



Capacity Constrained

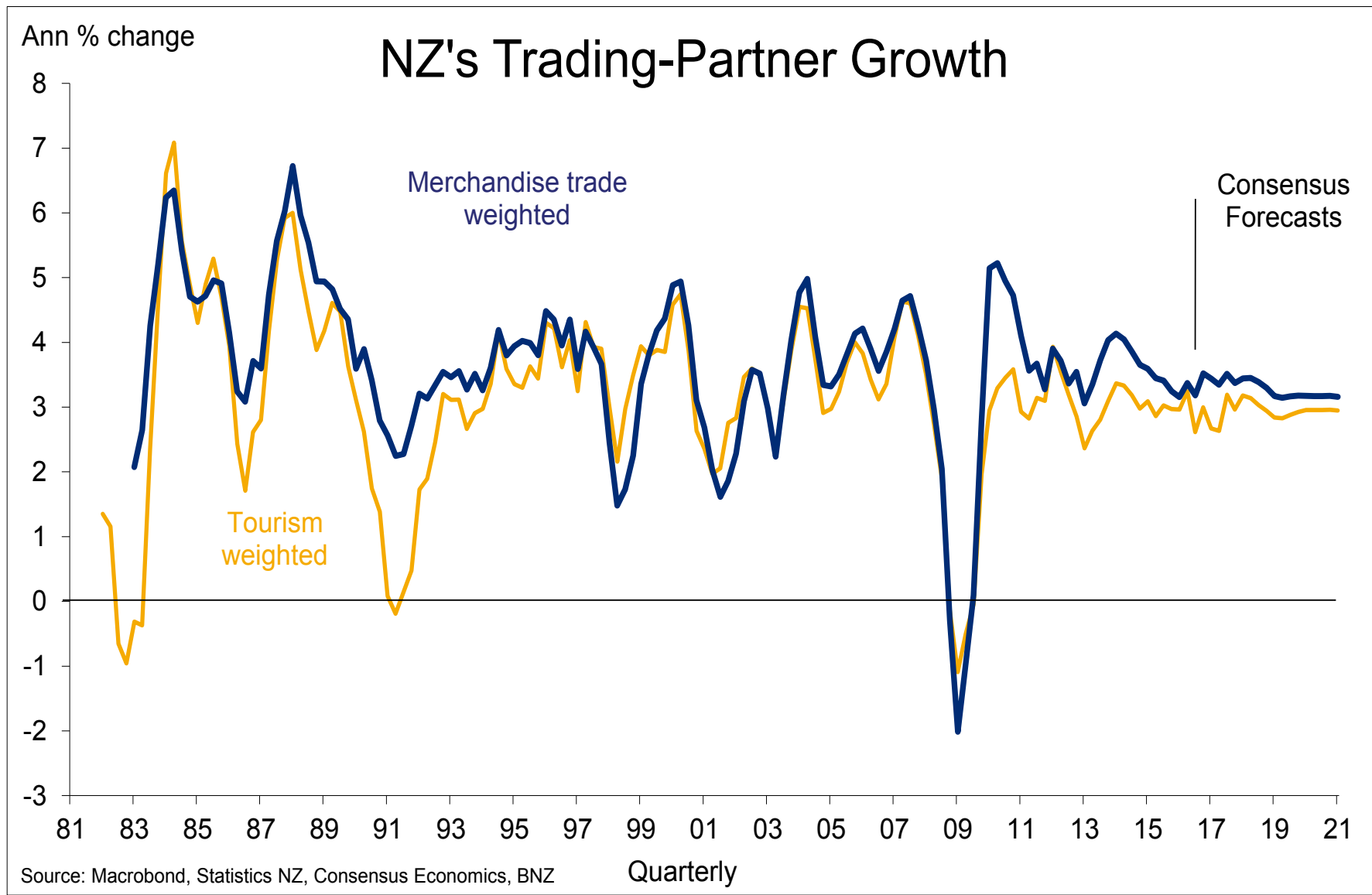
Stephen Toplis – Head of Research

July 2017

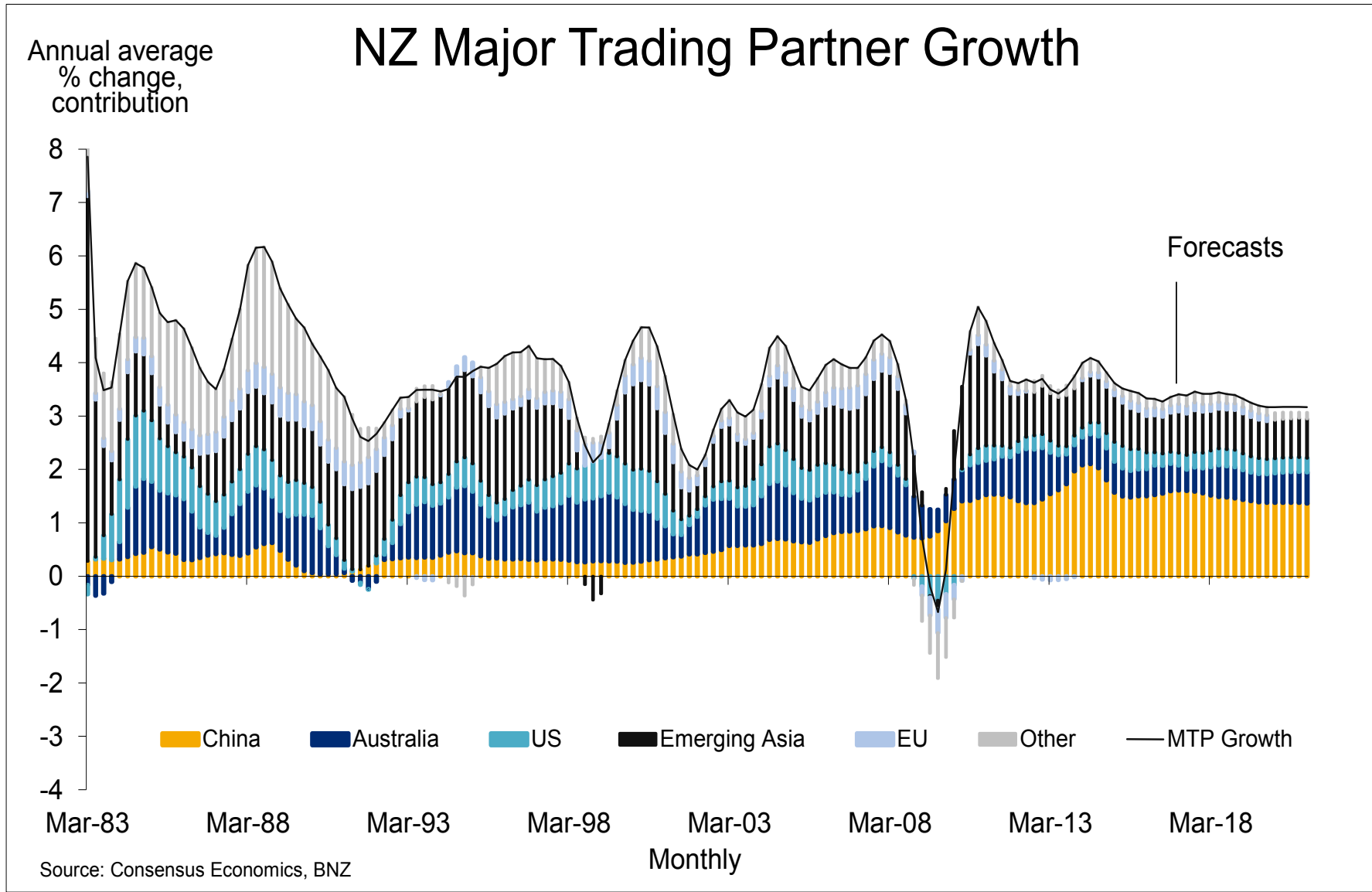
Key Discussion Points

- Economy capacity constrained
- Inflationary pressures rising but inflation contained
- Fiscal easing to boost the expansion
- Housing remains a focal point
- Face of the RBNZ to change
- Dairy bouncing
- Interest rates headed higher
- NZD stronger for longer
- NZ and Australia very different

Global Growth Remains Elevated



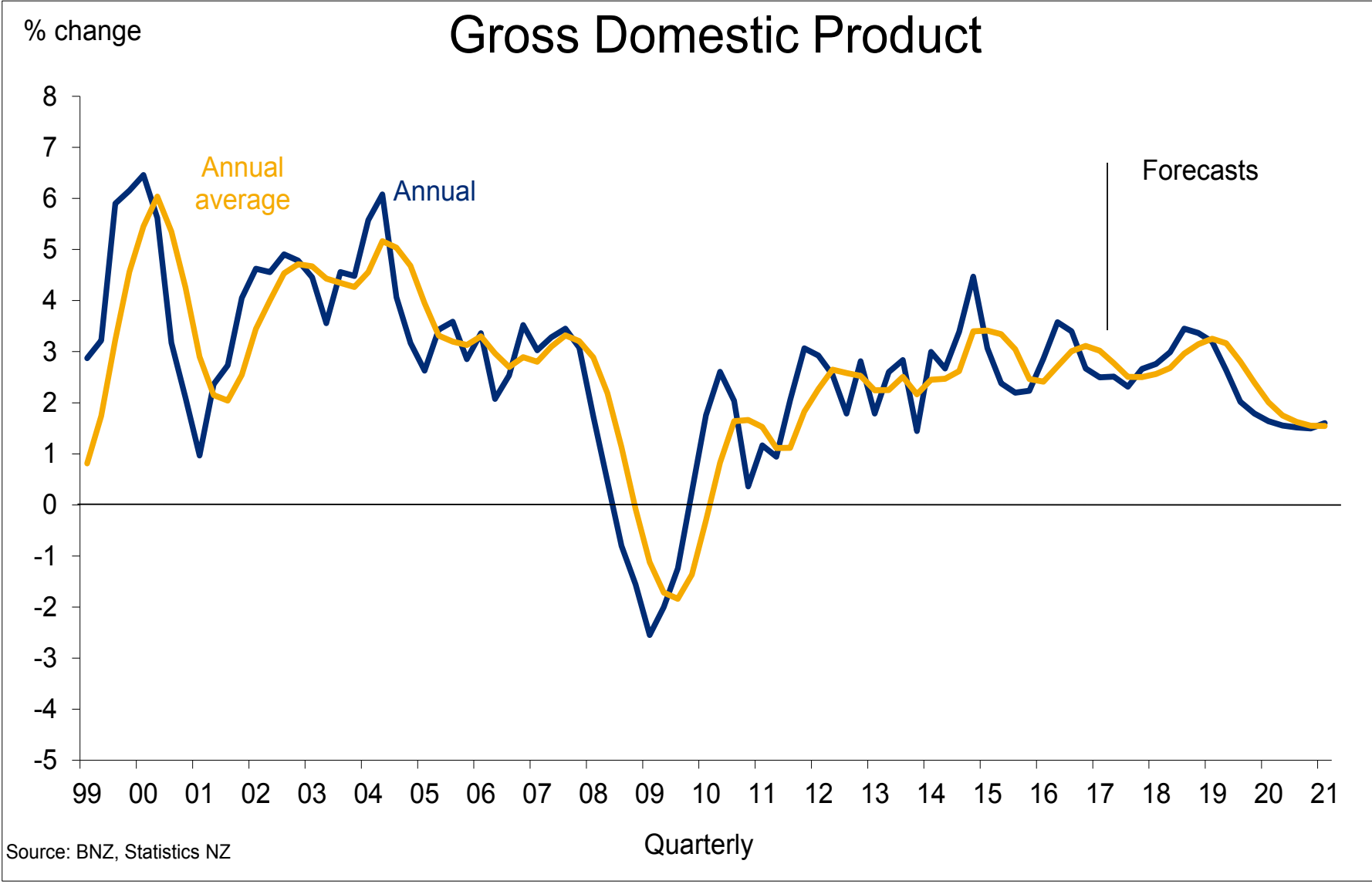
Asia Rules The Roost



Key Global Issues

- A lack of inflation
- Technological change
- Low Productivity growth
- An ageing population
- Climate change
- Brexit
- Unwinding monetary easing
- Chinese debt

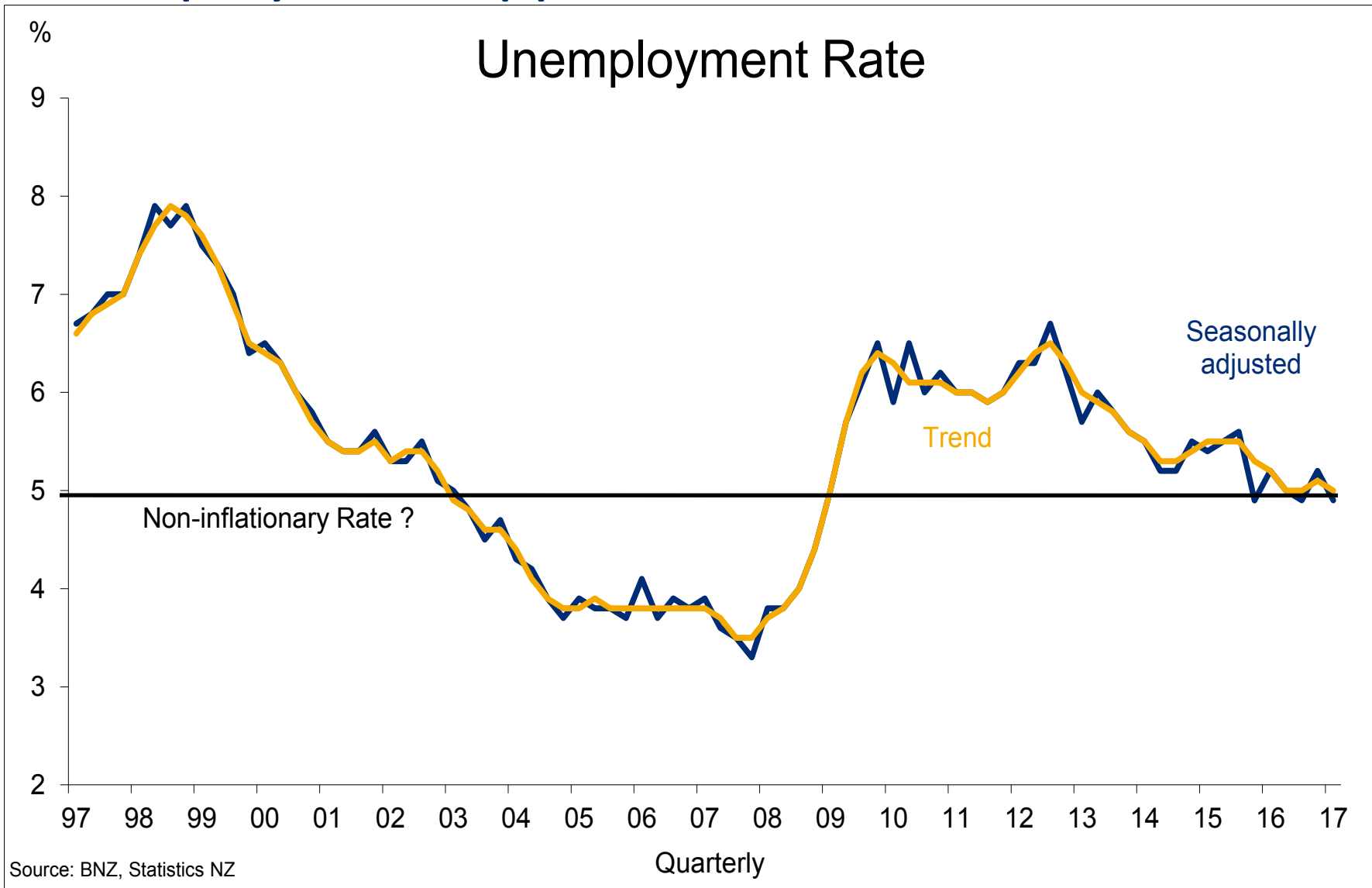
Growth Set To Slow



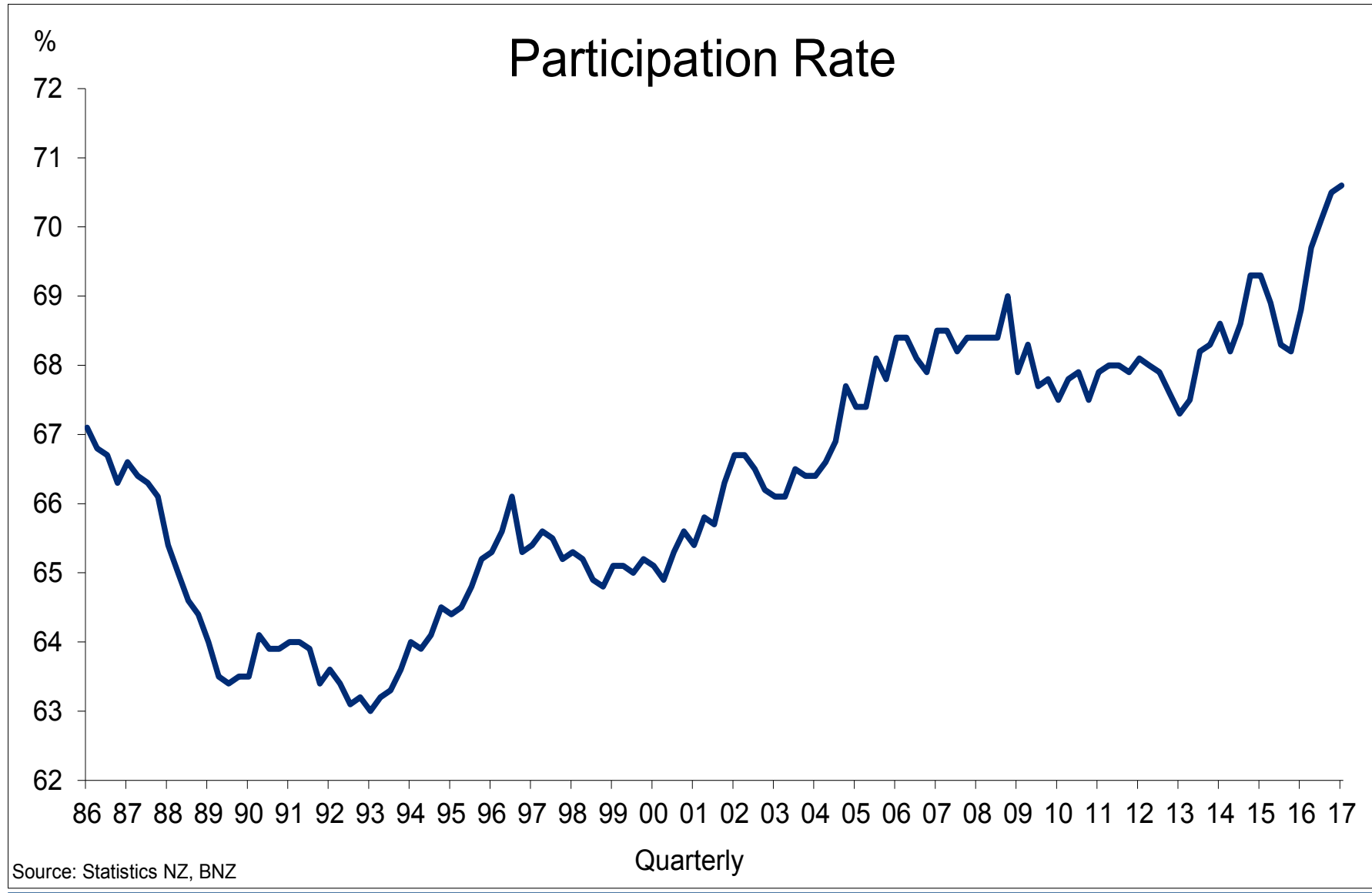
Capacity Constraints Everywhere

- Labour very scarce
- Capacity variables stretched
- Construction activity thwarted
- Tourism facilities packed
- Hotels full
- Commercial vacancy rates very low
- Dairy environmentally challenged
- Infrastructure creaking
- Credit in short supply
- Debt levels elevated

