

Economic Update May 2021

This presentation is general in nature and should not be seen as personalised advice. It has been designed in an educational nature and should not be relied upon as advice for your personal situation.

Bagrie Economics accept no liability for any loss or damage caused by this presentation.

Data and information have been gathered from sources Bagrie Economics believes to be reliable. The content does not constitute advice.

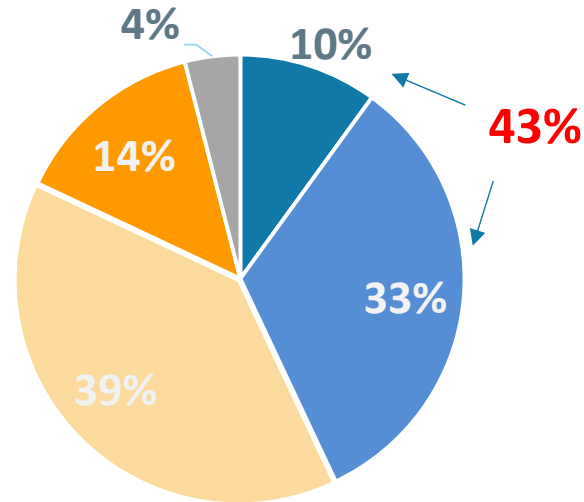
Top companies on the NZX in 1995

- Telecom
- Carter Holt Harvey
- GuocoLeisure
- Lion Nathan
- Fletcher Challenge Paper
- Goodman Fielder
- Tenon (Fletcher Forests)
- Fletcher Challenge Energy

Source: Bagrie Economics, Forsyth Barr

Dealing with change is the new normal, and NZ is complacent

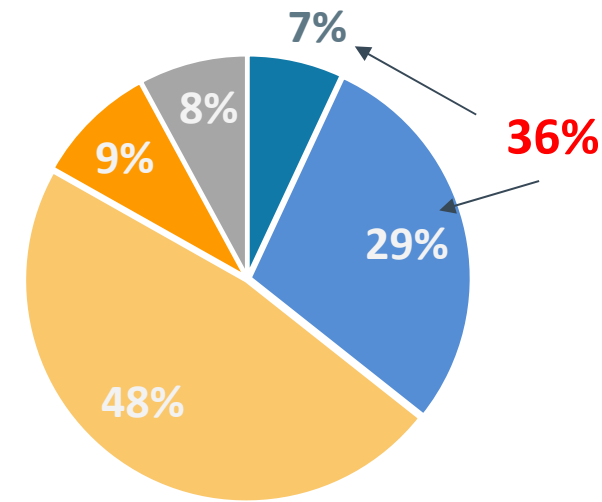
How much has the market changed for you in the past 2-5 years?



■ A lot ■ A fair amount
■ Not that much ■ Not at all

■ Unsure
 Base: All respondents

How much change do you expect going forward?



■ A lot ■ A fair amount ■ Not that much
■ Not at all ■ Unsure

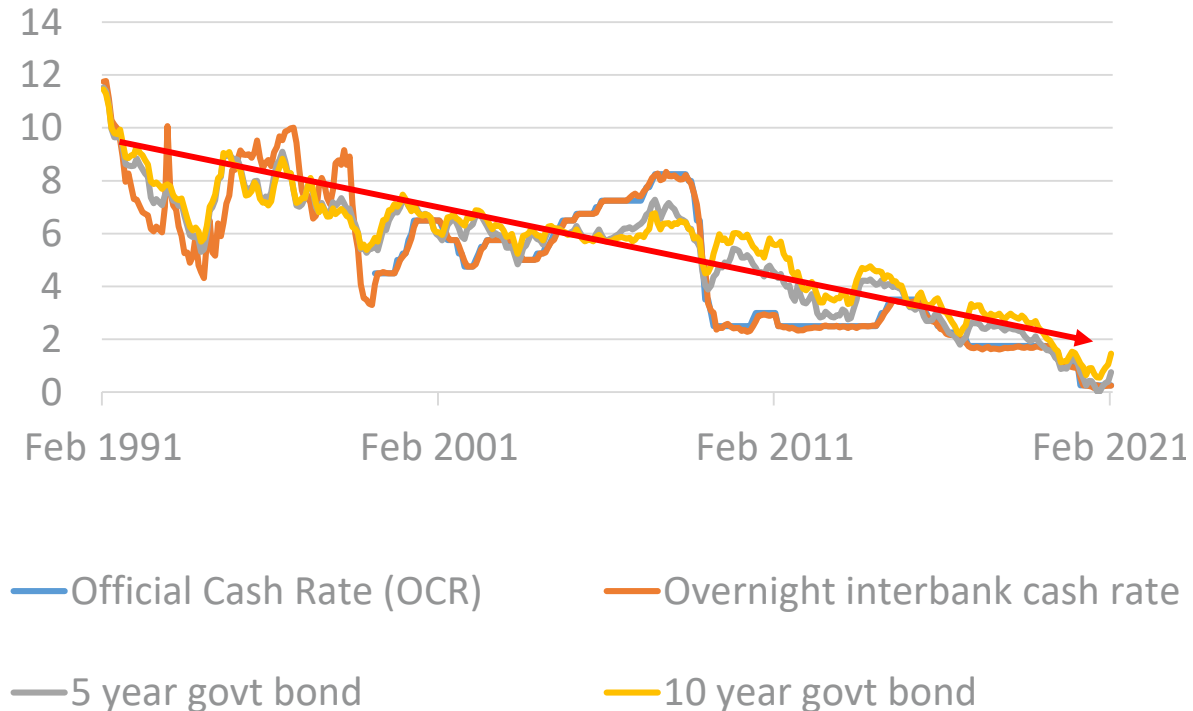
Base: All respondents (n=600)

Theme 1: Collision between economics, politics and social needs

- Covid-19 and global warming dominating. Inequality too. Housing unaffordability
- Share of the economic pie / where are the workers?
- Sovereign tensions – China and USA, the UK and Europe, **Australia prodding China**
- Nationalism replacing globalisation
- Central Banks doing whatever it takes and no exit strategy
- Have central banks lost their social license?
- Bigger government
- Supply chain disruption / inflation
- All about digital

