’s target of exports reaching 40% of GDP by 2025 is receding fast. Adding in services exports (including international education and tourism), exports remains in the 28%-30% of GDP band – where it has been stuck for the past decade.



So, are the nagging concerns justified? Or, are we set to live the life of a truly envious rock star life? Bluntly, the elephant in the room remains our debt imbalances. Latest Reserve Bank data indicate household sector debt at 165% of disposable income, topping earlier pre-crisis highs. And with credit to the housing (mortgage) sector increasing by 9% over the year to July, on top of the 6% increase the year earlier, there are no signs of this debt overhand stabilising.

The Reserve Bank is of course at pains to emphasise that risks to financial system stability are limited. But, together with international instability and volatility, the presence of an asset price bubble of this magnitude is not only unwelcome – it is potentially toxic. How, this imbalance (or bubble) is managed (whether voluntarily or involuntarily) will undoubtedly be an central influence in moulding New Zealand's medium to longer-term economic prospects. The short term outlook, though, remains positive – with the global political/economic scenario the primary cause for concern.



Statistics Indonesia; Dept of Statistics Malaysia
Bank of Korea; Philippine Ntnl Statistical Coord Board

Forecast summary table

	2013 Actual	2014 Actual	2015 Actual	2016 Actual	2017 Forecast	2018 Forecast	2019 Forecast
annual average % change, March years							
GDP (expenditure measure)	2.7	1.6	3.2	3.1	3.3	2.4	2.5
GDP (production measure)	2.3	2.8	3.6	2.5	3.2	2.4	2.5
Private consumption	2.4	3.1	2.6	2.3	3.3	2.2	2.6
Government consumption	-0.1	2.3	2.3	1.8	2.2	1.8	1.8
Housing investment	15.4	13.0	11.6	5.8	12.6	3.1	2.2
Business investment	3.0	5.3	8.9	1.4	2.7	2.0	2.8
Exports	3.1	-0.1	4.2	5.7	4.2	1.1	1.5
Imports	1.3	8.1	7.5	2.1	3.7	1.7	1.8
June quarters							
Employment (QES annual % change)	1.9	2.3	1.9	3.1	2.6	1.8	1.6
Unemployment (% of labour force)	6.0	5.3	5.5	5.1	5.3	5.3	5.4
Net migration (annual 000s)	7,907	38,338	58,259	69,090	66,000	56,000	55,000
annual % change, March quarters							
GDP deflator (average annual % change)	-0.5	4.3	0.5	0.7	0.6	1.3	0.9
Wages (avge hourly earnings)	1.7	1.6	1.7	1.6	1.8	2.1	2.1
Consumer prices (CPI)	0.9	1.5	0.3	0.4	1.6	1.1	1.1
Producer prices (PPI outputs)	0.1	4.0	-2.5	0.1	0.0	0.6	1.0
June years							
Current account balance ($bn)	-7.8	-5.8	-8.8	-7.4	-7.7	-9.2	-10.4
Current account balance (% of GDP)	-3.6	-2.5	-3.6	-2.9	-3.0	-3.4	-3.7
Net international investment position (% of GDP)	-69.3	-65.0	-61.8	-64.9	-65.6	-66.7	-68.2
Government OBEGAL ($bn)	-4.4	-2.6	0.7	1.0	1.6	2.4	2.1
Government OBEGAL (% of GDP)	-2.0	-1.1	0.3	0.4	0.6	0.9	0.7
average levels, March quarters							
Exchange rate (TWI)	75.9	80.0	77.9	72.2	74.1	71.9	70.6
90-day bank bill rate	2.7	3.0	3.6	2.6	1.9	1.9	1.9
10-year bond rate	3.7	4.6	3.3	3.1	2.2	2.3	2.5
Memo items							
Merchandise export receipts (fob $m, June years)	43,800	49,073	45,987	46,725	47,552	48,340	49,301
Merchandise import payments (cif $m, June years)	44,159	47,469	48,815	50,076	51,994	53,985	56,053
International visitor arrivals (000s, March years)	2,611	2,752	2,948	3,255	3,427	3,509	3,592
Residential new building consents (000s, March years)	17.4	22.4	25.0	27.8	29.8	28.4	28.0
New car registrations (000s, March years)	158.6	191.2	227.6	239.8	246.4	253.2	260.5
Core retail sales nominal (annual % chge, March years	2.0	3.7	5.1	5.3	4.3	3.8	4.1

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