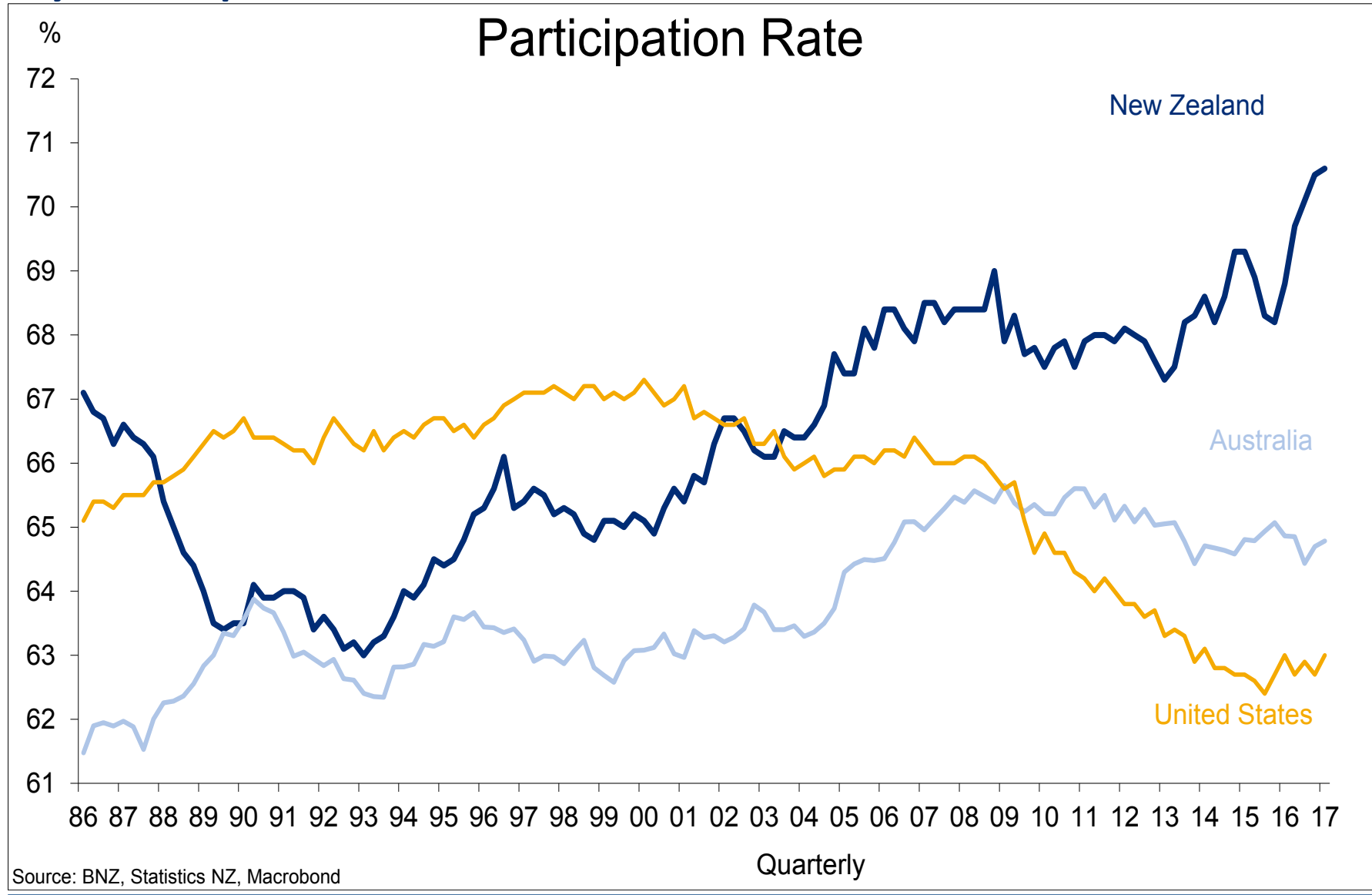
Unemployment Approaches Nairu



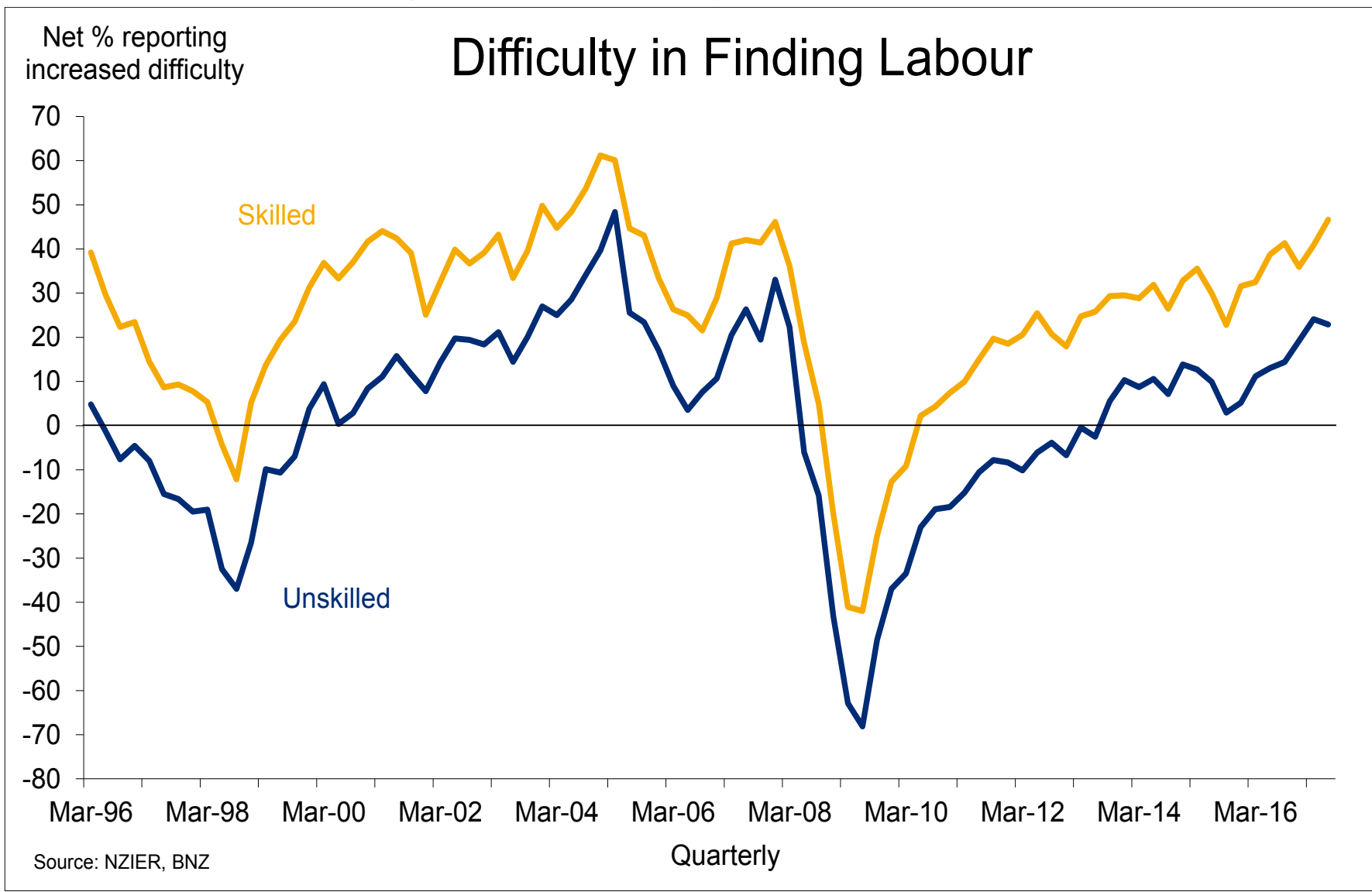
Participation Soars



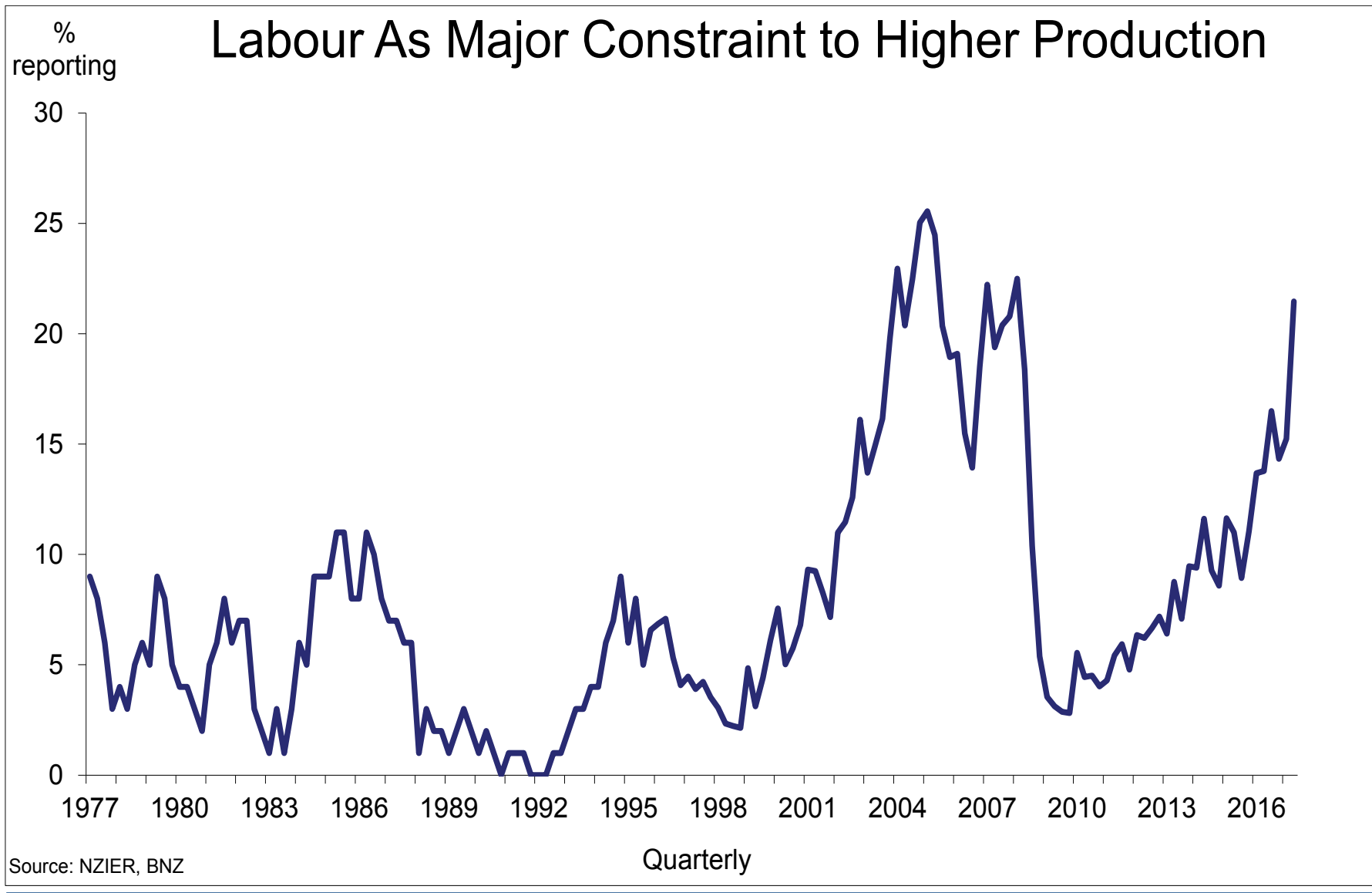
By Comparison



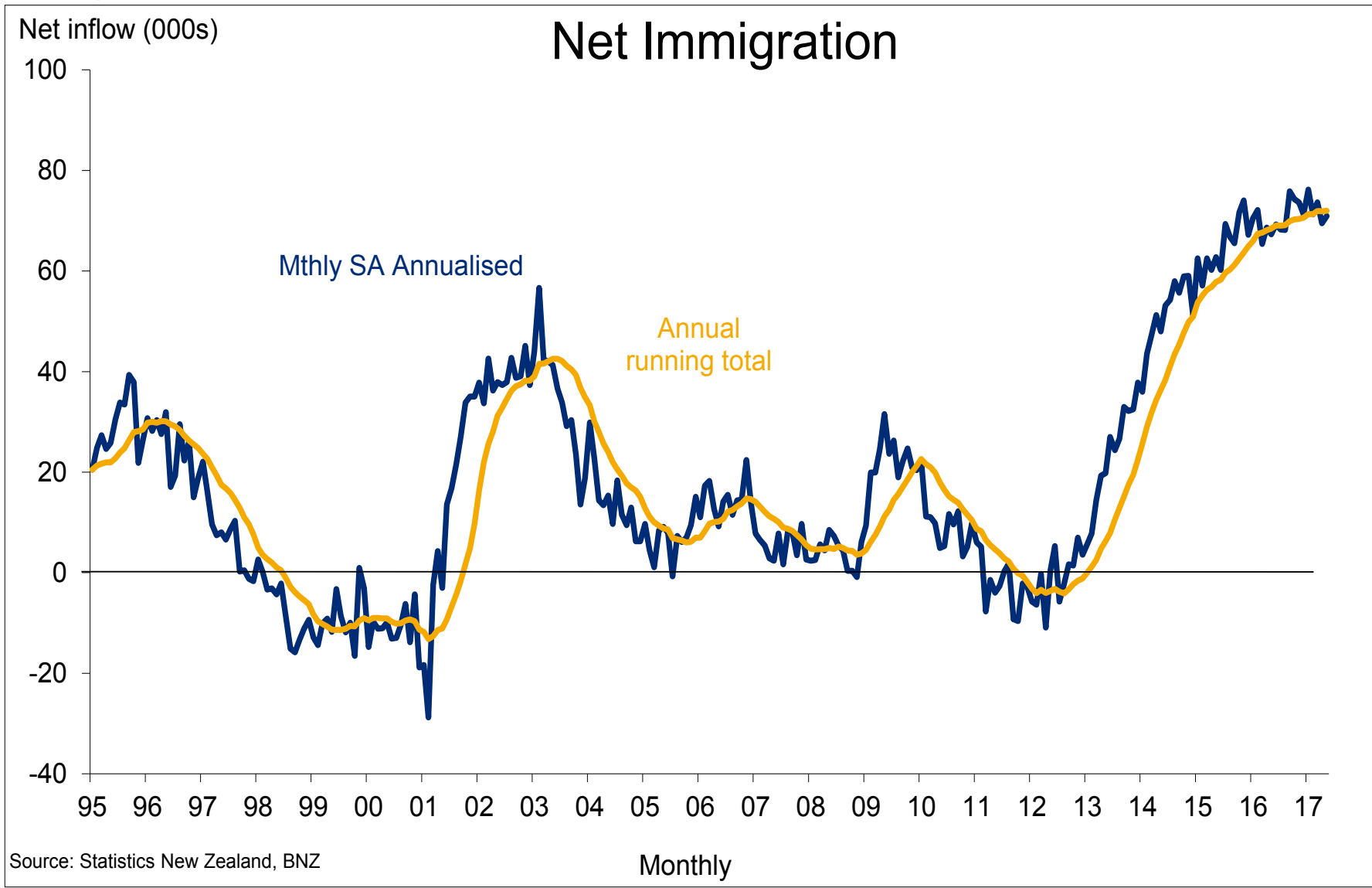
Labour Shortages Intensify



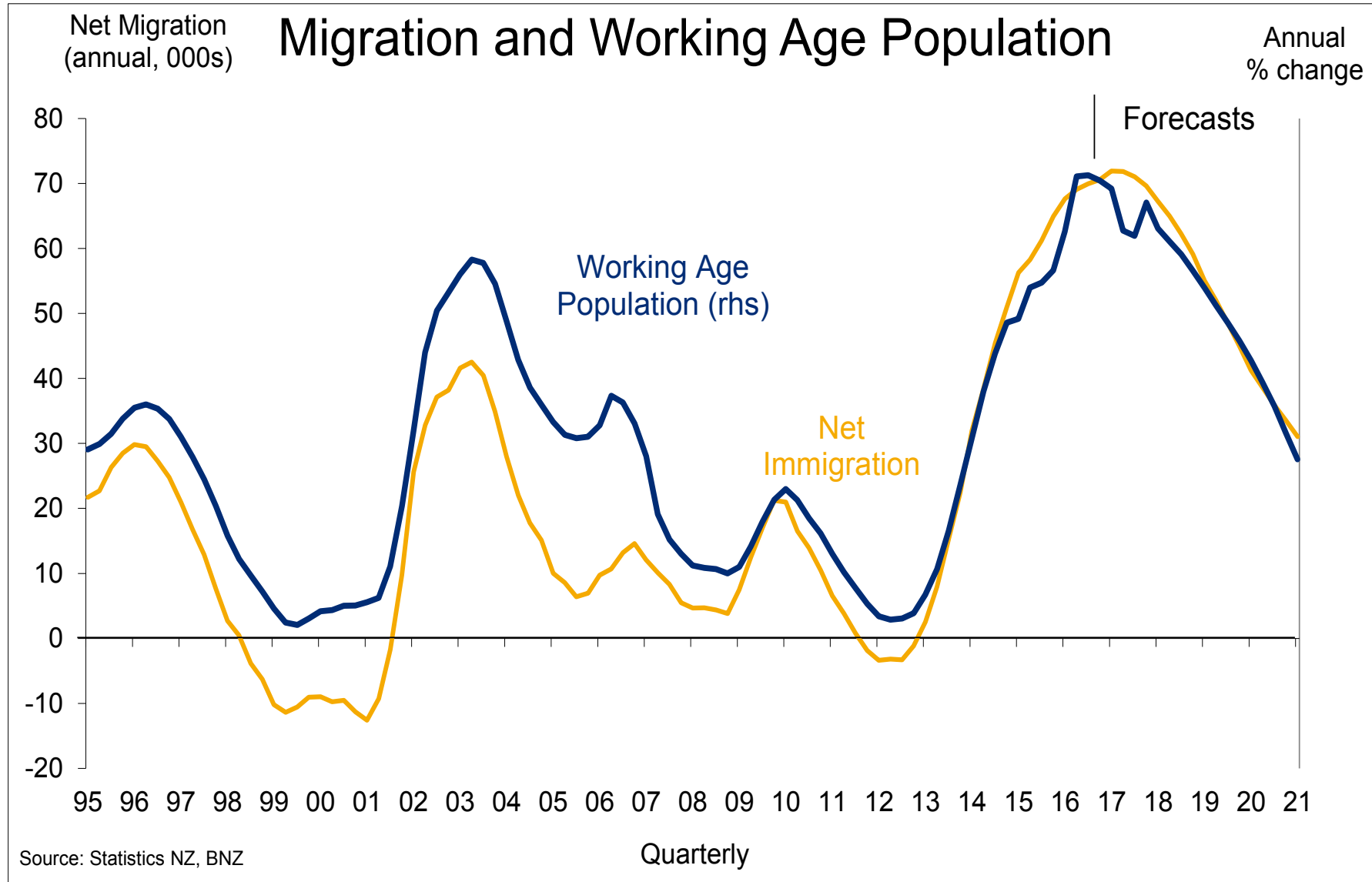
Shortages Constrain Production



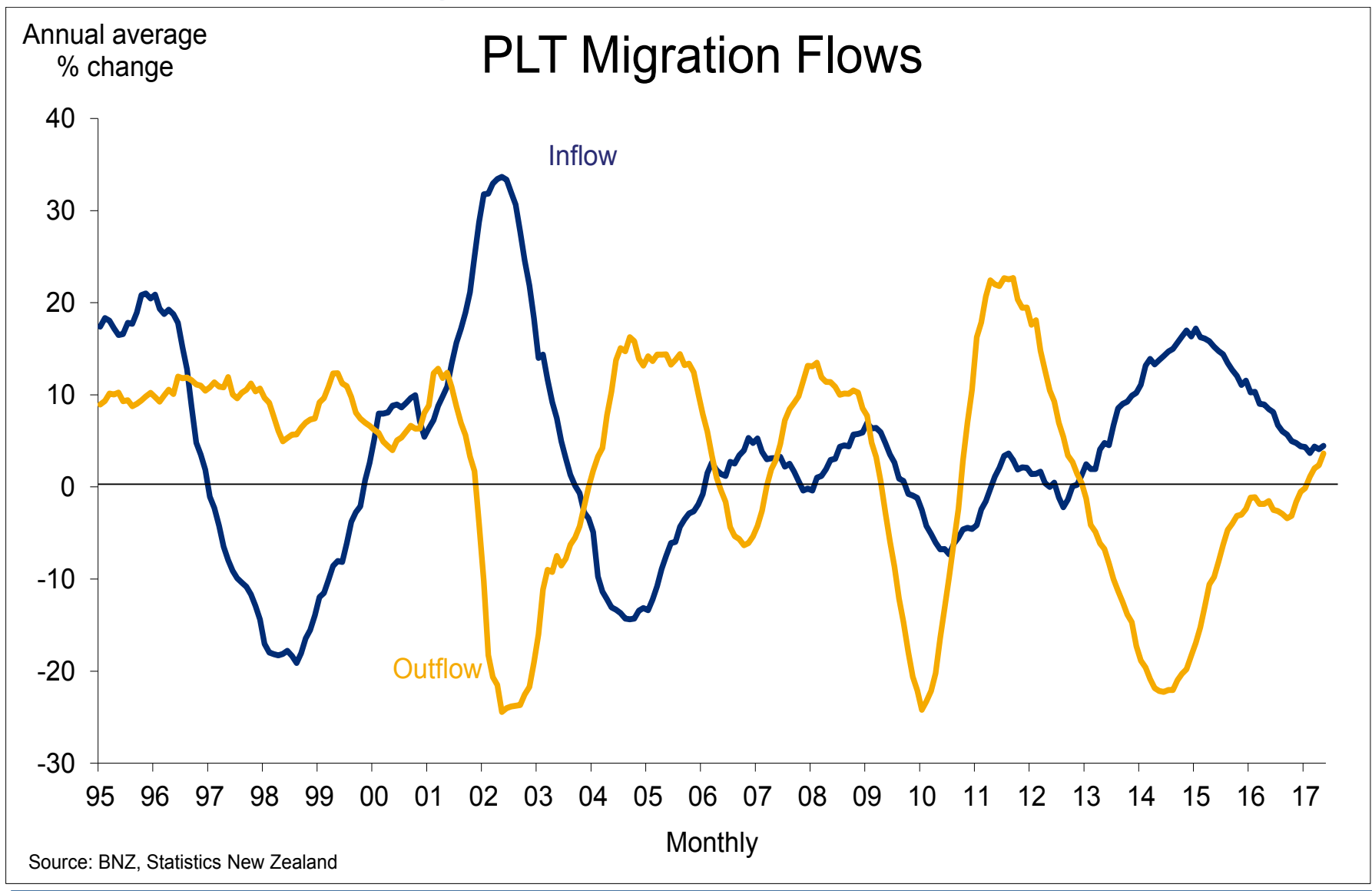