Theme 2: A downtrend in interest rates at an end

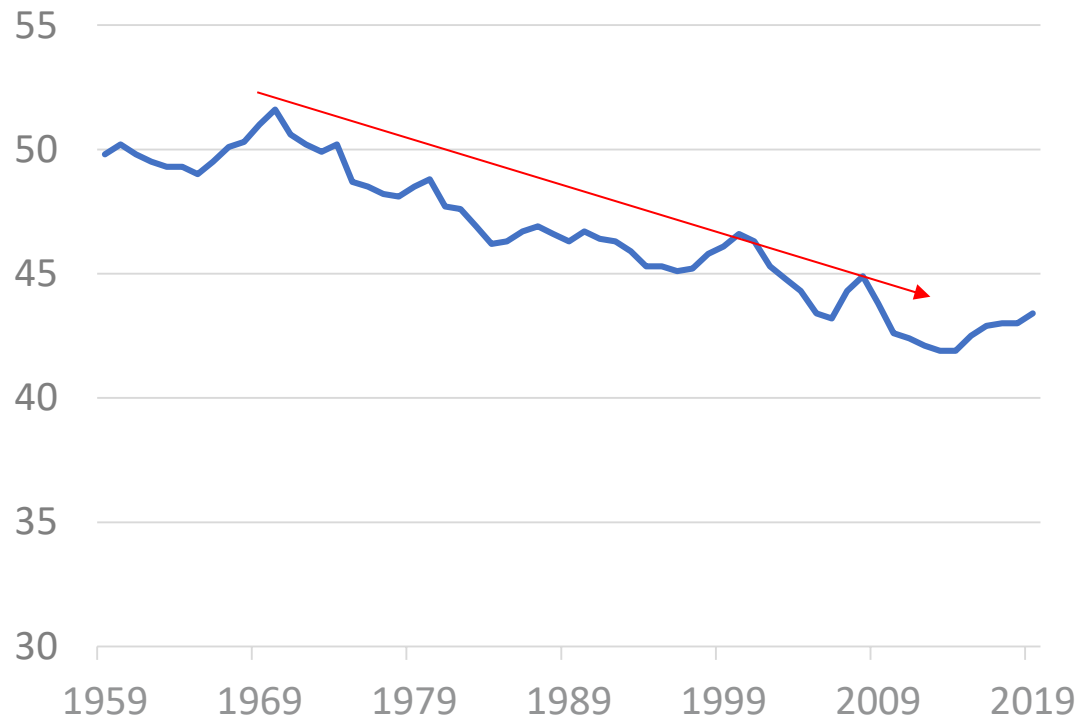
Interest rate trends



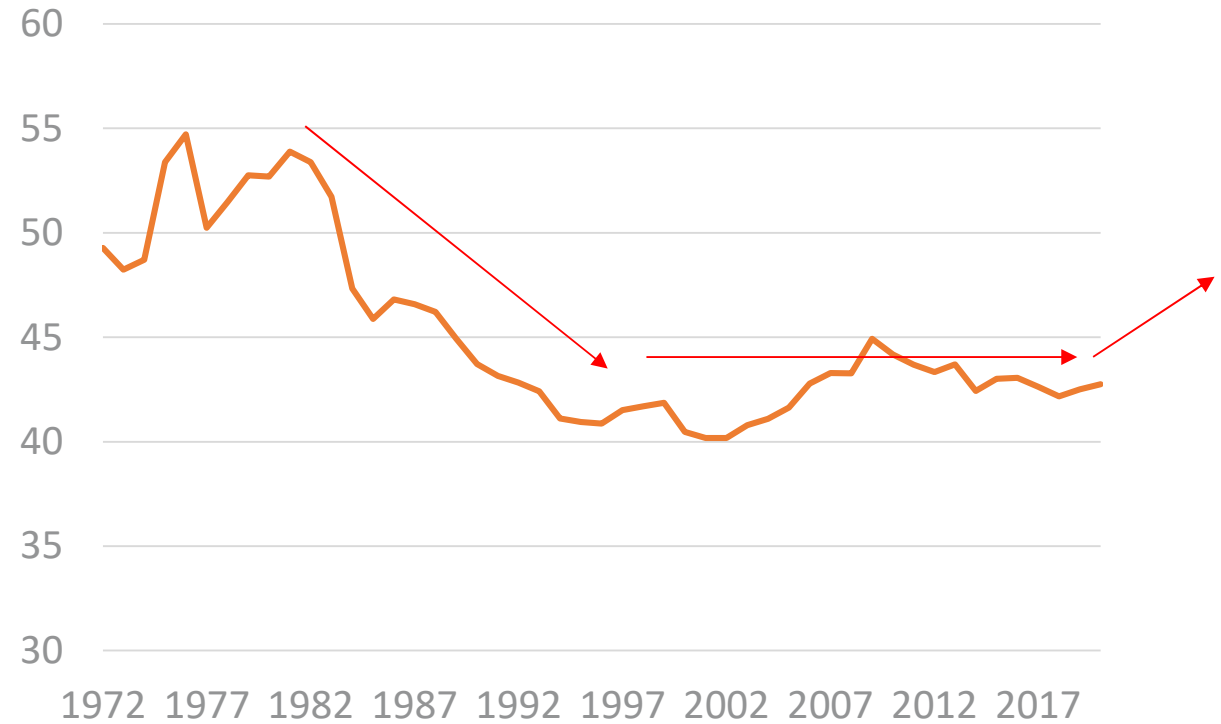
- Low and lower interest rates have dominated
- Wealth creation has been asset price dominated
- Government / fiscal policy has been average
- Where will growth come from going forward and what will drive it?
- **New growth model**
- Businesses will need to focus on **“real” growth**
- **Government policy will need to step up**
- Higher electricity prices exposing poor decisions

Theme 3: Redistribution policy agenda pressure

Compensation of employees - share of GDP % (USA)



Compensation of employees - share of GDP % (NZ)



Theme 4: What worries people?