Migration Safety Net Loosens



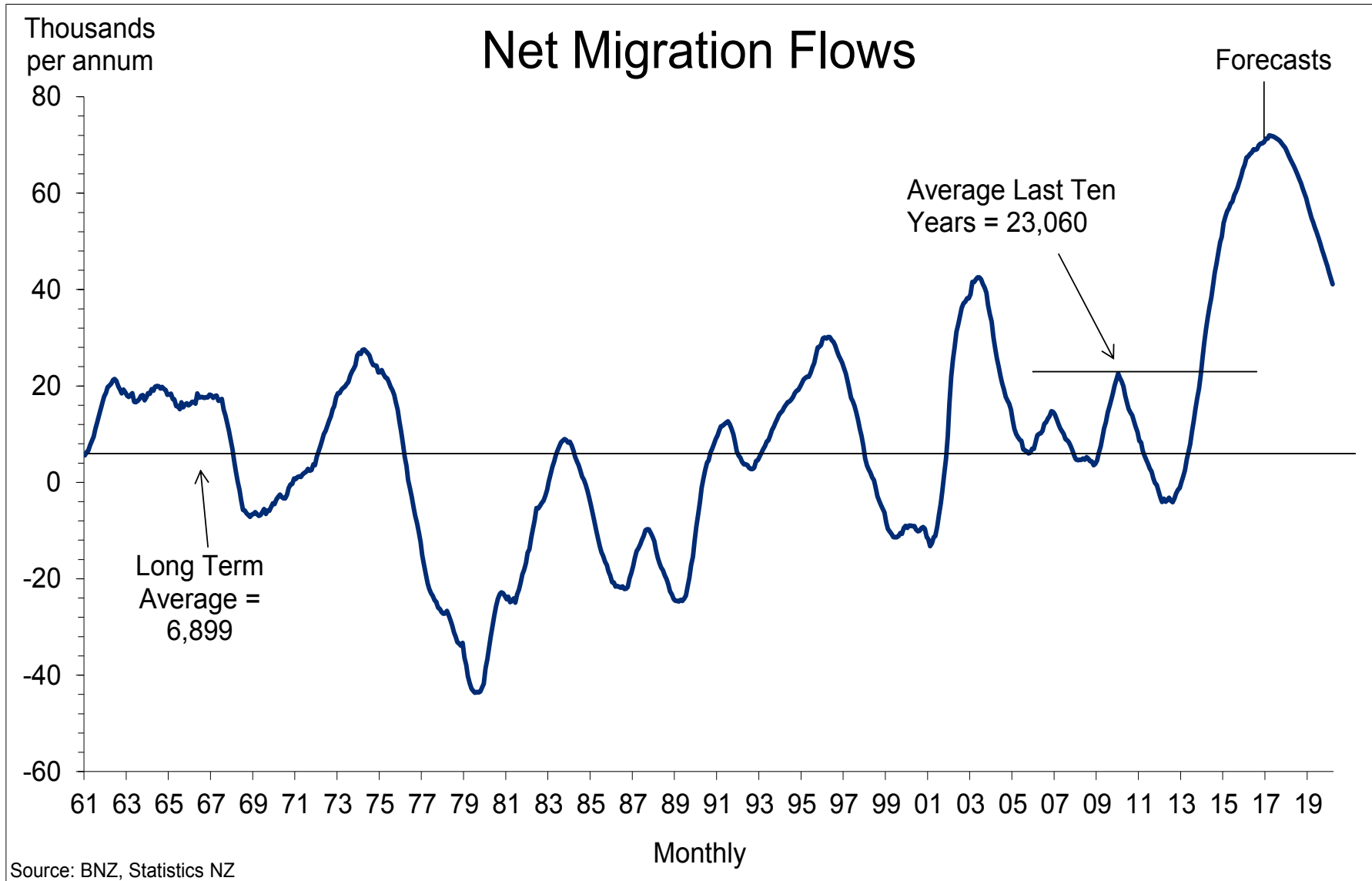
It Matters



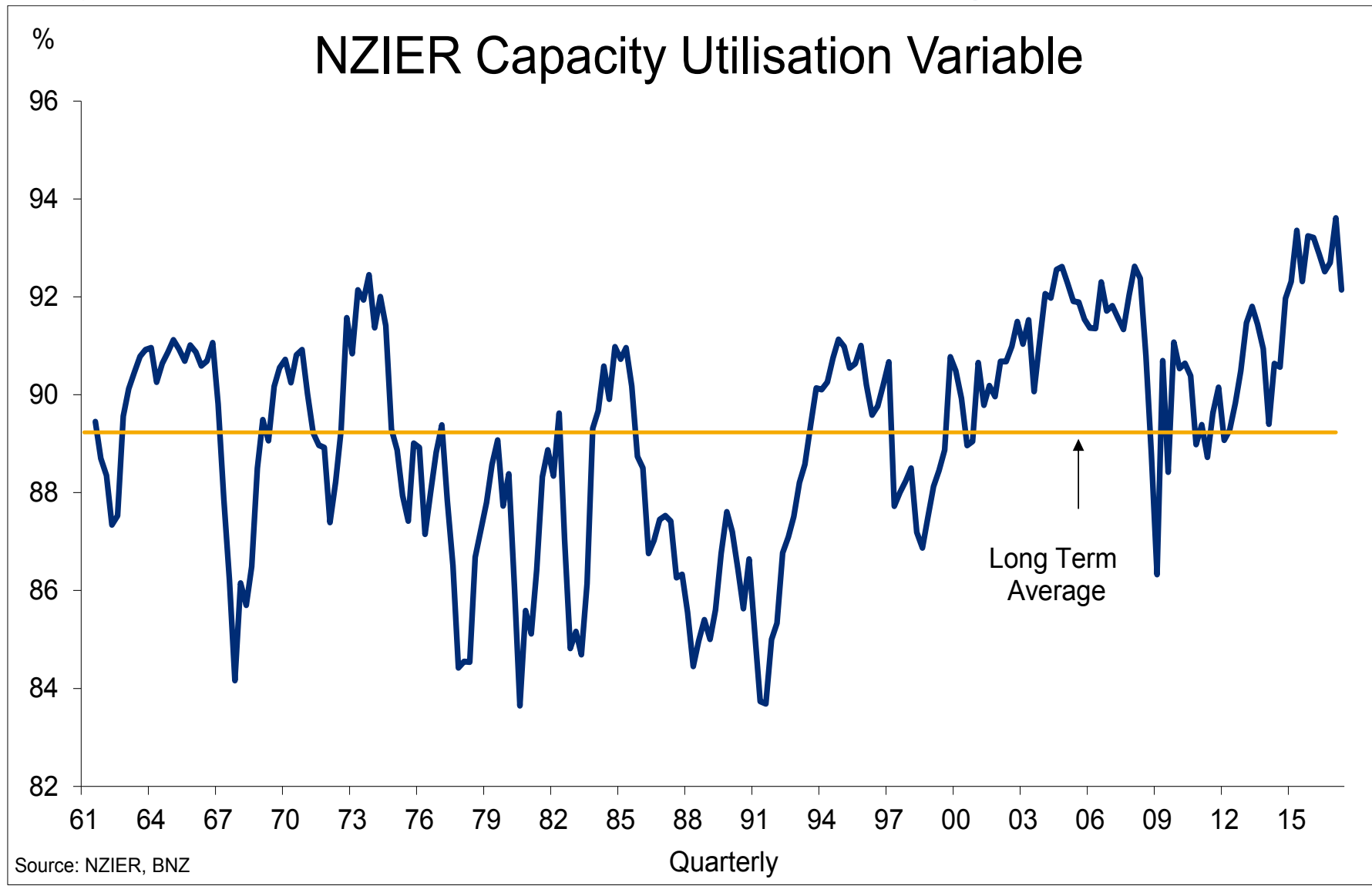
Jaws Are Closing



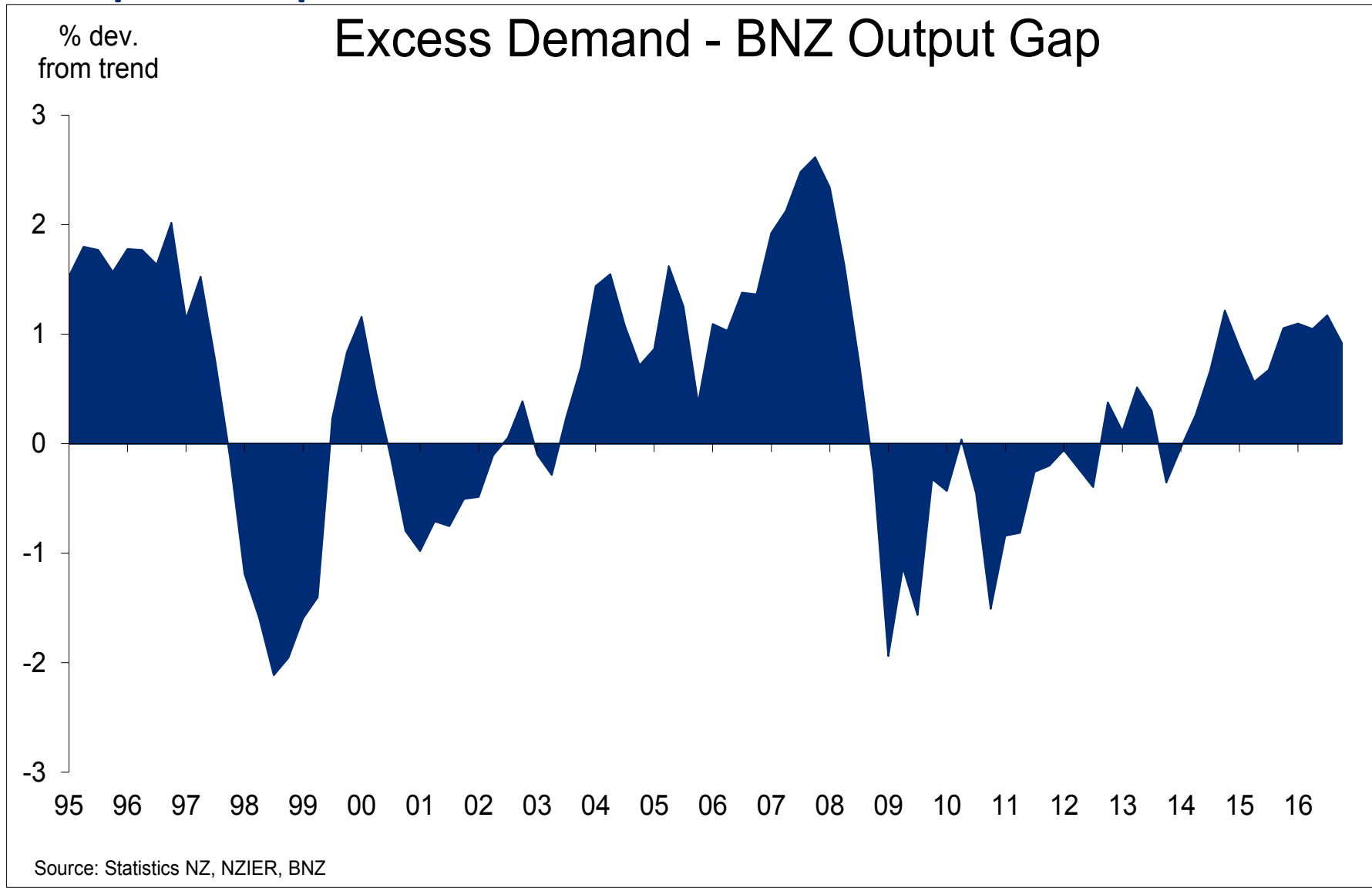
In Perspective



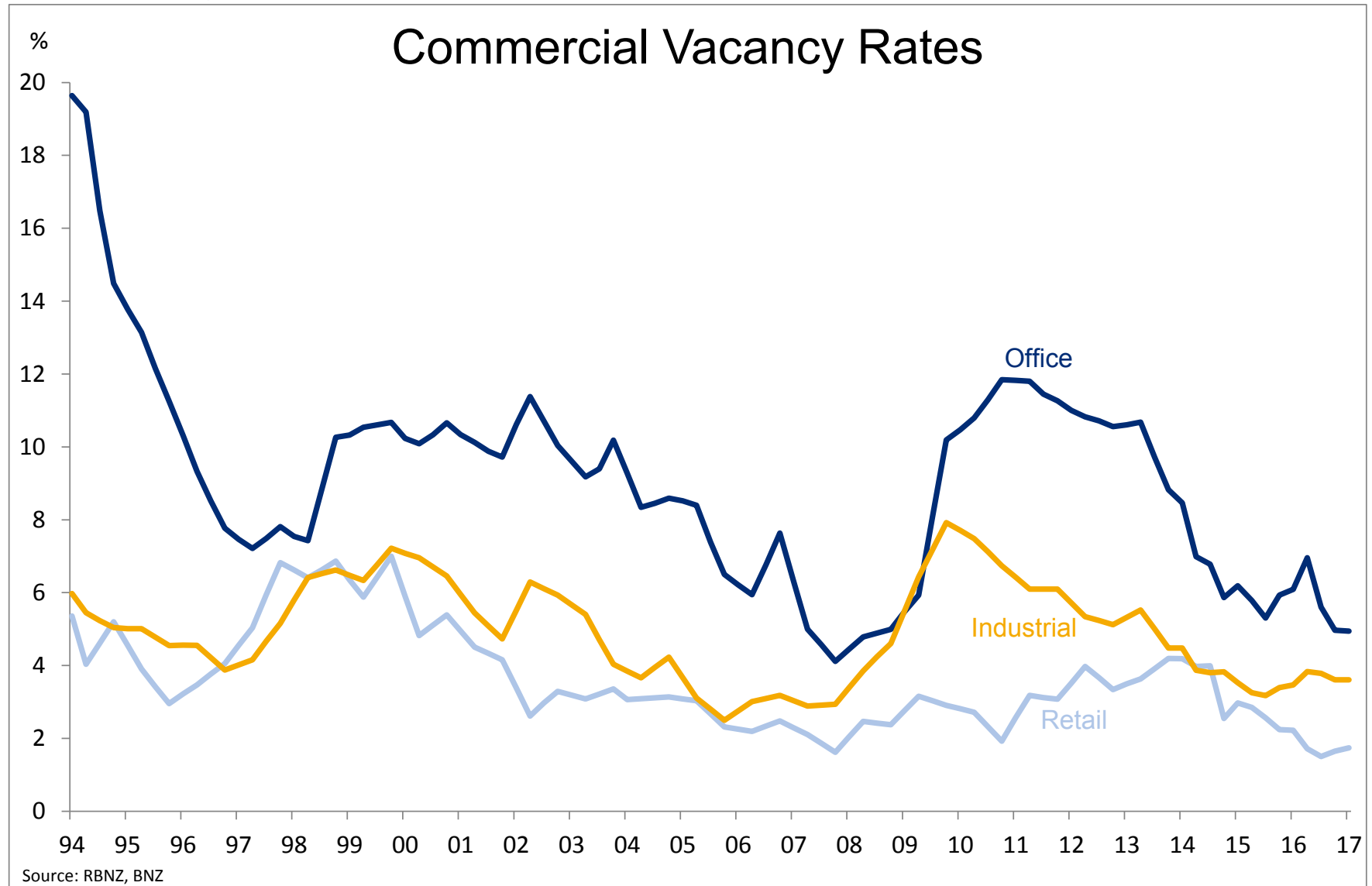
Capacity Utilisation Near Record Highs



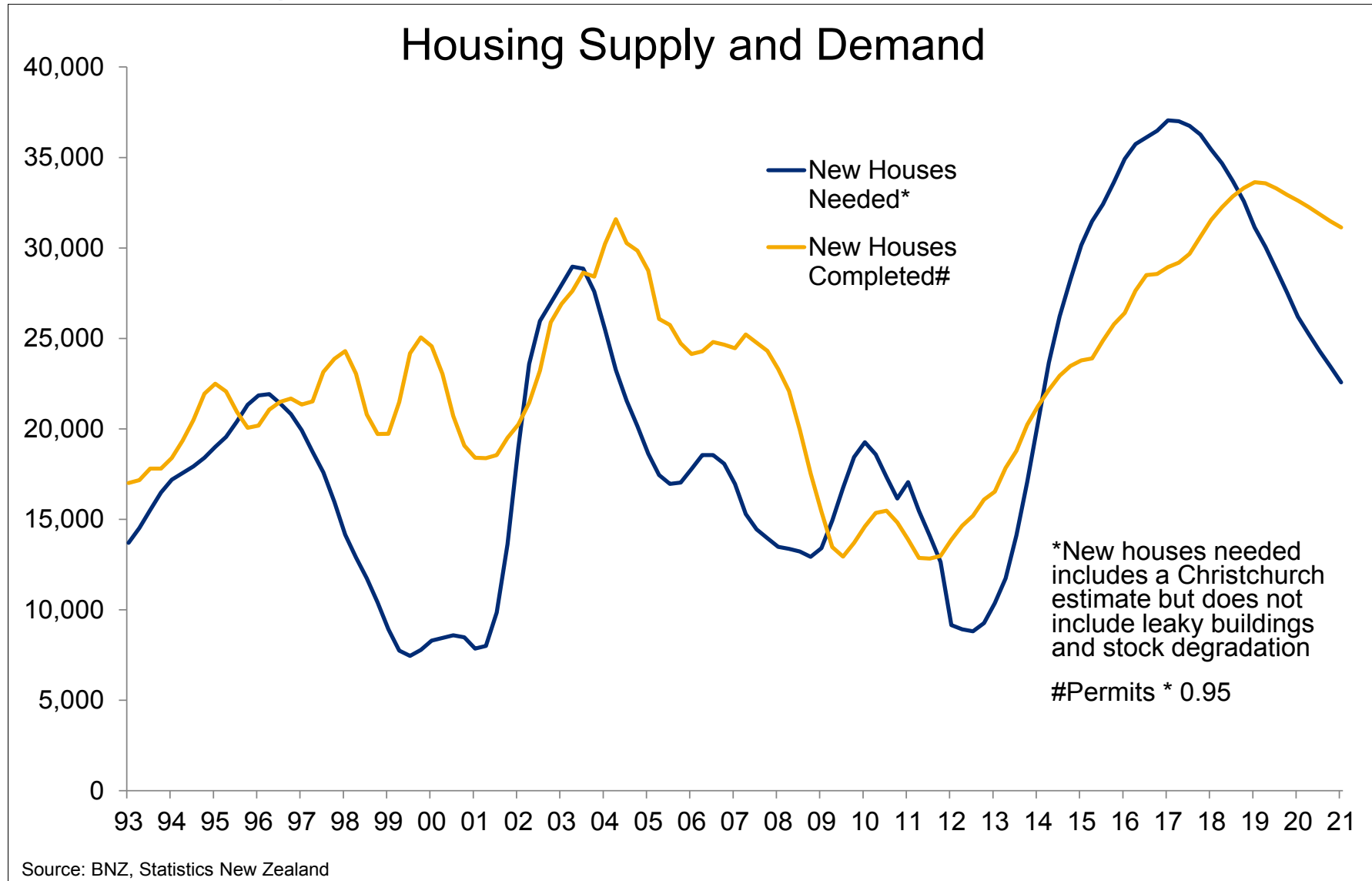
Output Gap Positive