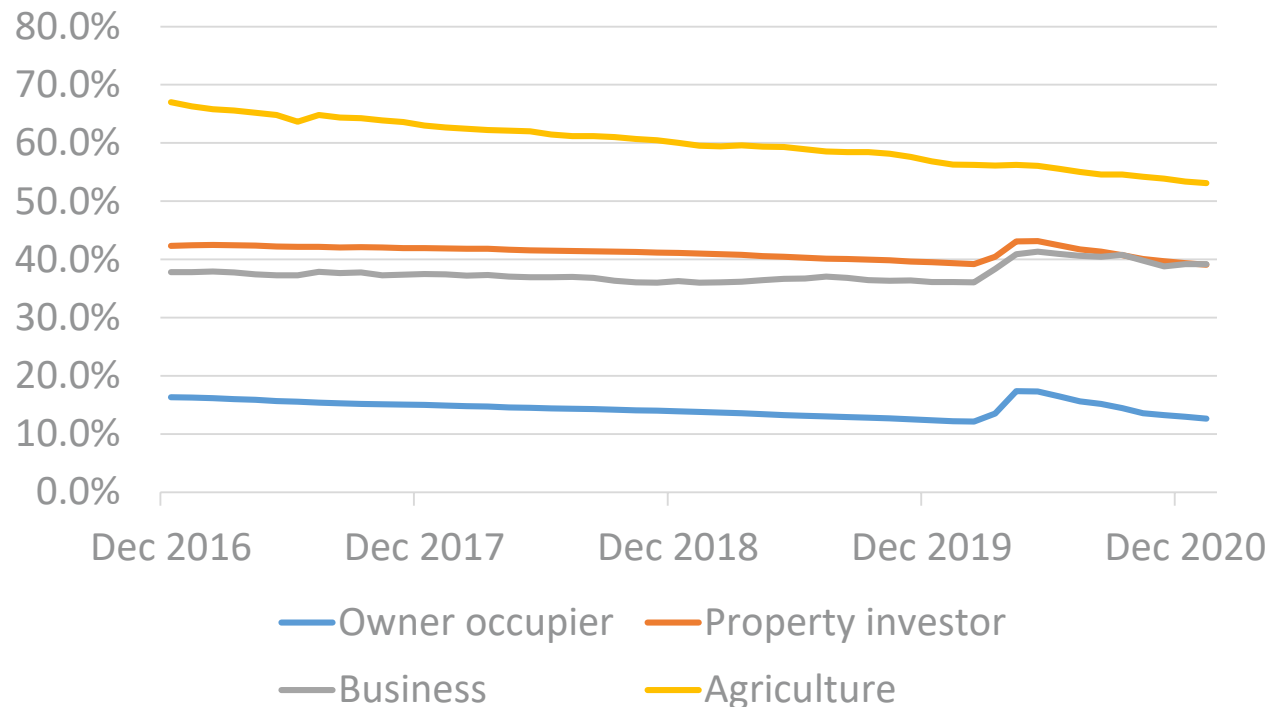
Feb 2021

1. Housing
2. Poverty / inequality
3. Inflation/ cost of living
4. The economy
5. Healthcare

- Housing is perceived as the most important issue today by 60% of people – more than double the next most important issue (poverty / inequality)
- Housing a concern for just 22% of Australians

Government has acted – RBNZ next (again)

Interest only loans by category (% of all loans)



- “We have not done enough of what we can do, and that is what we will be doing over the next few months.”
- Debt-to-income caps?
- Change bank risk weightings?
- Additional capital buffer on some residential lending?
- Caps on interest only lending for investors?
- **Bottom line – residential less attractive**

Property investors in the firing line

- Brightline extension well flagged
- Removing interest rate deductibility is major
- \$80 billion property investor debt @ 3% = \$2.4 billion non-deductible expense removed
- Gross yield now needs to be higher to compensate for removal of deduction
 - Rents?
 - Decline in asset value?
- Banks will change lending criteria
- Government being more interventionist / taking risk as land banker
- Can the government undertake and manage risk?
- Alternatives for investors?

Theme 5: A technical recession

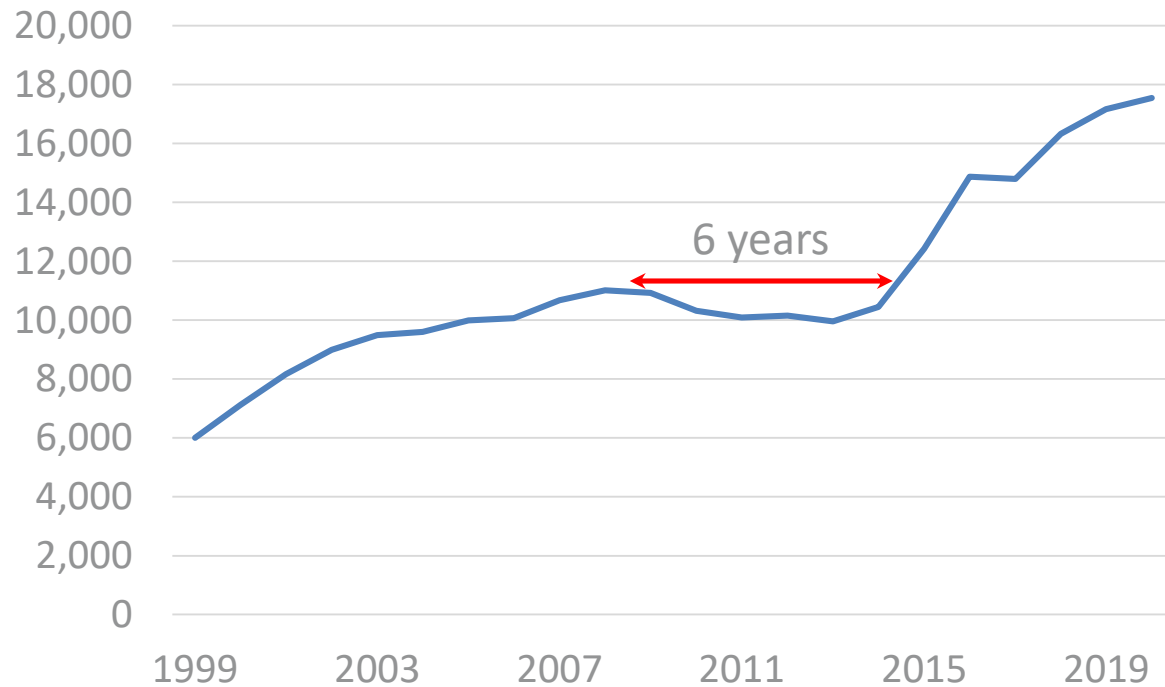
Electronic card transactions monthly % change



- Don't blink - we are in recession but about to come out of it too!
- December quarter negative and March 2021 too. We are in April
- Post lockdown surge tempered by settling period
- Border control restrictions now biting

Tourism faces a long recovery. Airfare cost trend to reverse?