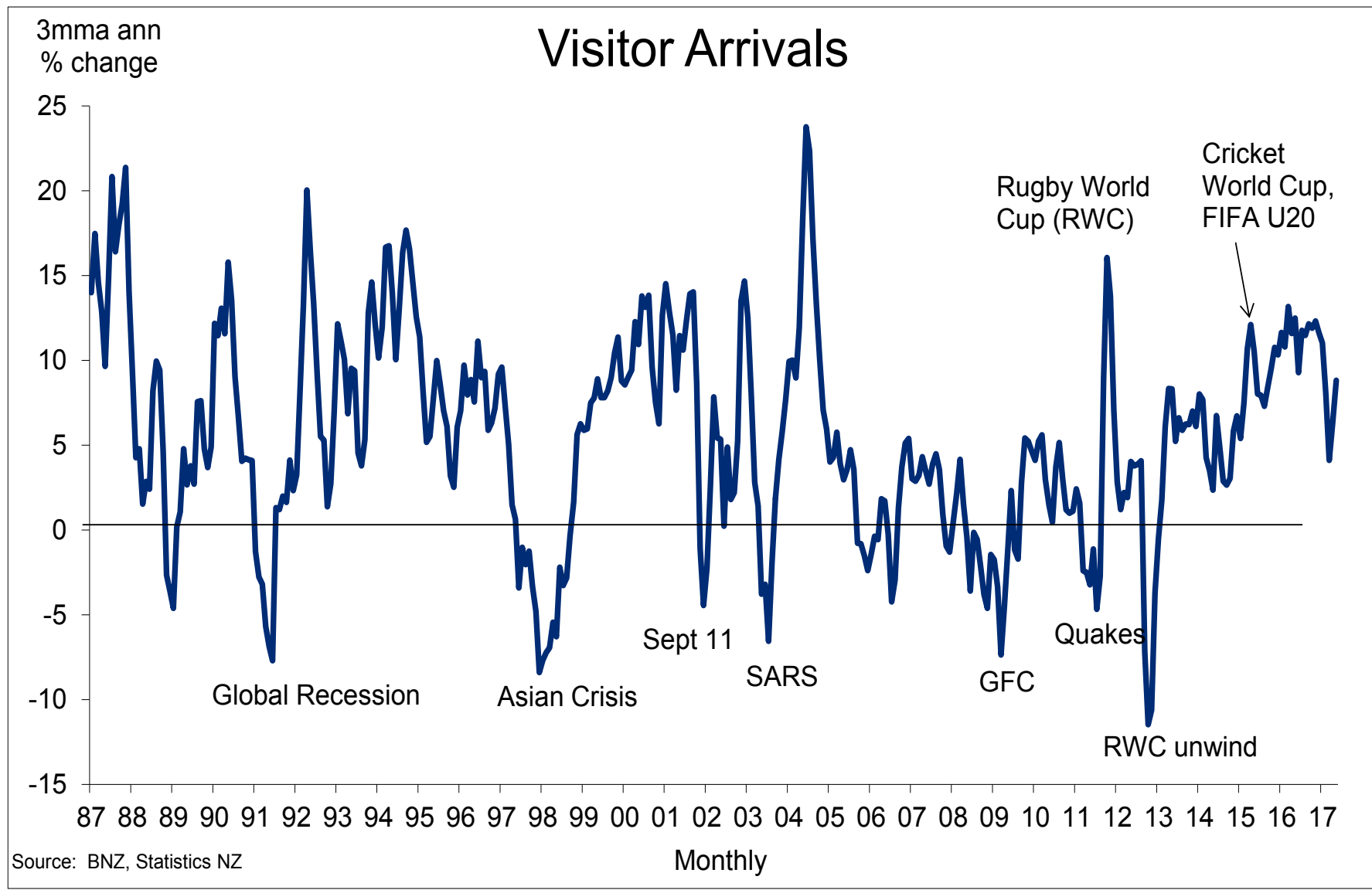
Vacancy Rates Low



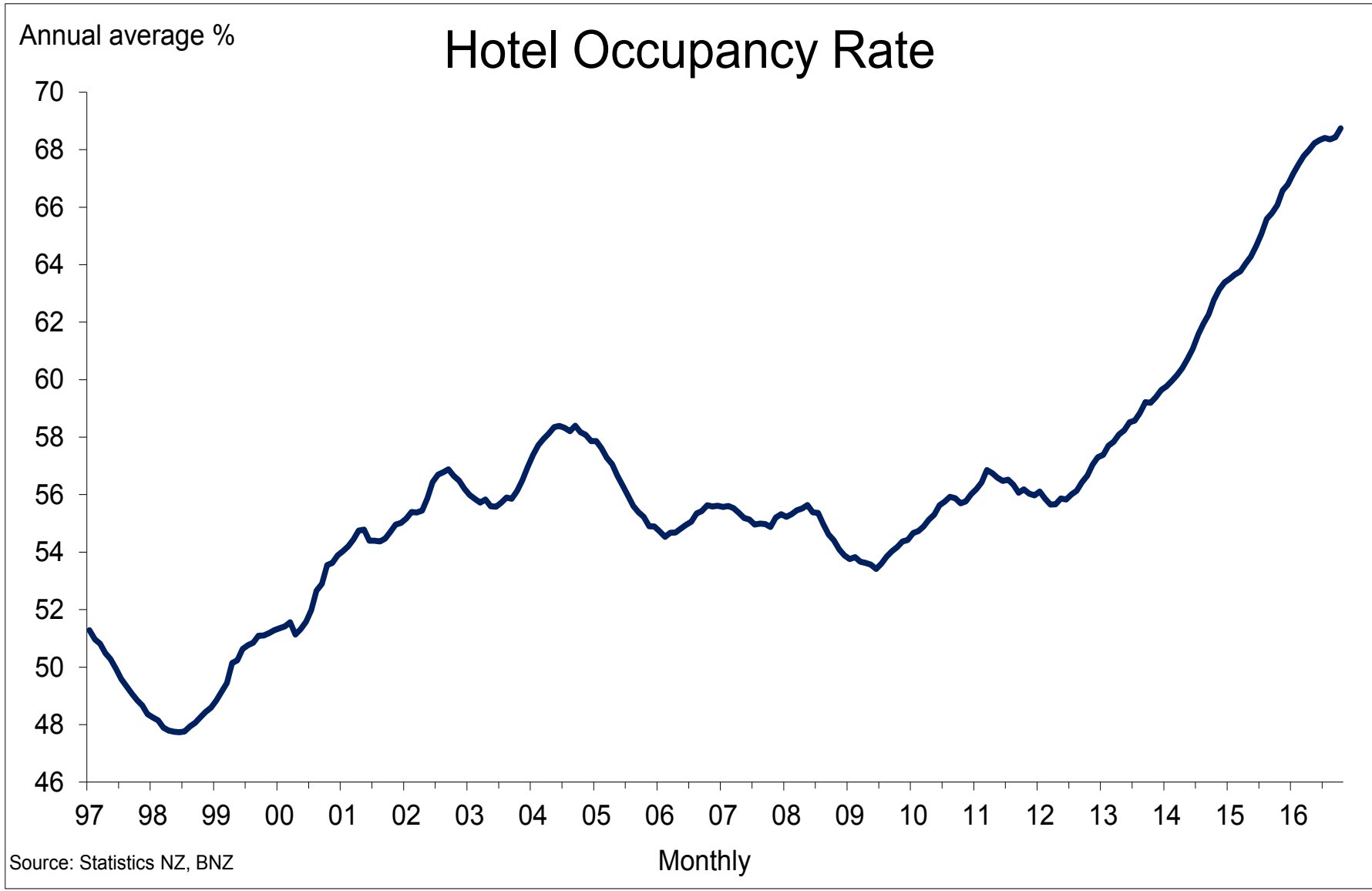
Not Enough Houses



Tourism Growth Peaking



No Room At The Inn



Track Overcrowding

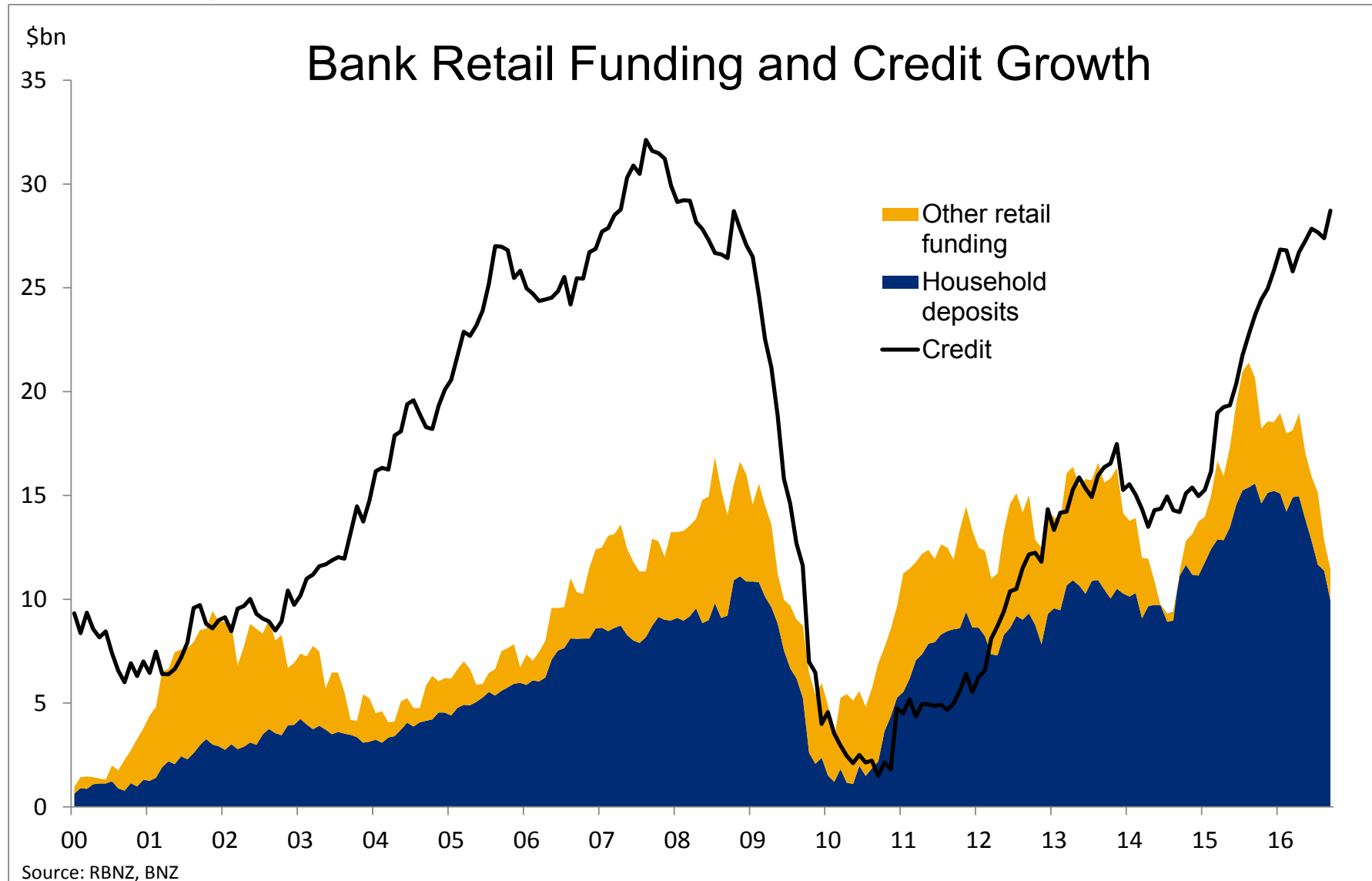


Tourists stream across the busy Tongariro Crossing on Easter Sunday, when queues for toilets stretched to the dozens.
Source: Fairfax

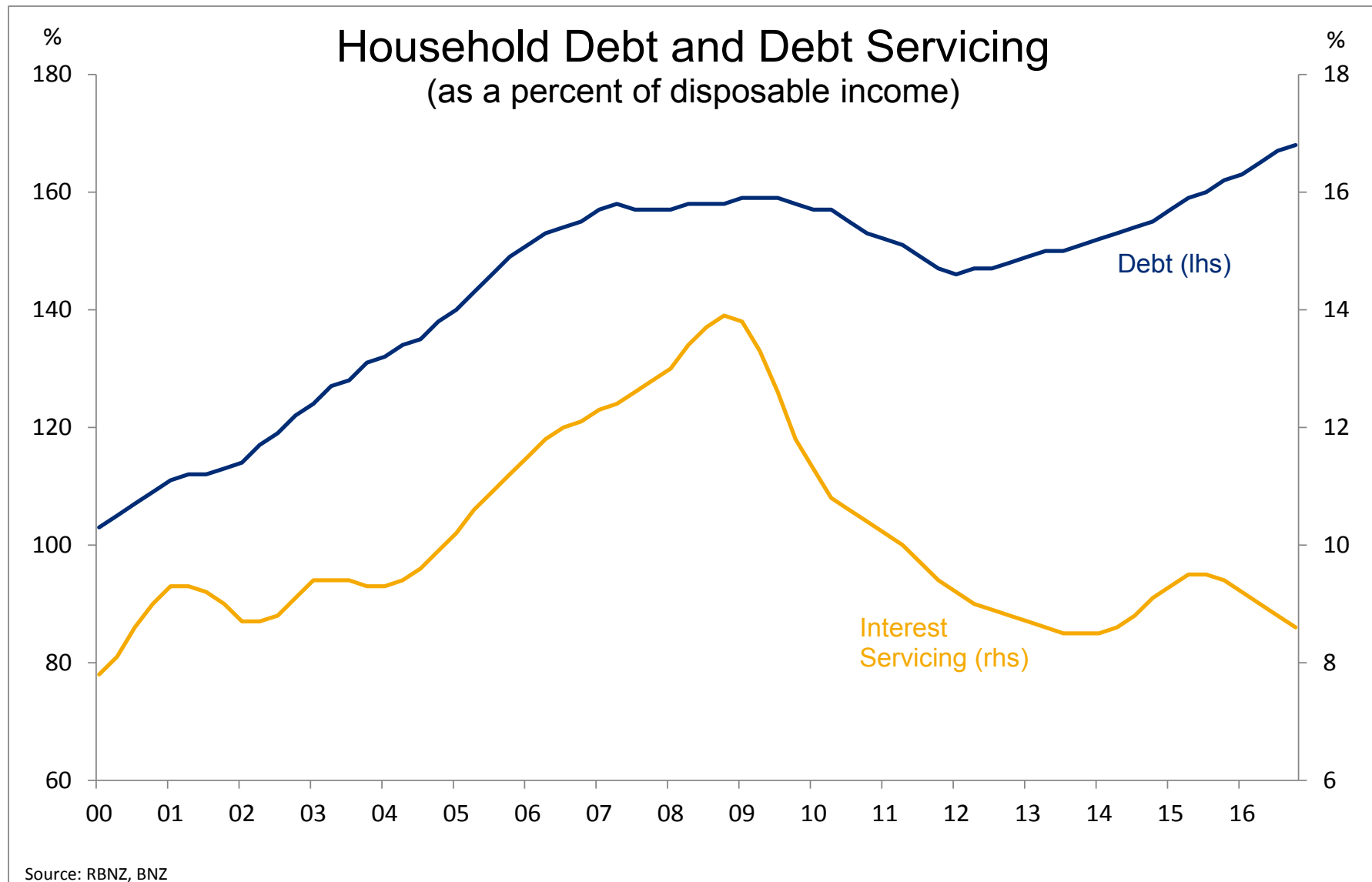
Credit Constraints Problematic

- Rising capital controls
- Raised LVRs
- Shortage of domestic deposits
- Limit-long developer lending
- Aussies want their money back
- Soaring house prices