International tourism spend \$m



International airfare costs (index)



Stress metrics still contained and not showing a recession

Credit card advances 90 days past due (% of advances outstanding)

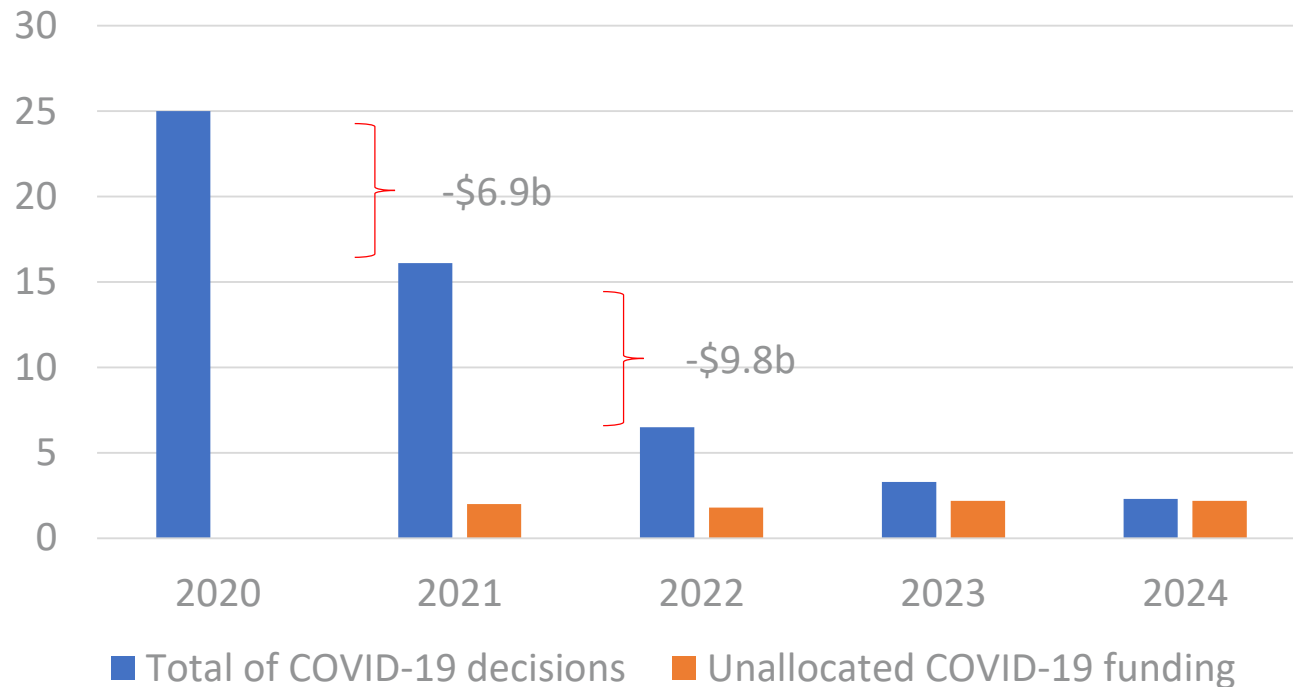


Quarterly personal involvements (number)