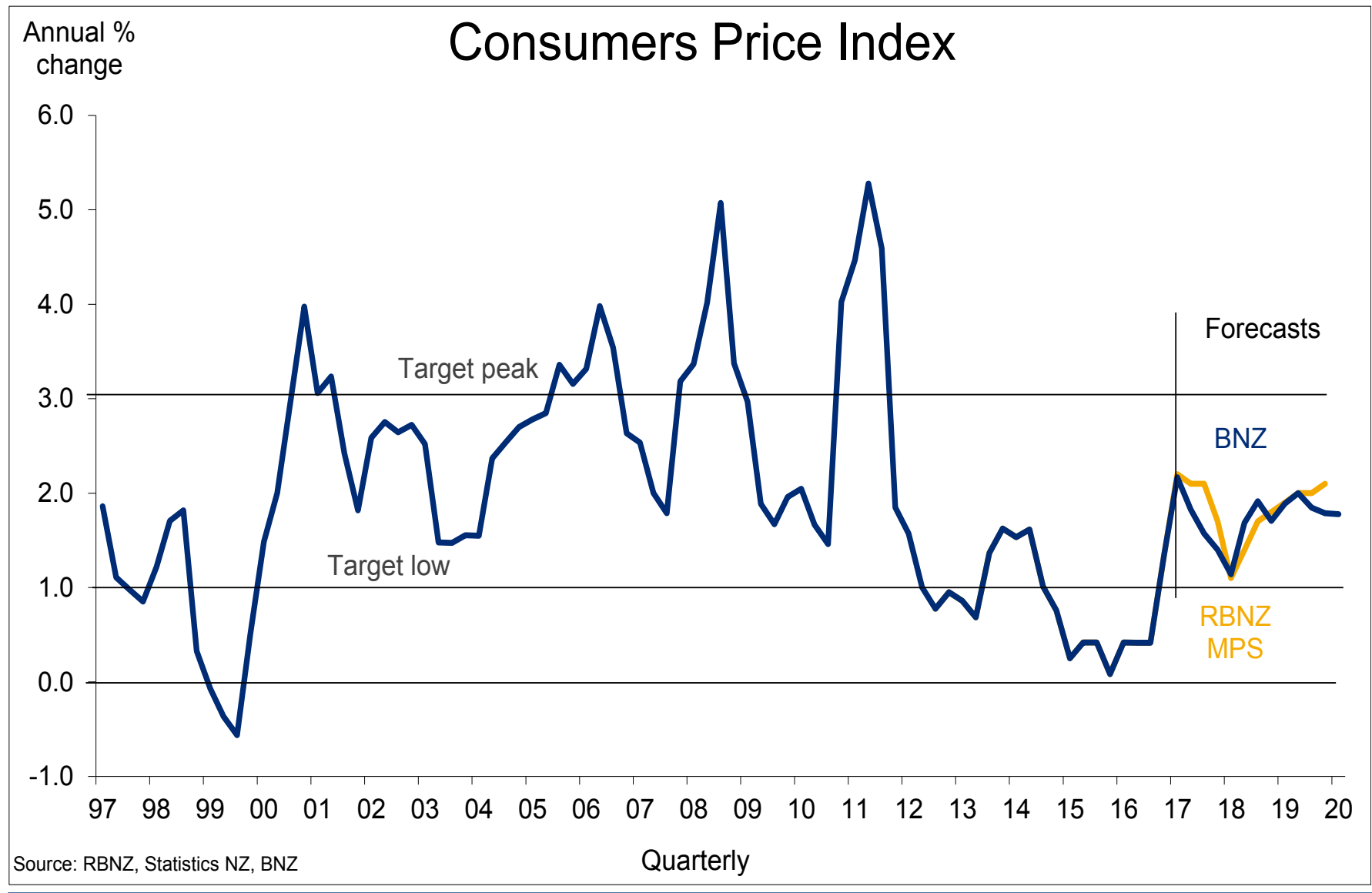
Funding Constraints Grow



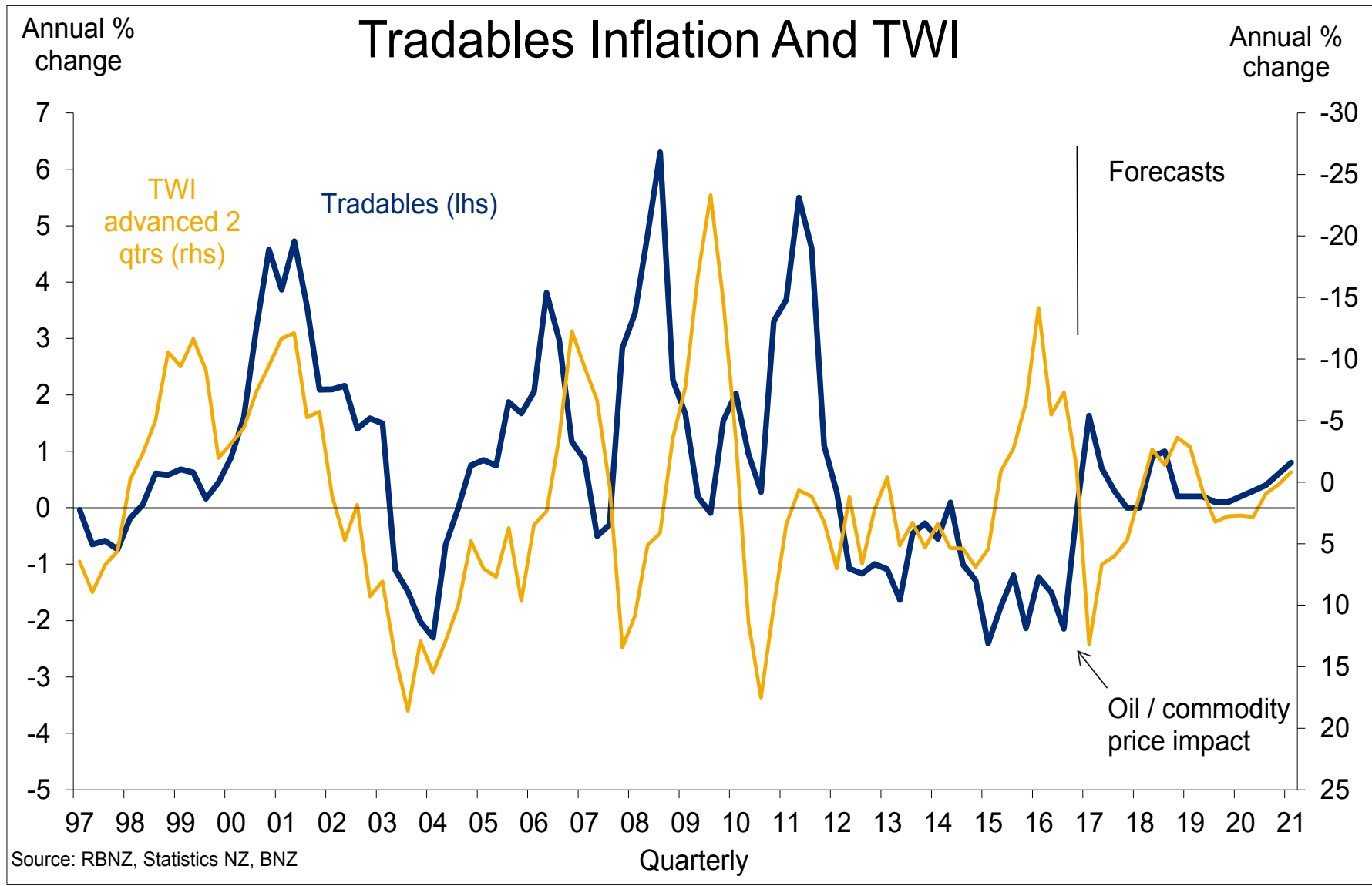
Debt Levels Elevated



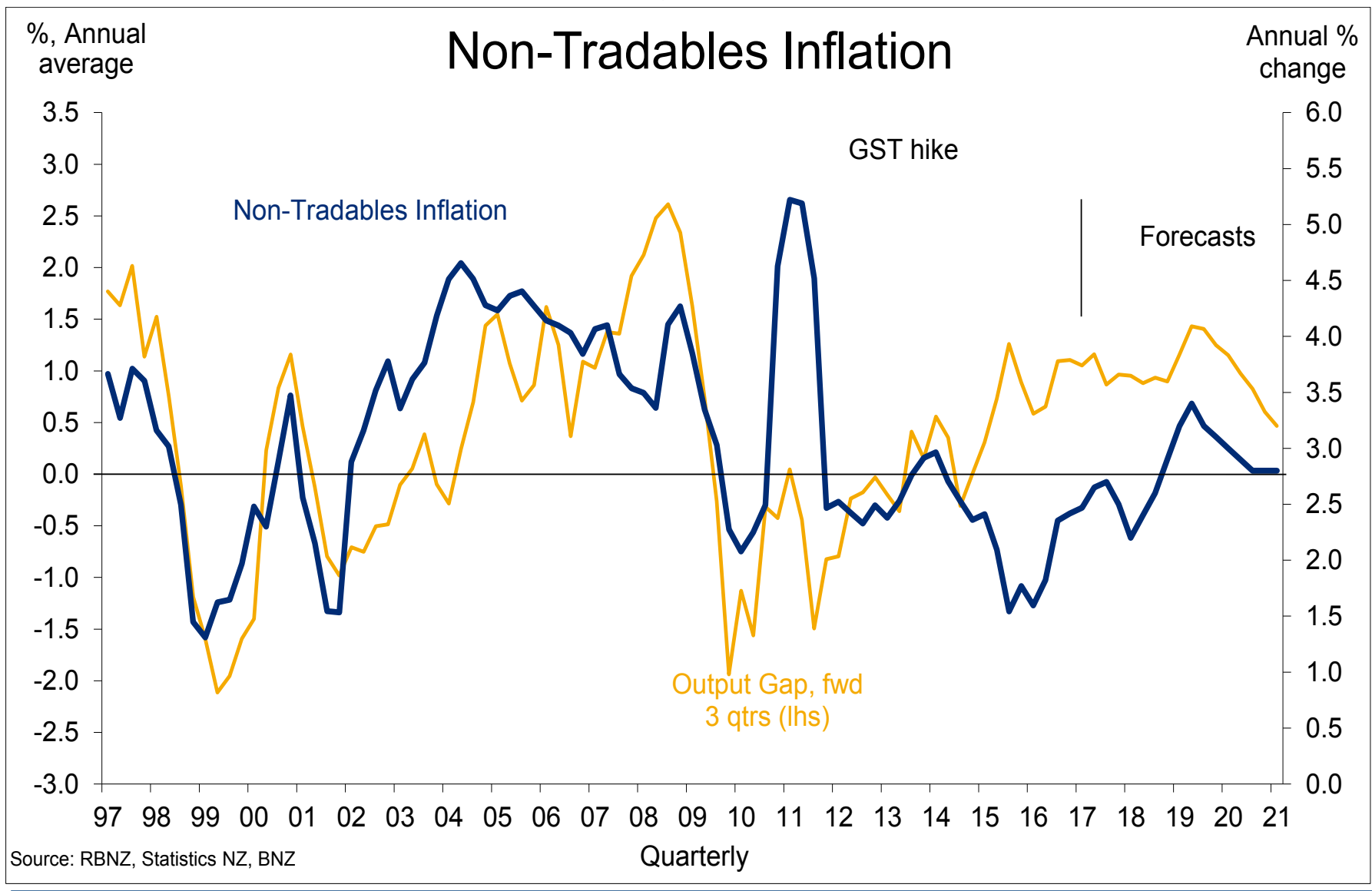
Inflation (of sorts) Returns



Tradeables Unthreatening

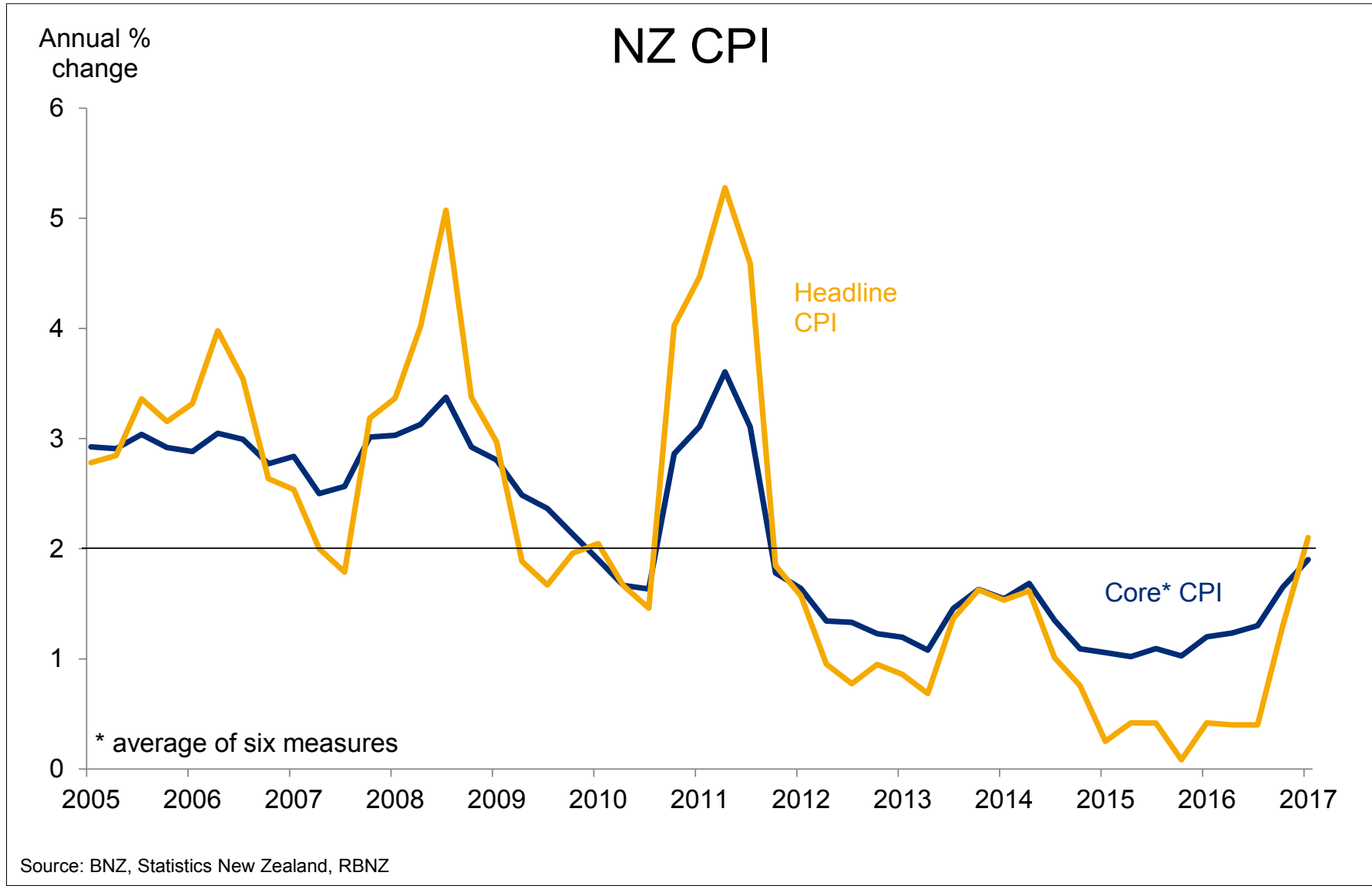


Non Tradeables A Worry

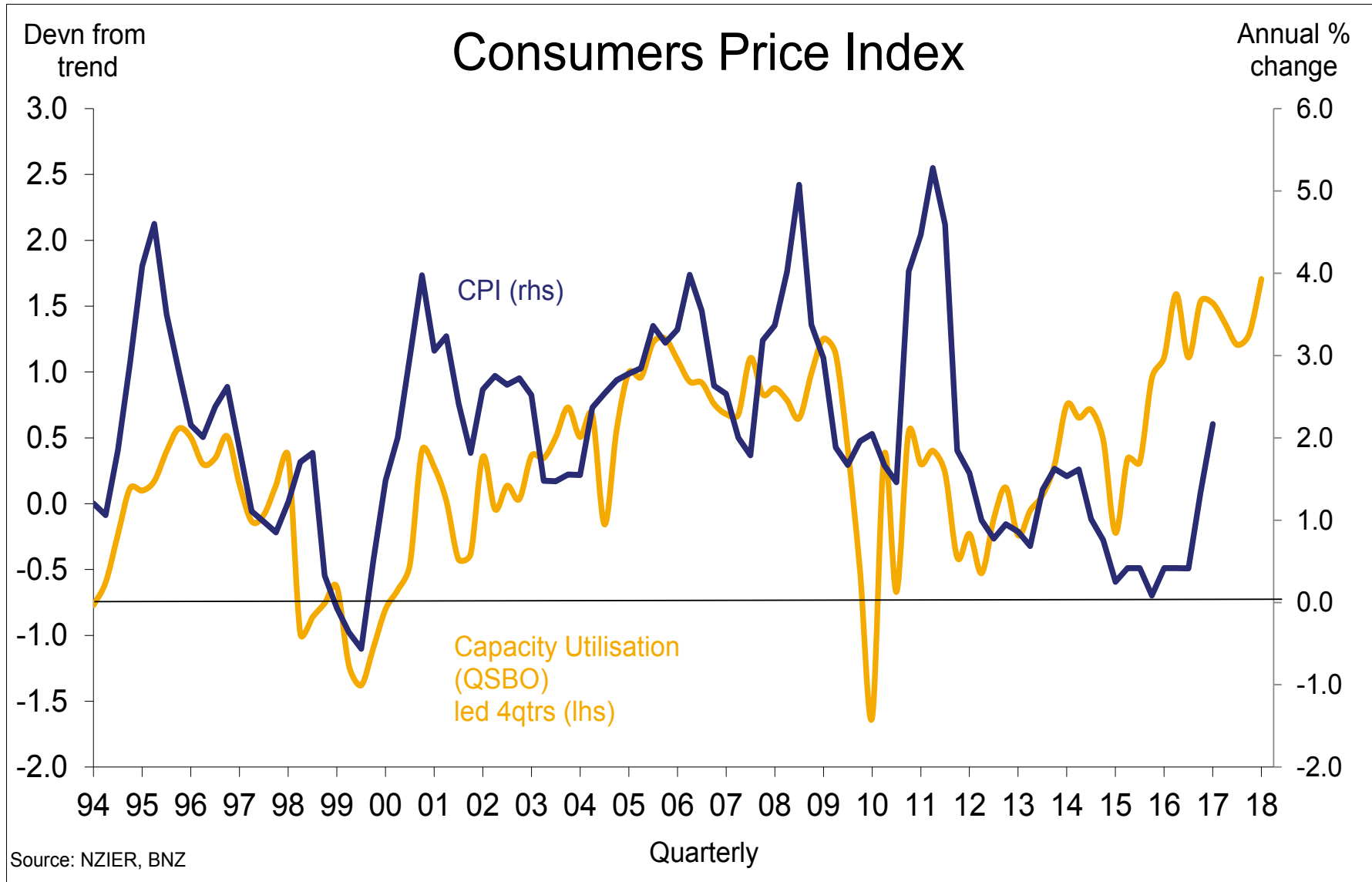


Source: RBNZ, Statistics NZ, BNZ

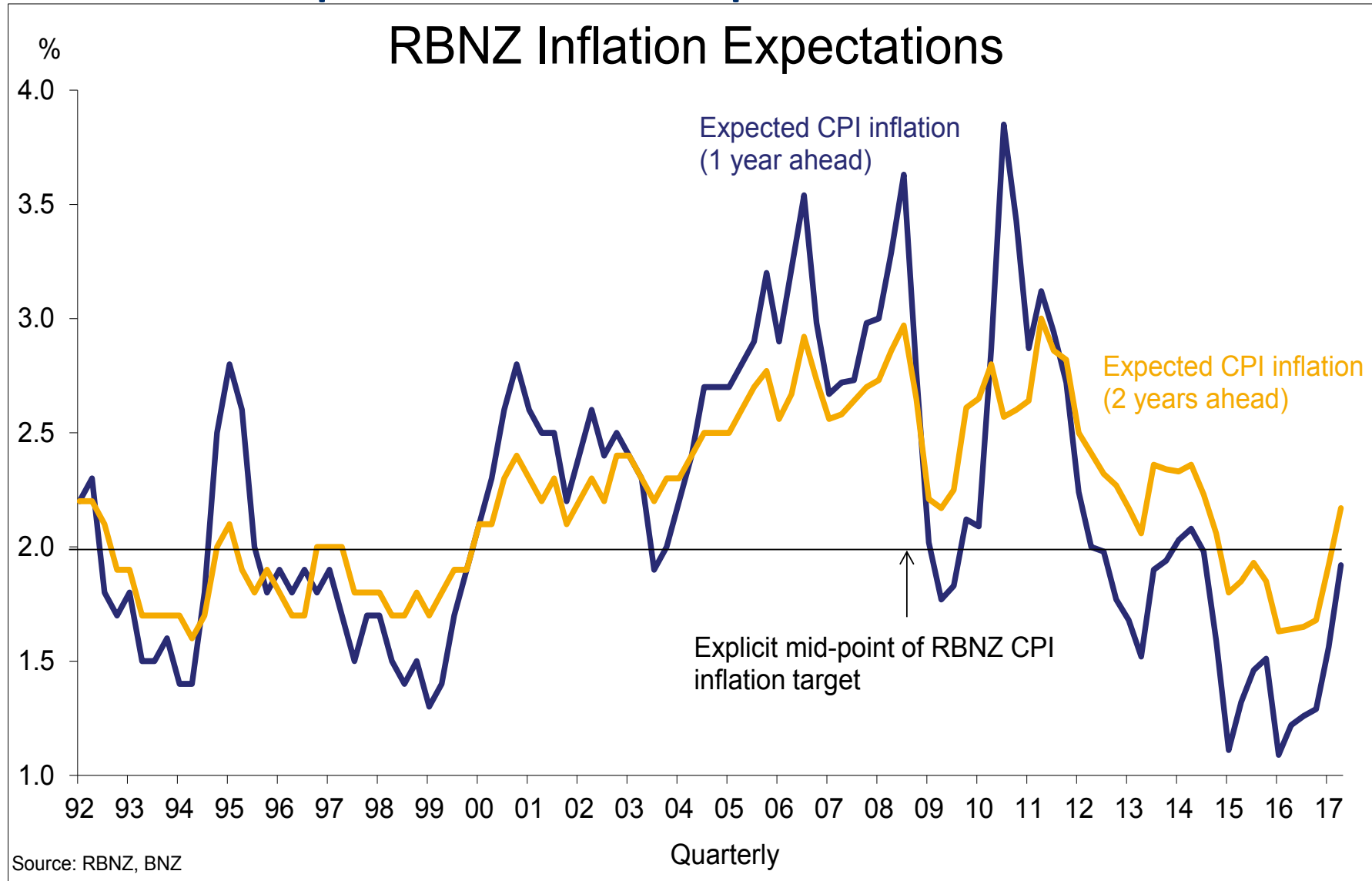
Core Too



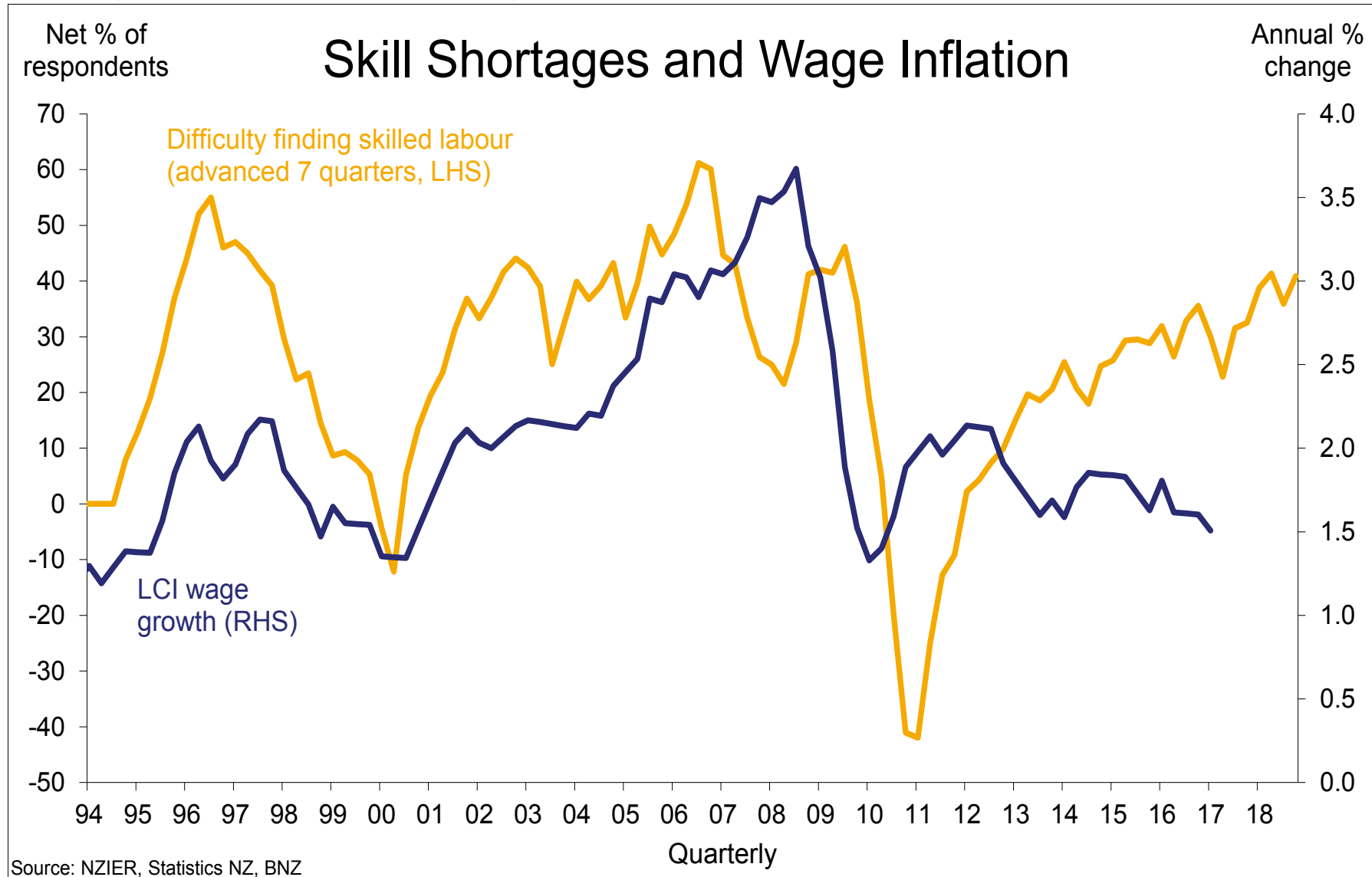
Capacity Pressures Impact



Inflation Expectations Jump



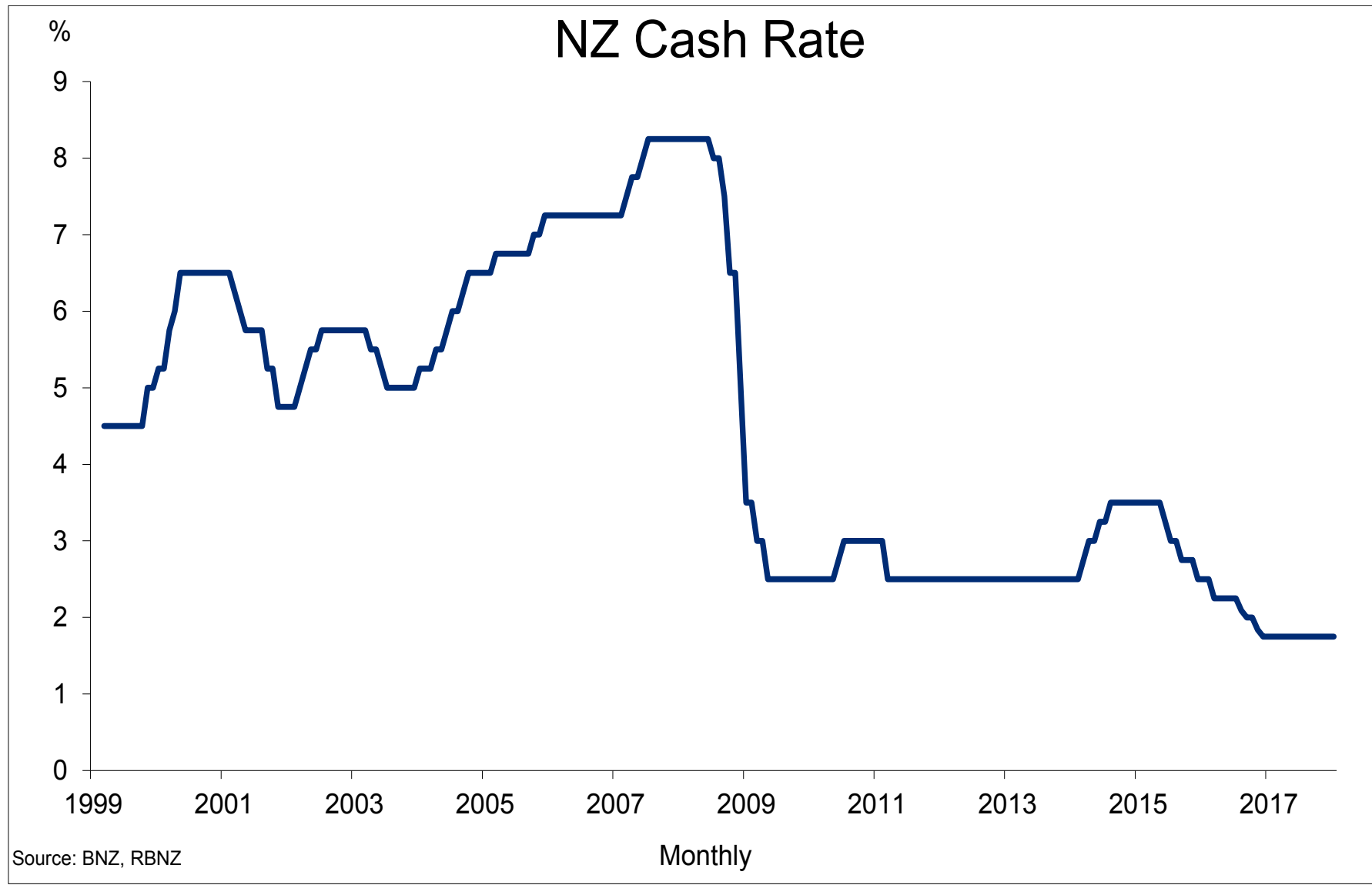
Wages The Missing Link



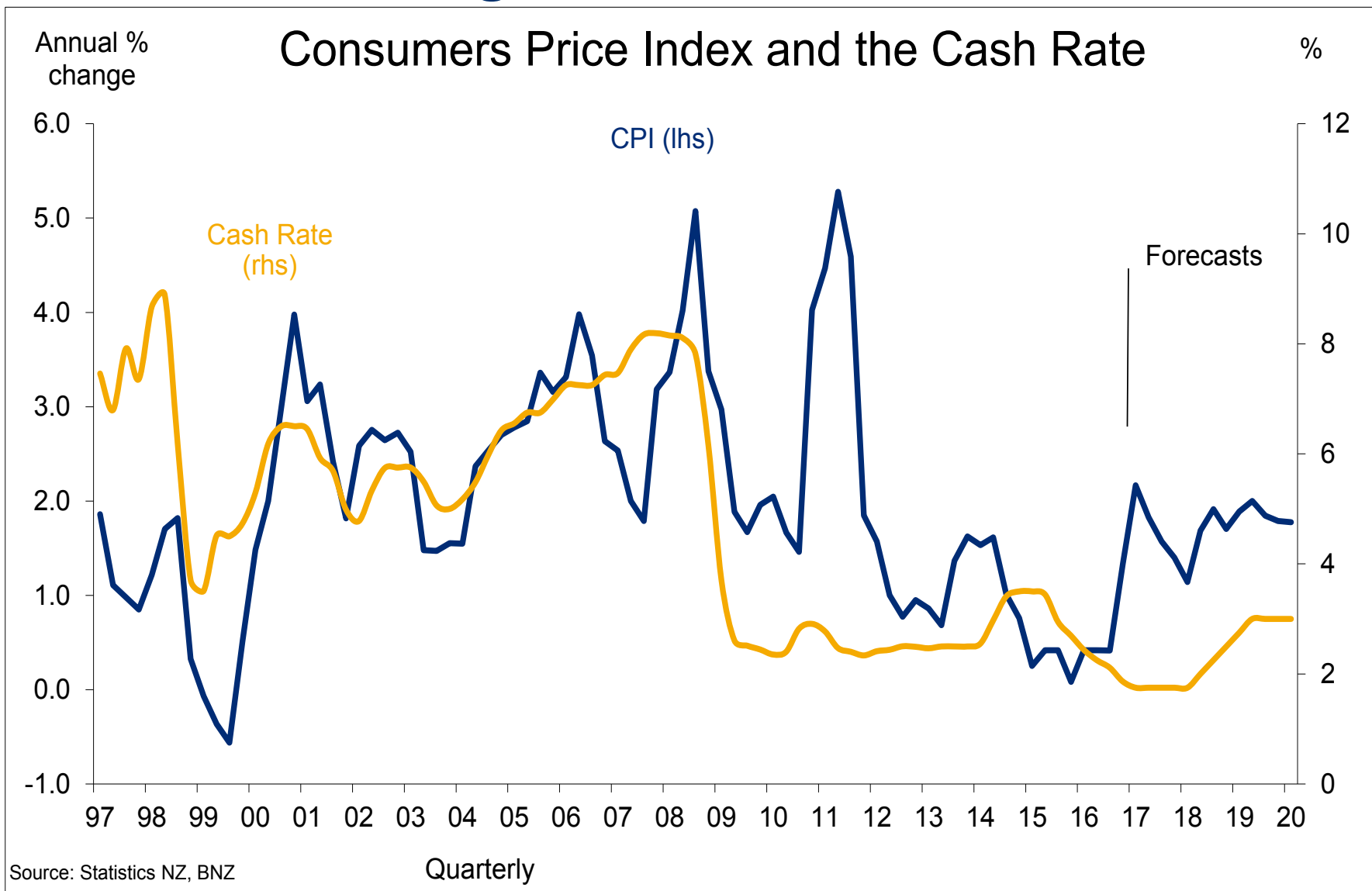
Why?

- Global competition
- Low past headline inflation
- Measurement issues
- Technology

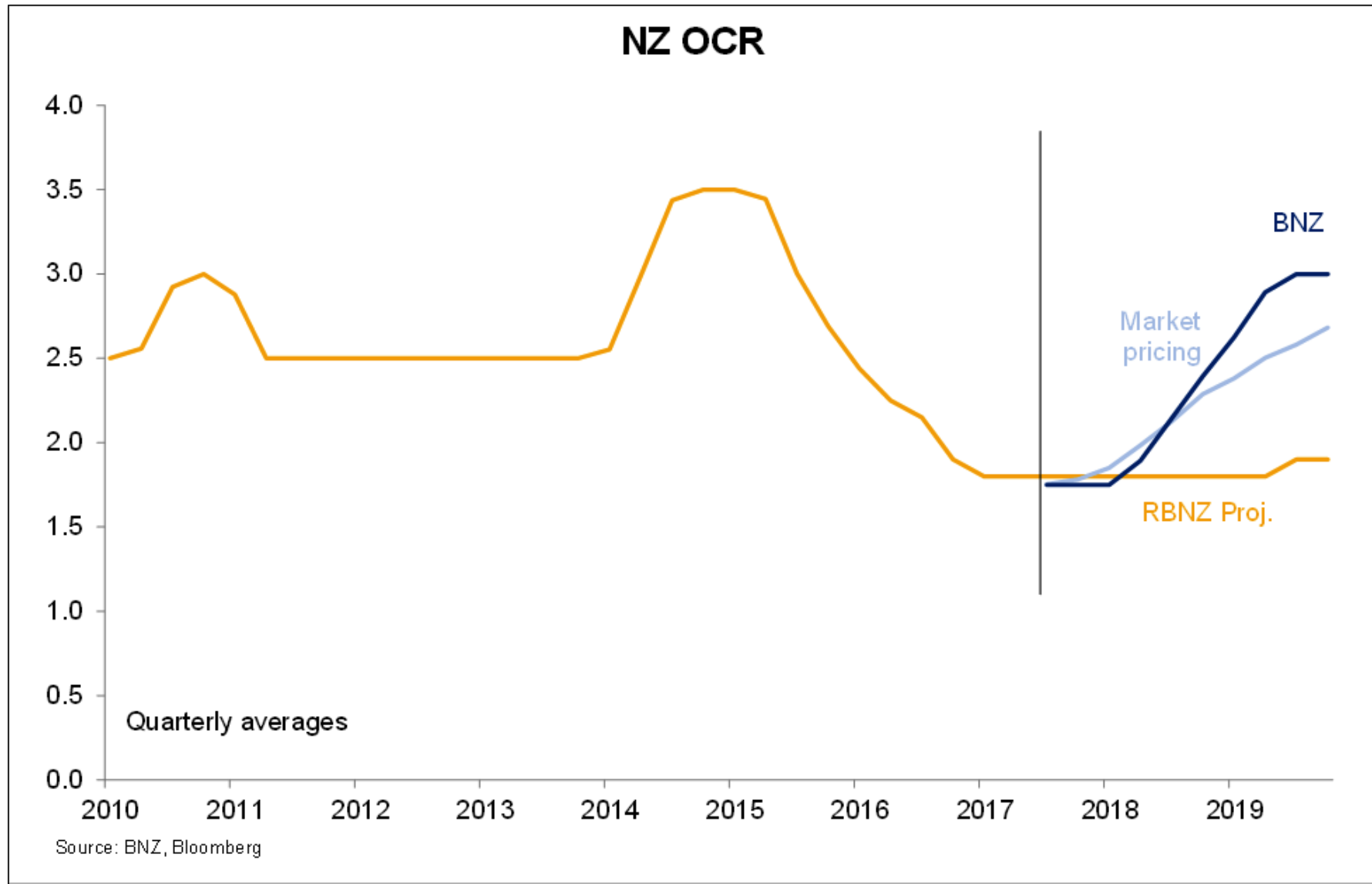
Is This Degree Of Stimulus Warranted?



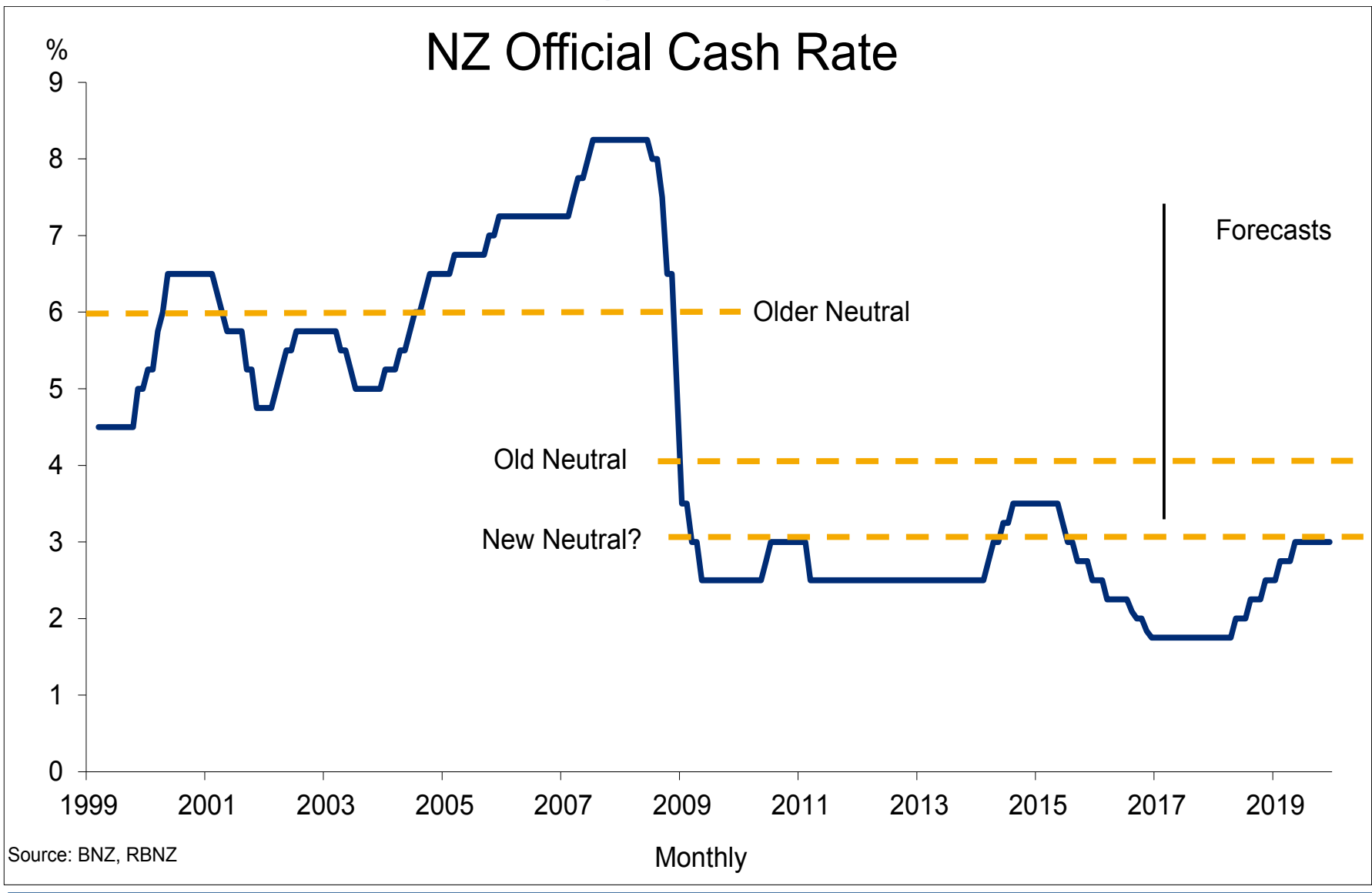
Rates To Head Higher



And The Market Knows It

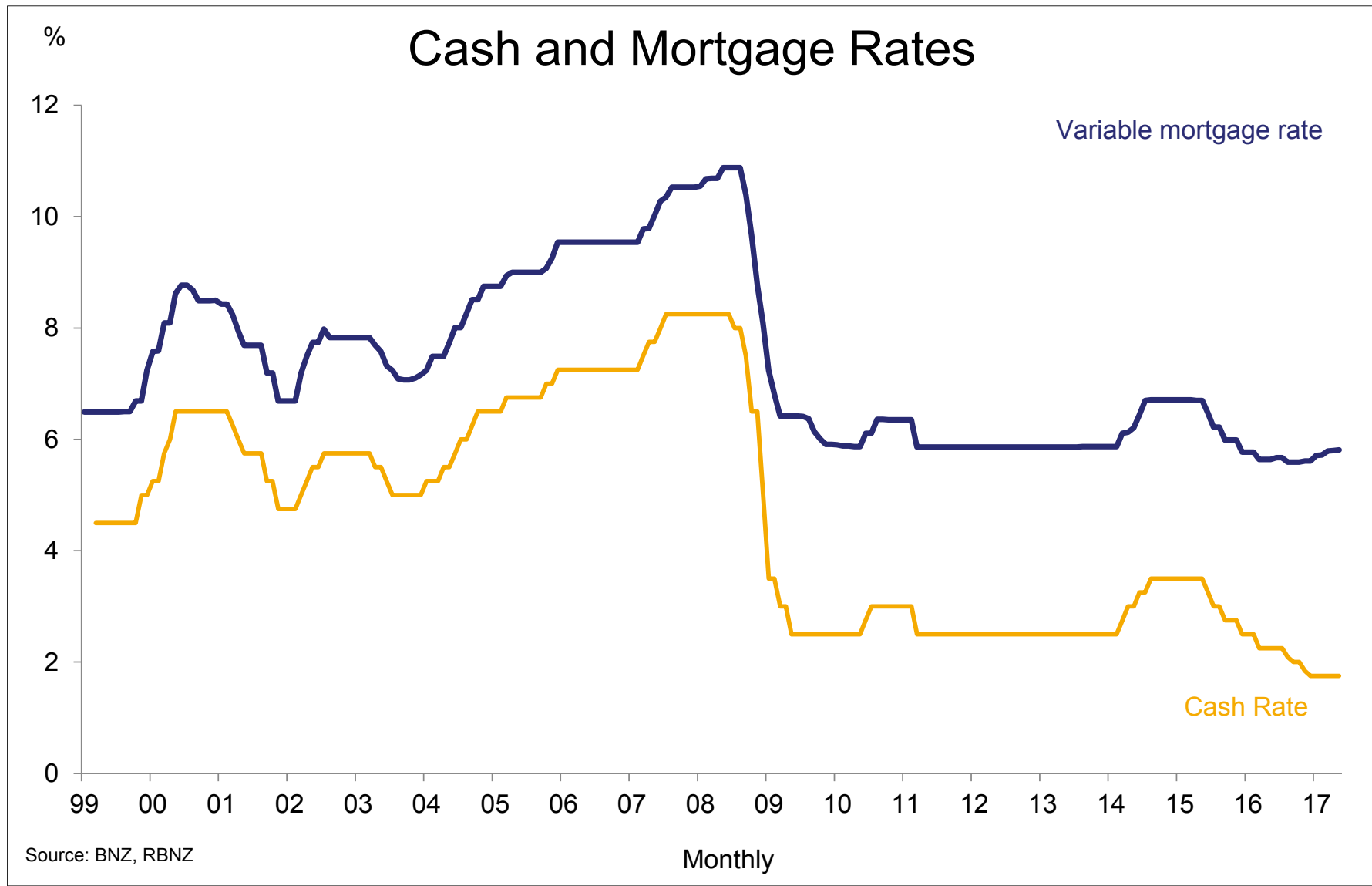


Neutral May Be Falling

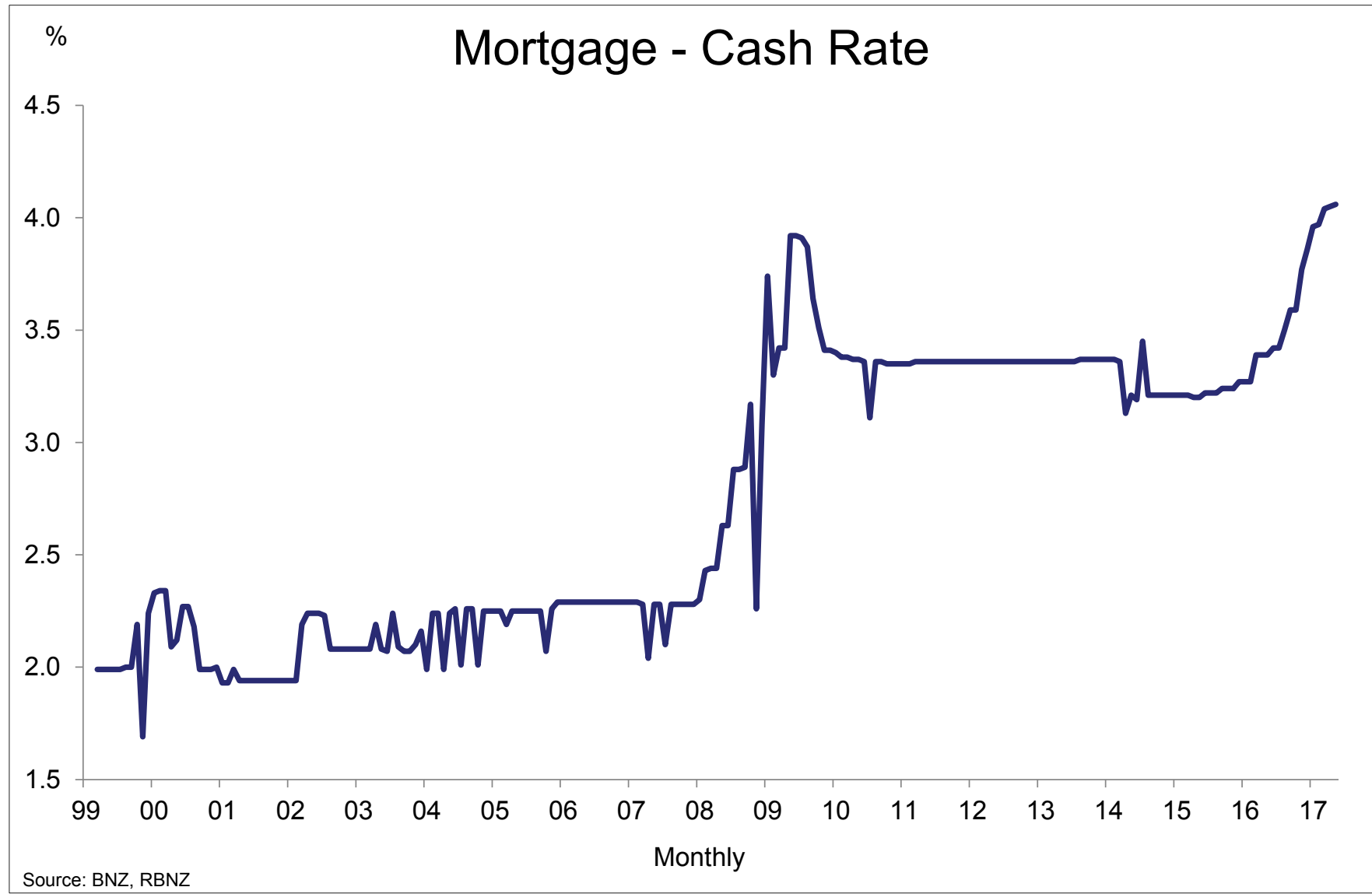


Source: BNZ, RBNZ

As Spreads Widen



More and More



Policy Conundrums

Migration

- Increase migration =>
 - Ease labour market constraints
 - Increase pressure on housing
- Cut migration
 - Ease pressure on housing
 - Heighten labour shortages

Housing policy

- Build more houses
 - Satisfy electorate demands
 - Put more pressure on an already constrained building sector
 - Crowd out private sector
- Don't build houses
 - Lose electorate support

Policy Conundrums

Monetary Policy

- Rates unchanged
 - Pushes domestic inflation higher
 - Exacerbates housing demand
 - Supports inefficient allocation of capital
 - Creates excess domestic demand
- Raise rates
 - Slow housing market down
 - Help “equilibrate” the economy
 - Build a war chest for future use
 - Risk low inflation for longer