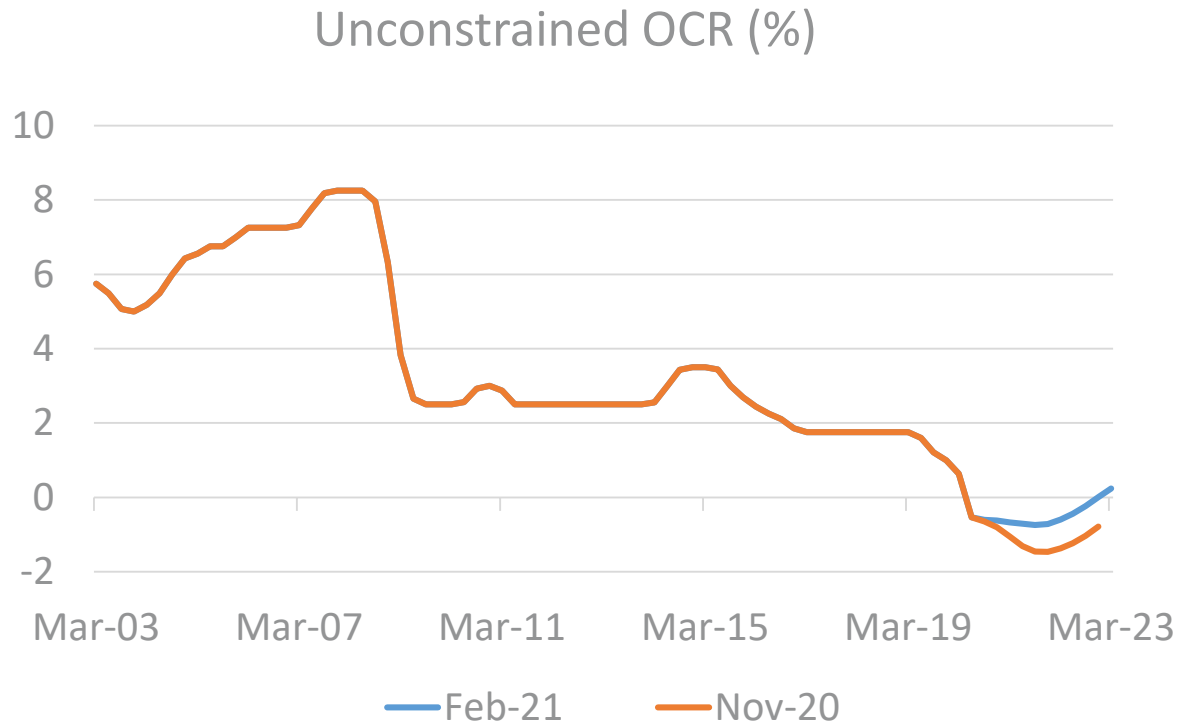
Theme 6: Lots of stimulus

COVID-19 Response and Recovery Fund \$ billion



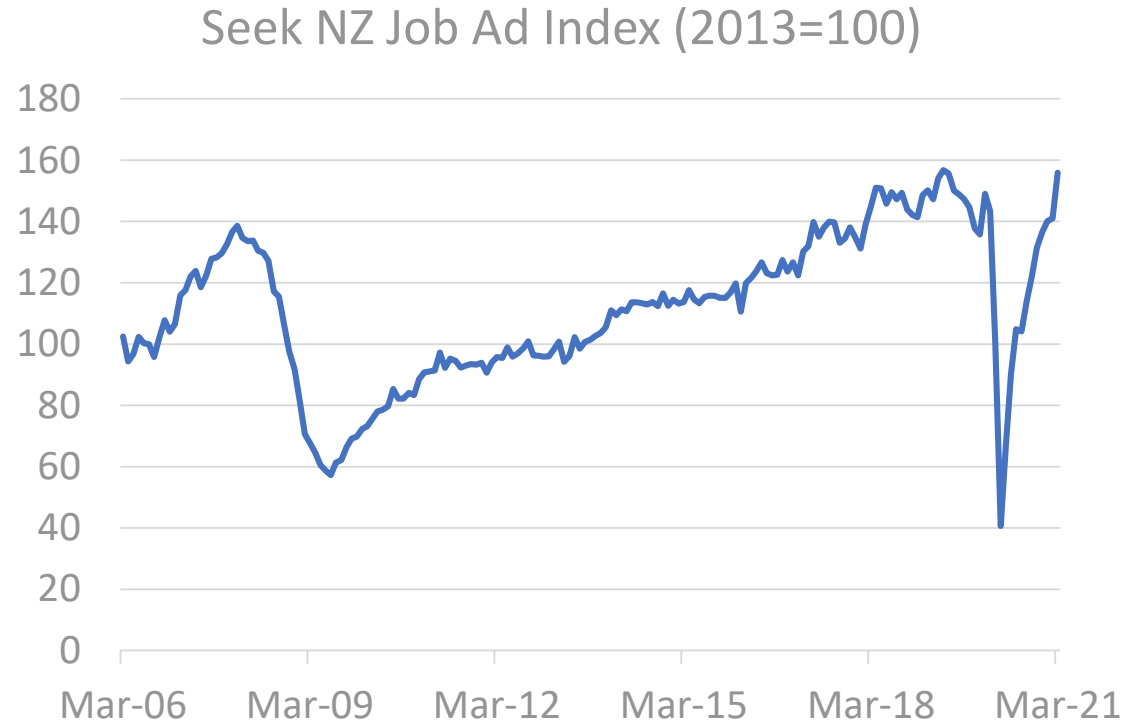
- Fiscal stimulus is still major but fading in size
- There will be pressure to “spend” the remaining \$10 billion from the COVID relief fund
- Shovel ready projects have been a mirage
- The government would be better to help the supply side (i.e RSEs)

Unconstrained OCR highlights degree of stimulus



- Unconstrained OCR is a representation of monetary policy including unconventional measures
- Very stimulatory but less so relative to last year
- Deployment of funding for lending program (a crisis tool) is puzzling
- No exit strategy in play yet
- Laws of unintended consequences appearing – strong lift in deposits

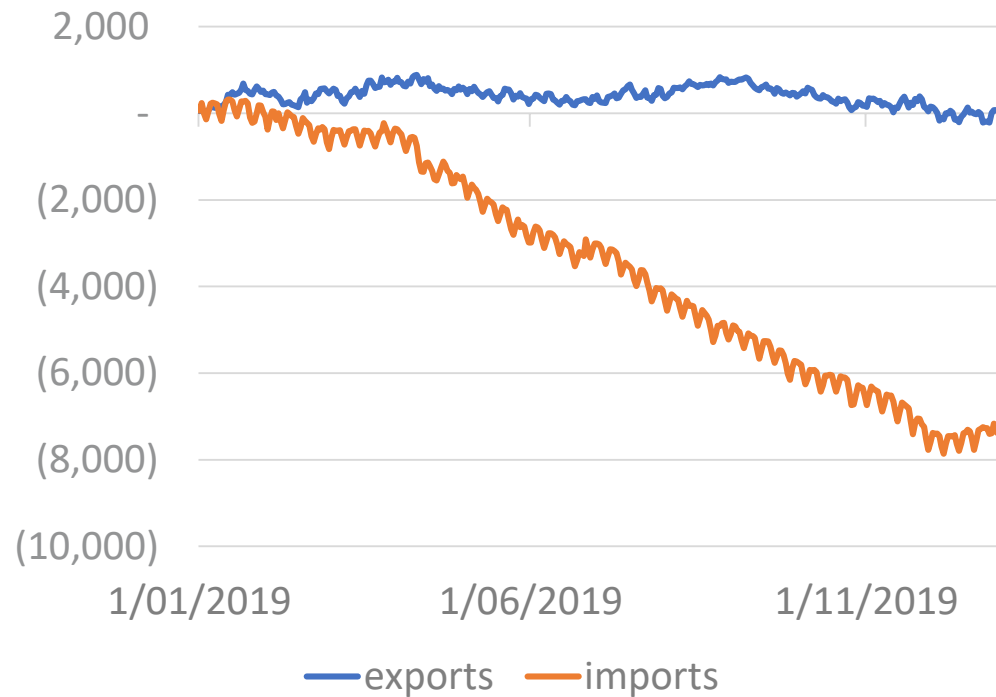
Theme 7: Demand is not the issue; meeting demand is. Finding staff!!!!



Auckland the only region with job ads below 2019 levels
Skill shortages appearing despite 200k people out of work

Imports were the 2020 story. Exports 2021?

Exports and imports 2020 vs 2019 \$m



Exports 2021 vs 2020 \$m

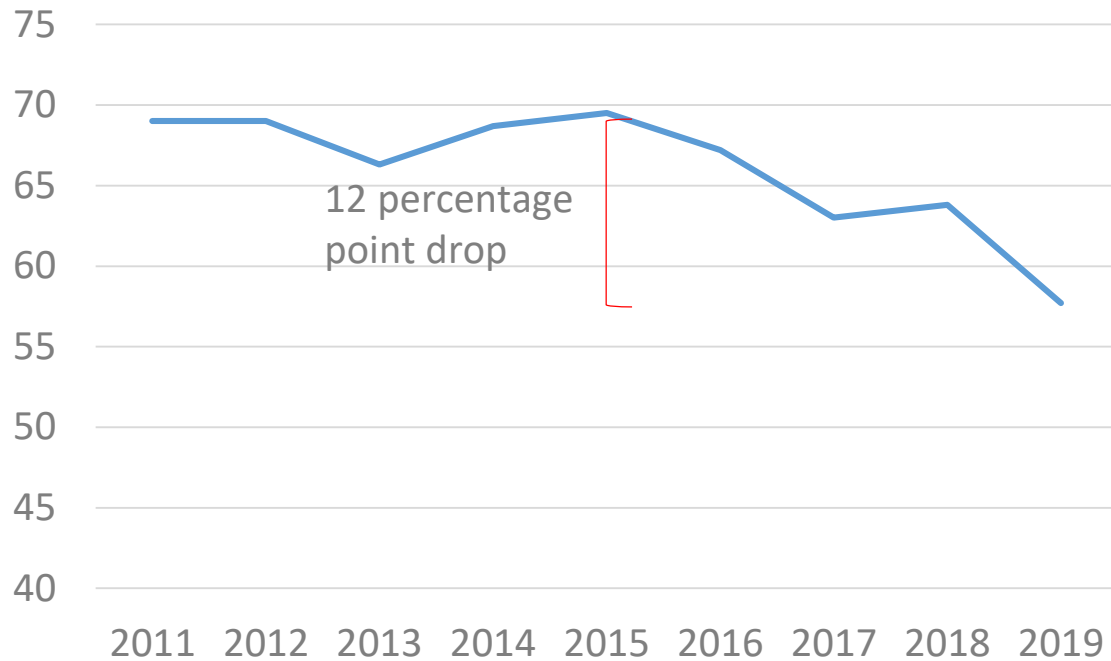


What do supply disruptions mean?

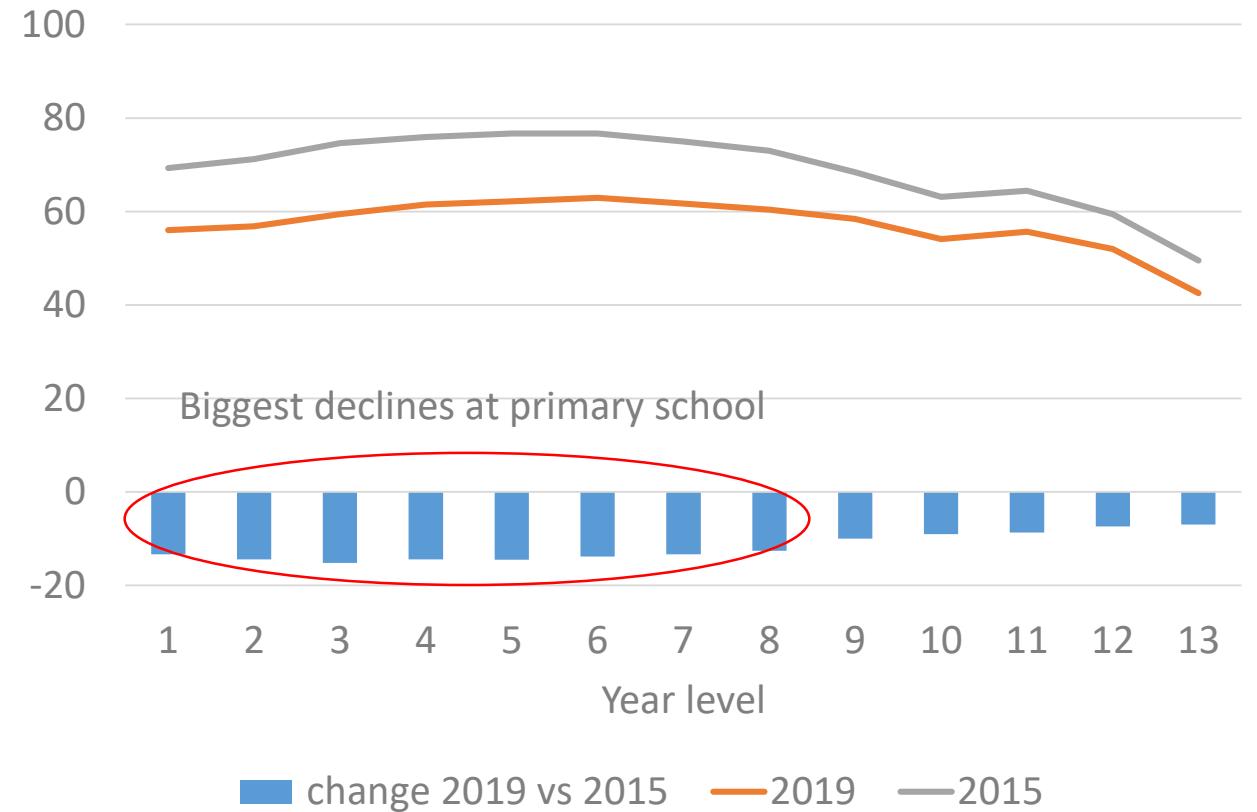
- Constrained growth = less volume
- **Lower productivity**
- Rising costs including wages
- Margin erosion if you can't pass on price increases
- **Competition for supplies (including labour)**
- Investment decisions get delayed. i.e. horticulture's inability to access RSEs may mean fewer trees planted
- **Conversations will change and security of supply will be focused on = more nationalism**
- Opportunities for manufacturing to come back home? Industrial property?

Student school attendance

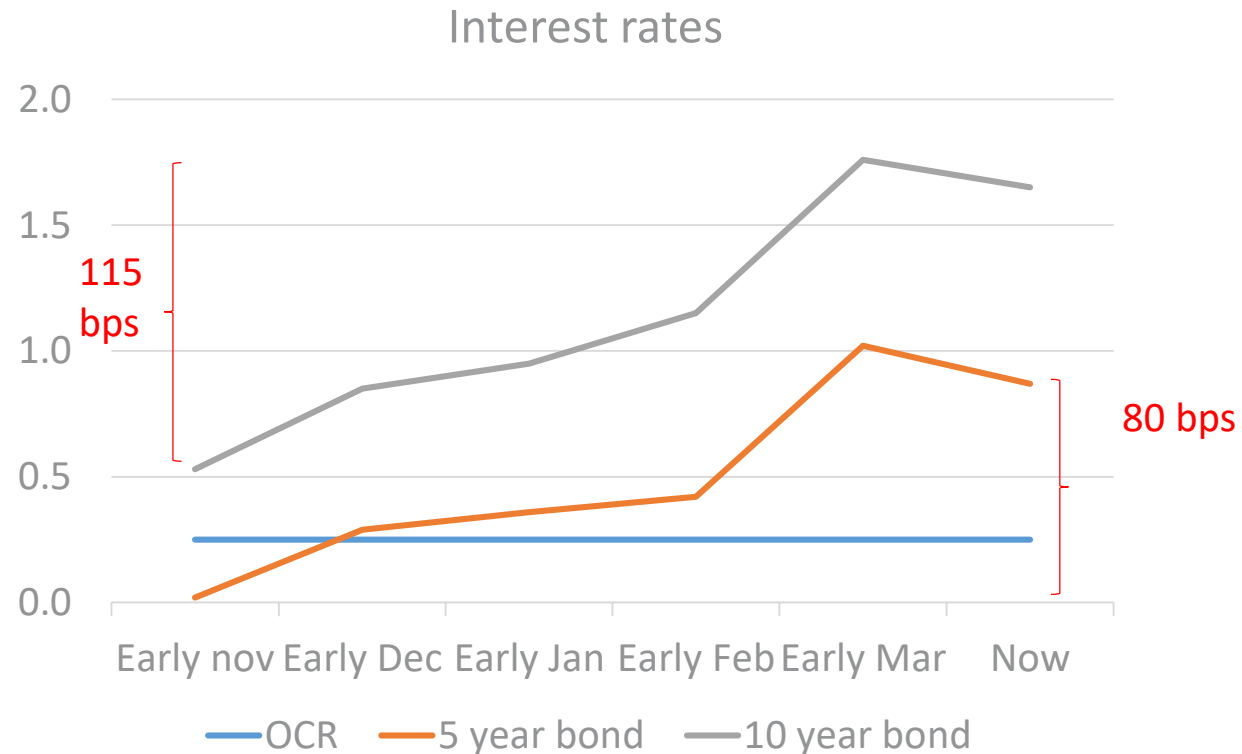
% of students regularly attending school



Student attendance by year level

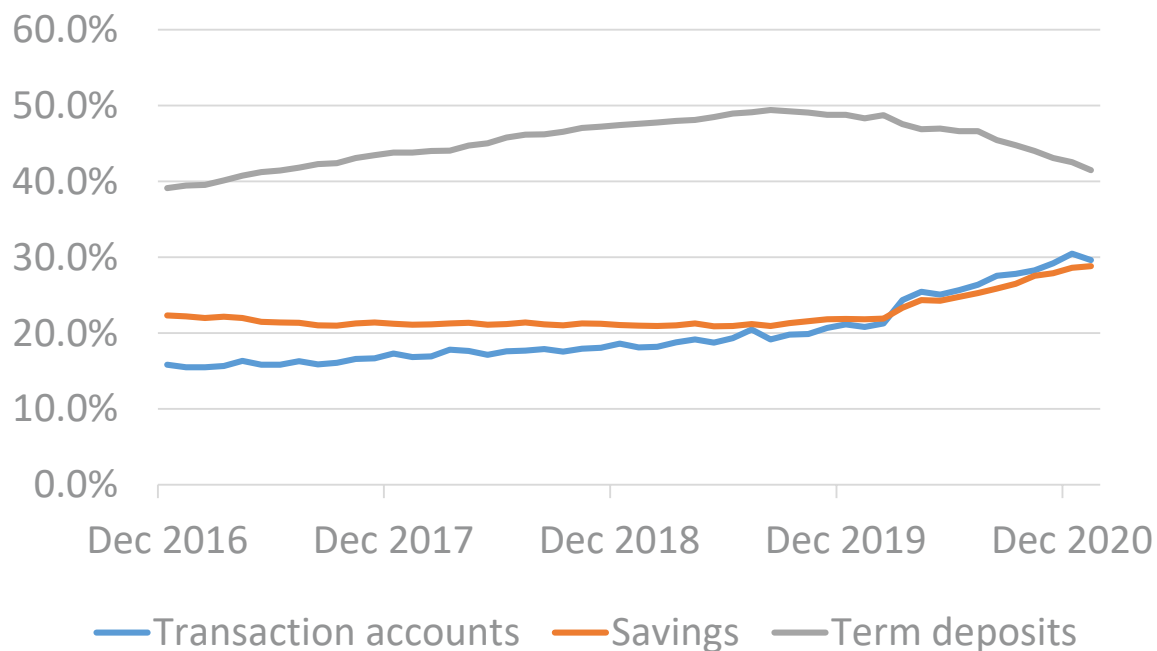


Theme 8: Interest rate expectations continue to normalise. Interest rates well off lows



Will rising wholesale rates lift borrowing rates? Bank funding costs are key

Share of bank deposits



- Banks continue to benefit from cheap funding
- 85% of bank funding is <1 year maturity
- \$230 billion comes from overnight money
- **That is \$230 billion in savings and transactions accounts looking for a home!!!**
- The RBNZ can anchor funding costs (for a while yet)
- But eyes on inflation

Theme 9: Pressure on costs

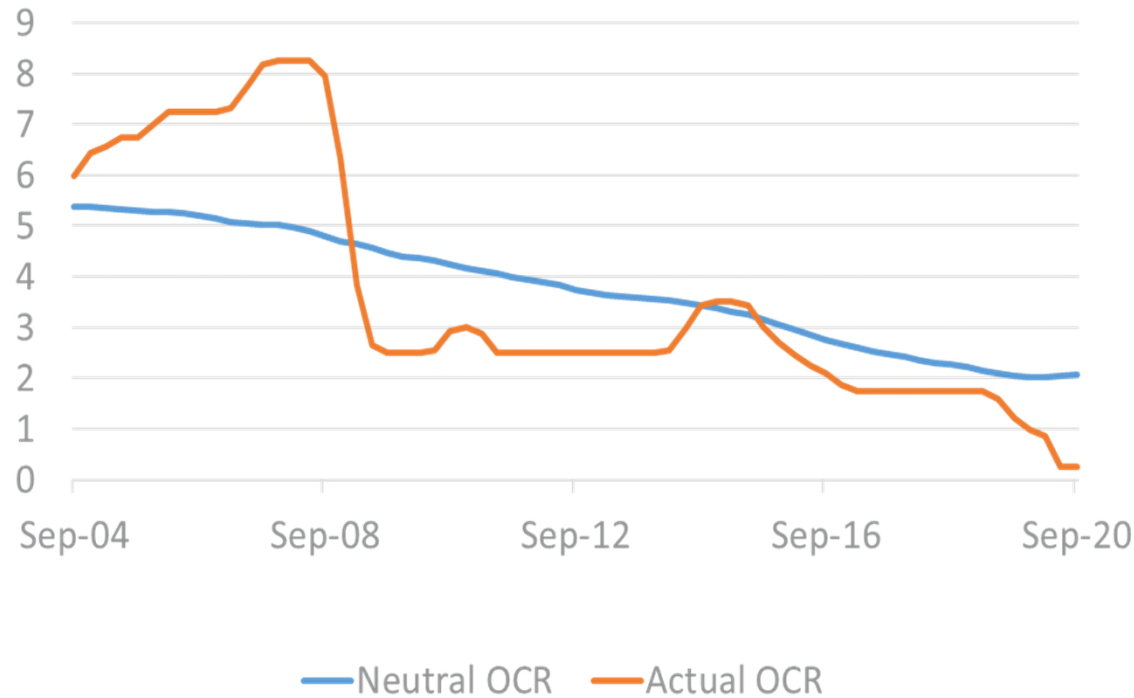
Pricing intentions and costs (net balance expecting increase)



Source: Bagrie Economics, ANZ Business Outlook Survey

Theme 10: Less low interest rates but still low

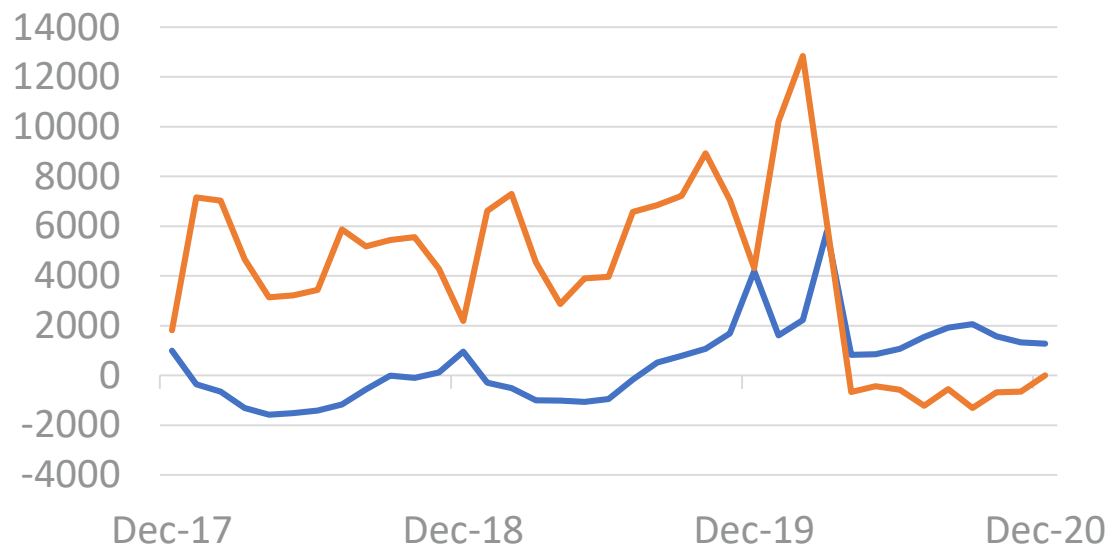
OCR and estimated neutral rate



- Neutral Official Cash Rate has fallen
- This means lower interest rates than we are used to
- Even when interest rates move up, it will not be by much
- Other levers RBNZ can pull to tame the likes of housing
- Term deposit back to 3%?

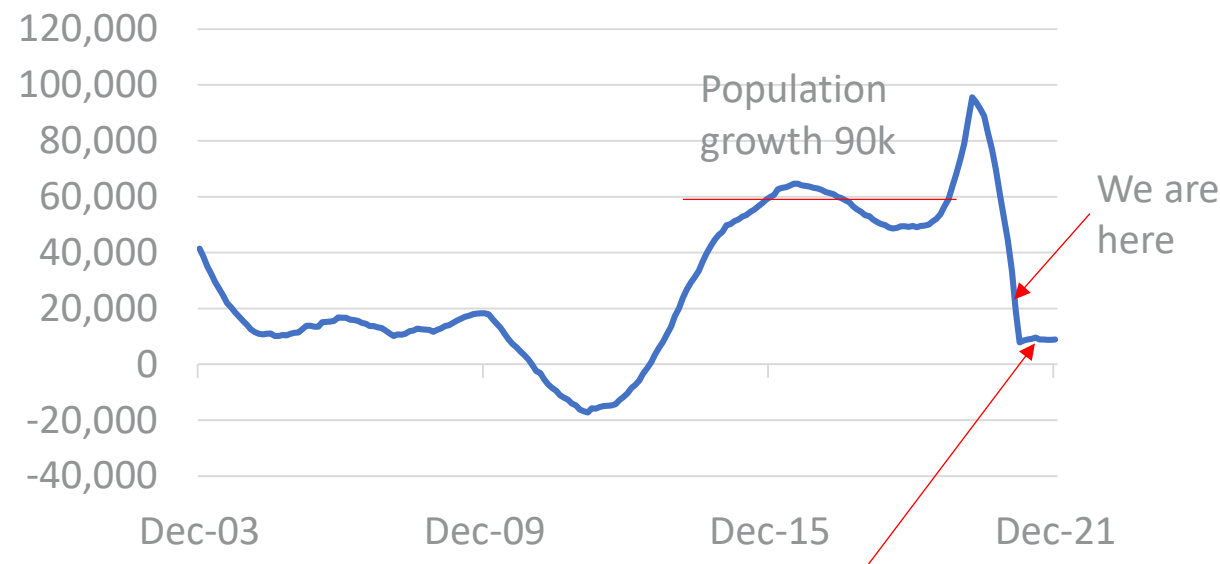
Theme 11: Are we going to end up building too many houses?

Net migration - monthly



- Net migration (NZ citizens)
- Net migration (non-NZ citizens)

Net migration - annual



Population growth 90k

We are here

Net migration <10k = population growth 40k

Where to from here?

Good / winners

- Healthcare
- Infrastructure
- Can we get water policy right?
- Digital transformation has gone explosive
- Food supply but caveats
- The green economy / renewables
- Manufacturing? If we can be competitive
- COVID has reinforced importance of China

Challenges and questions

- Tourism faces a long road back
- Where to for housing?
- Post COVID19 supply chains?
- Economics and social side are colliding
- Govt policy will become more interventionist
- Poor decisions now exposed i.e. gas
- Inflation pressures are simmering
- Can NZ remain “Switzerland” in China issues