Policy Conundrums

Prudential Policy

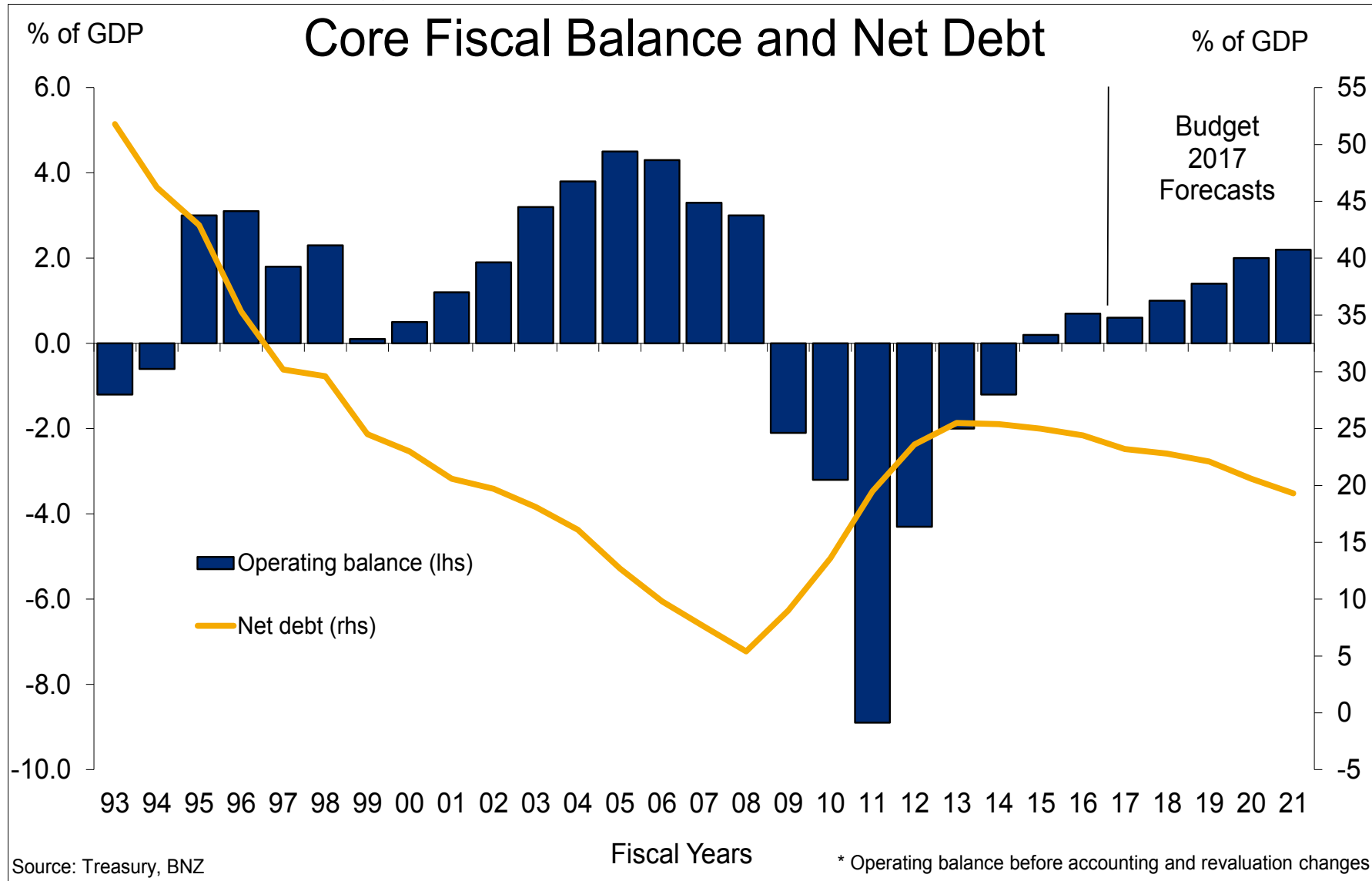
- Tighten lending criteria
 - Enhance bank balance sheets
 - Reduce housing activity
 - Reduce housing supply
 - Cut rates
- Don't tighten lending criteria
 - Bank balance sheets further pressured
 - Increase housing demand

Policy Conundrums

Fiscal Policy

- Ease
 - Provide housing
 - Build infrastructure
 - Reduce taxes
 - Create excess demand
- Hold
 - Reduce debt
 - Build war chest for future downturn
 - Lose electorate support

Room For A Spend Up



RBNZ Under Attack?

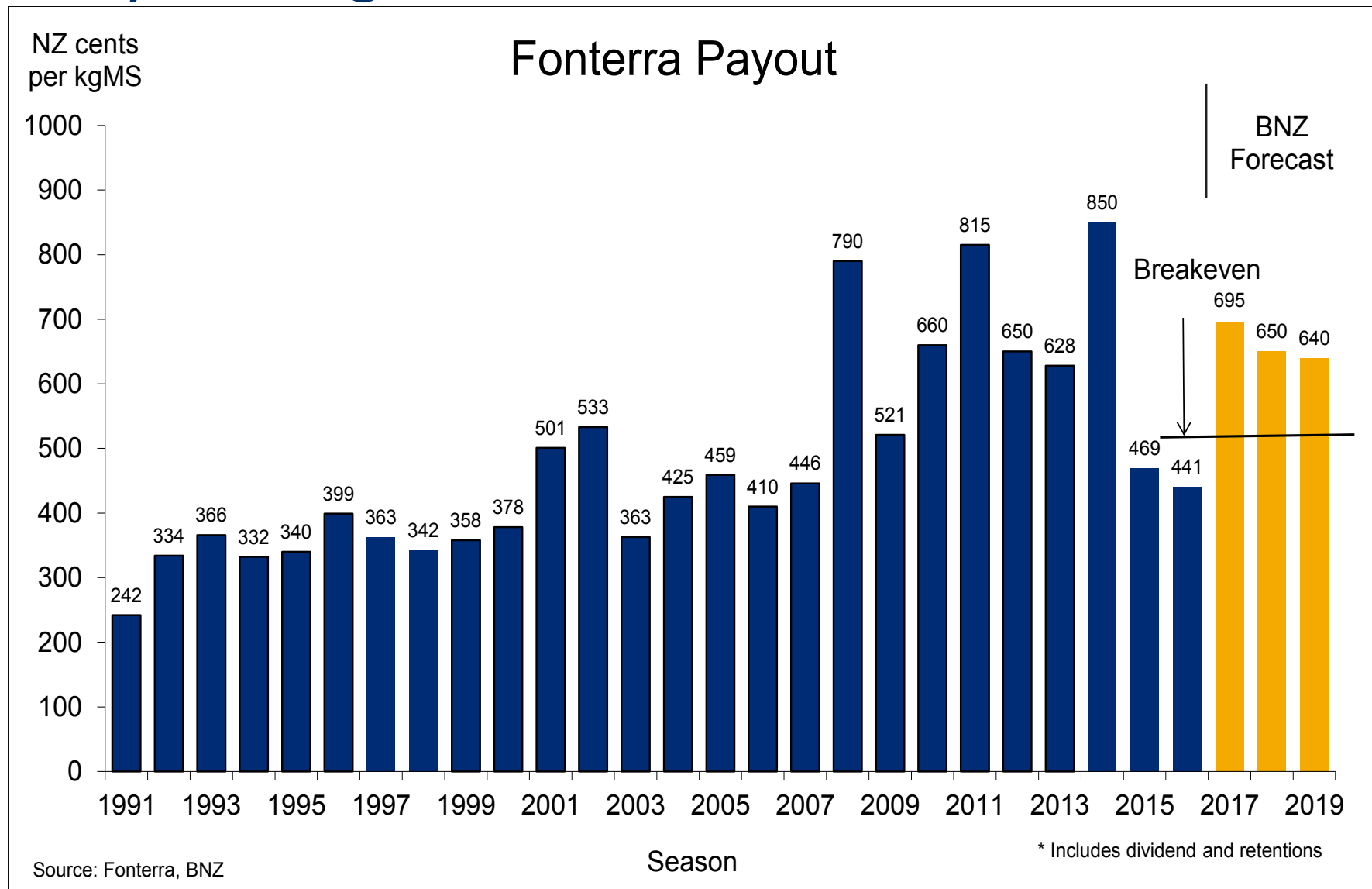
- Dual target: full employment and inflation
- Move to Board from single decision maker
- Board has four RBNZers and three external
- Minutes of Board to be published

Changes At The Bank

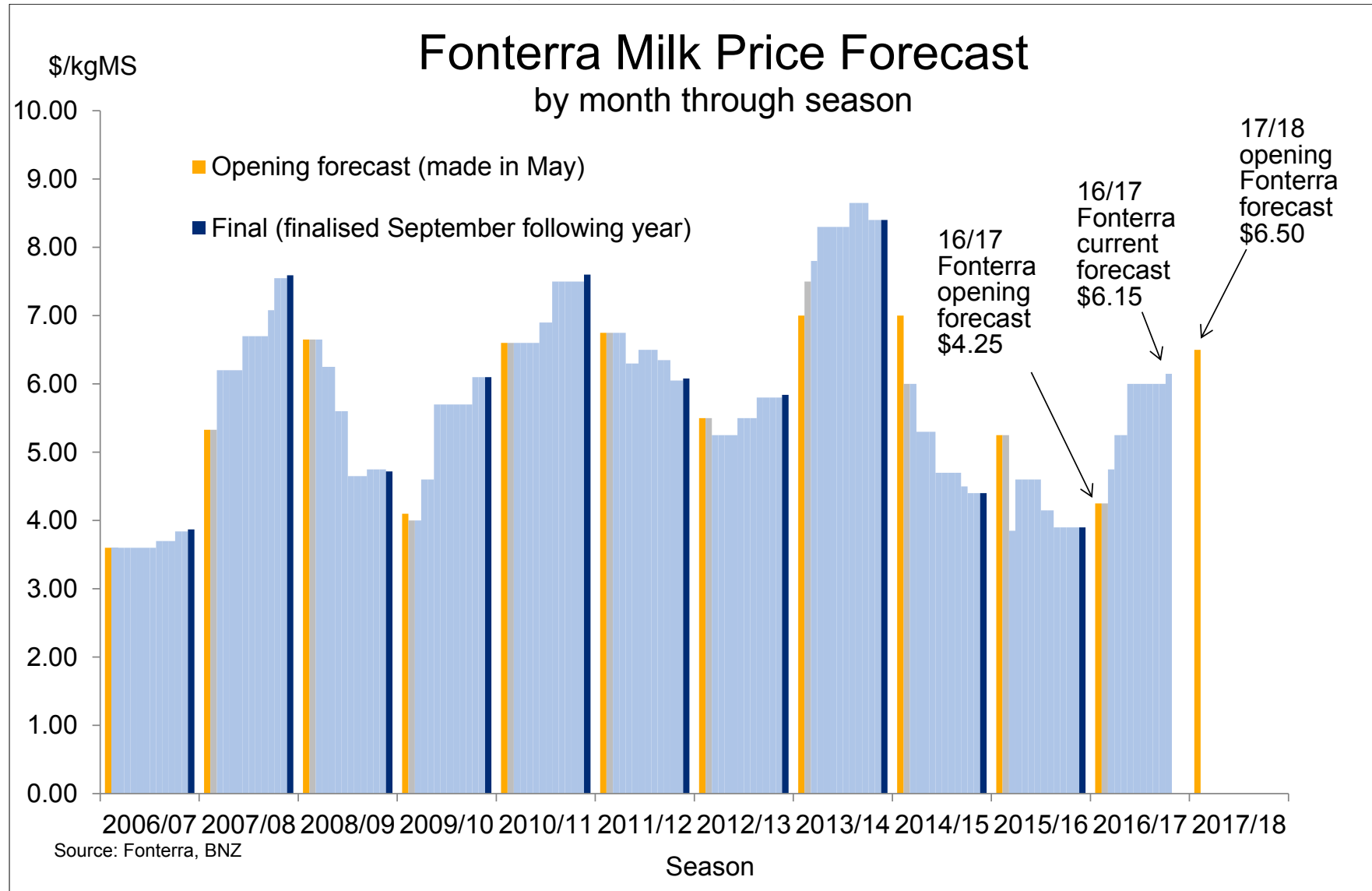
- Wheeler departs September
- Spencer takes over
- Spencer departs March

Dairy

Dairy Looking Good



No Room For Complacency

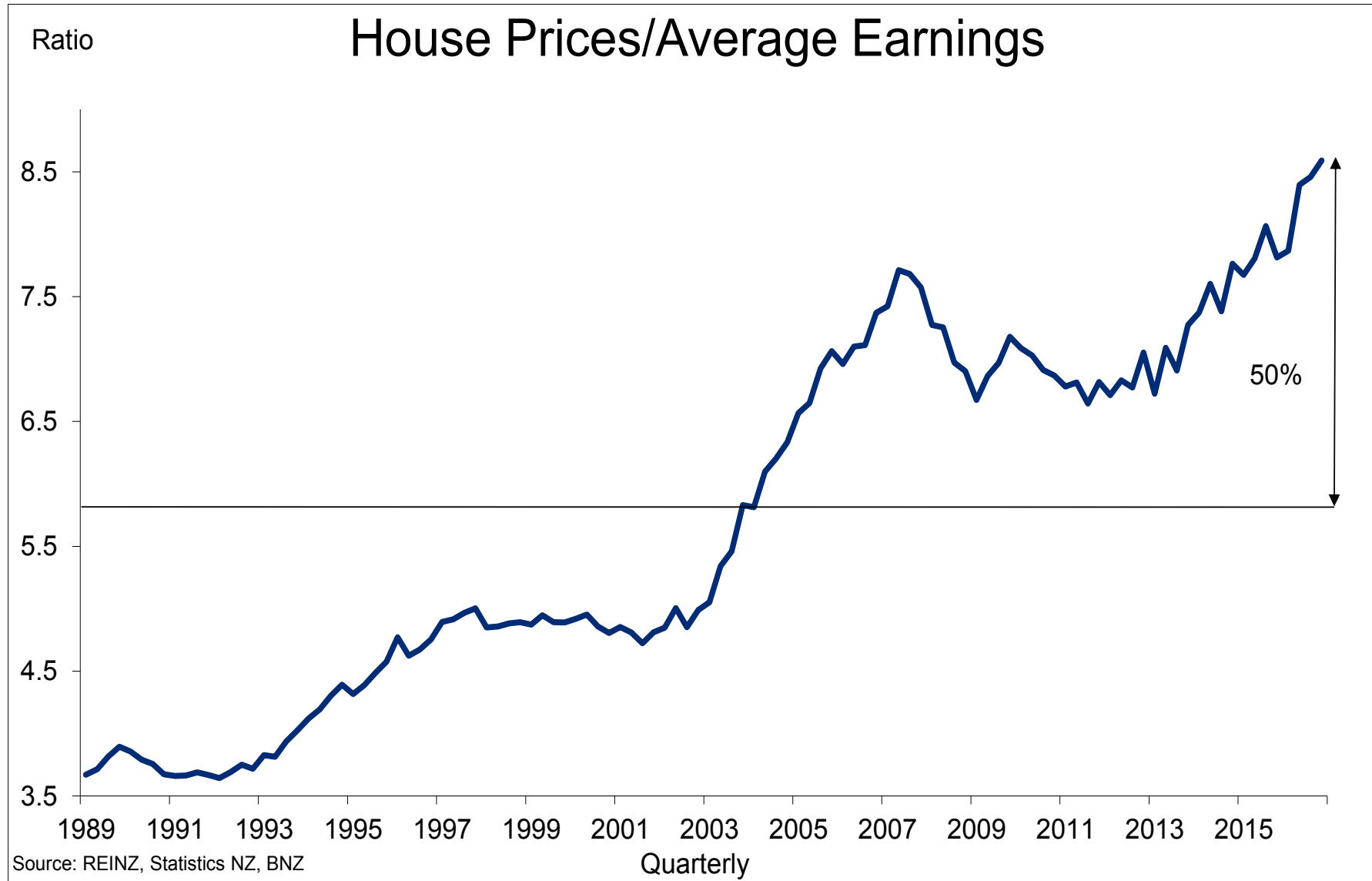


Problems

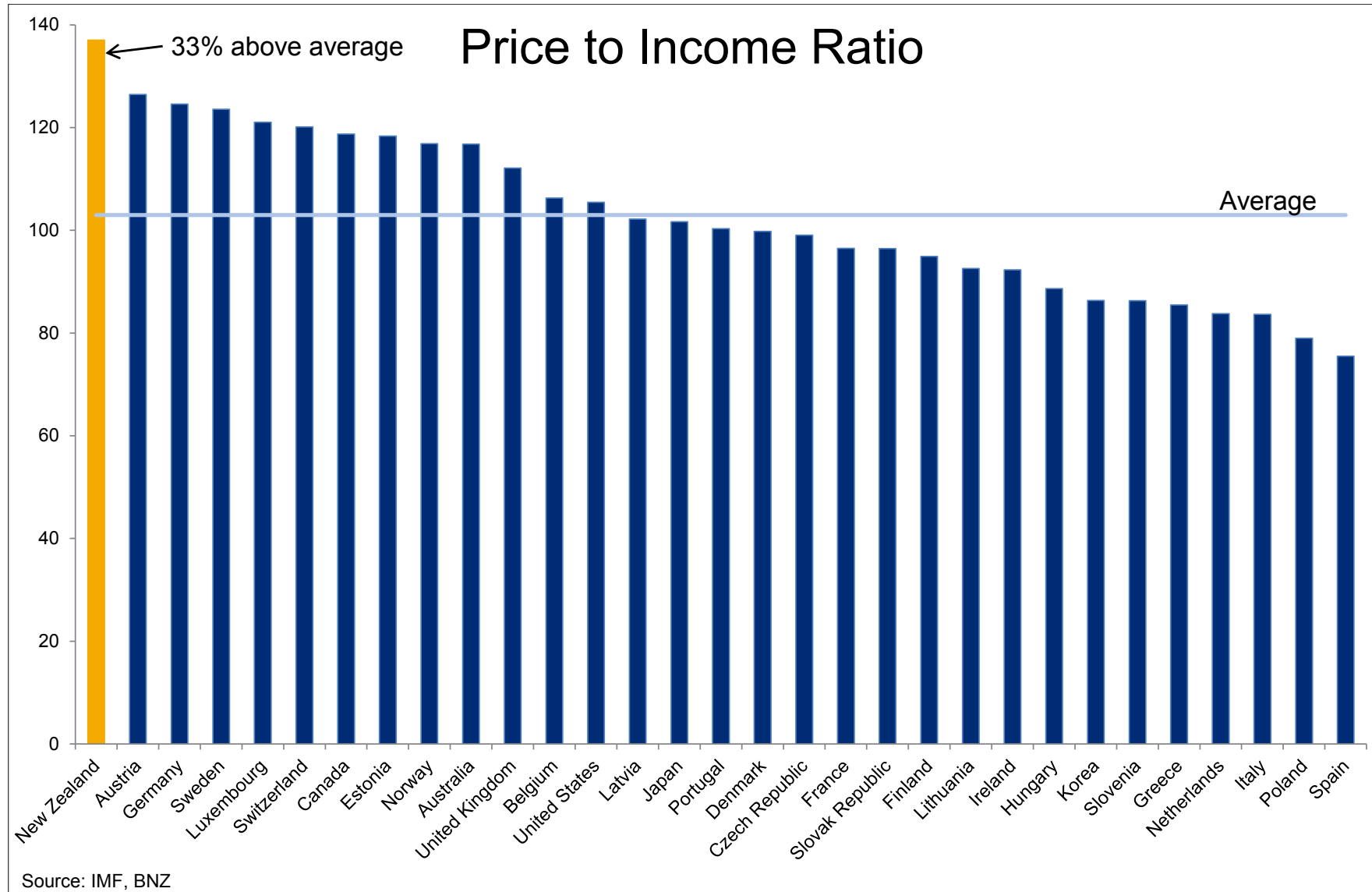
- European production to increase
- EUR too weak
- EU stockpile building
- Grain and oil prices weak

And Then
There's Housing

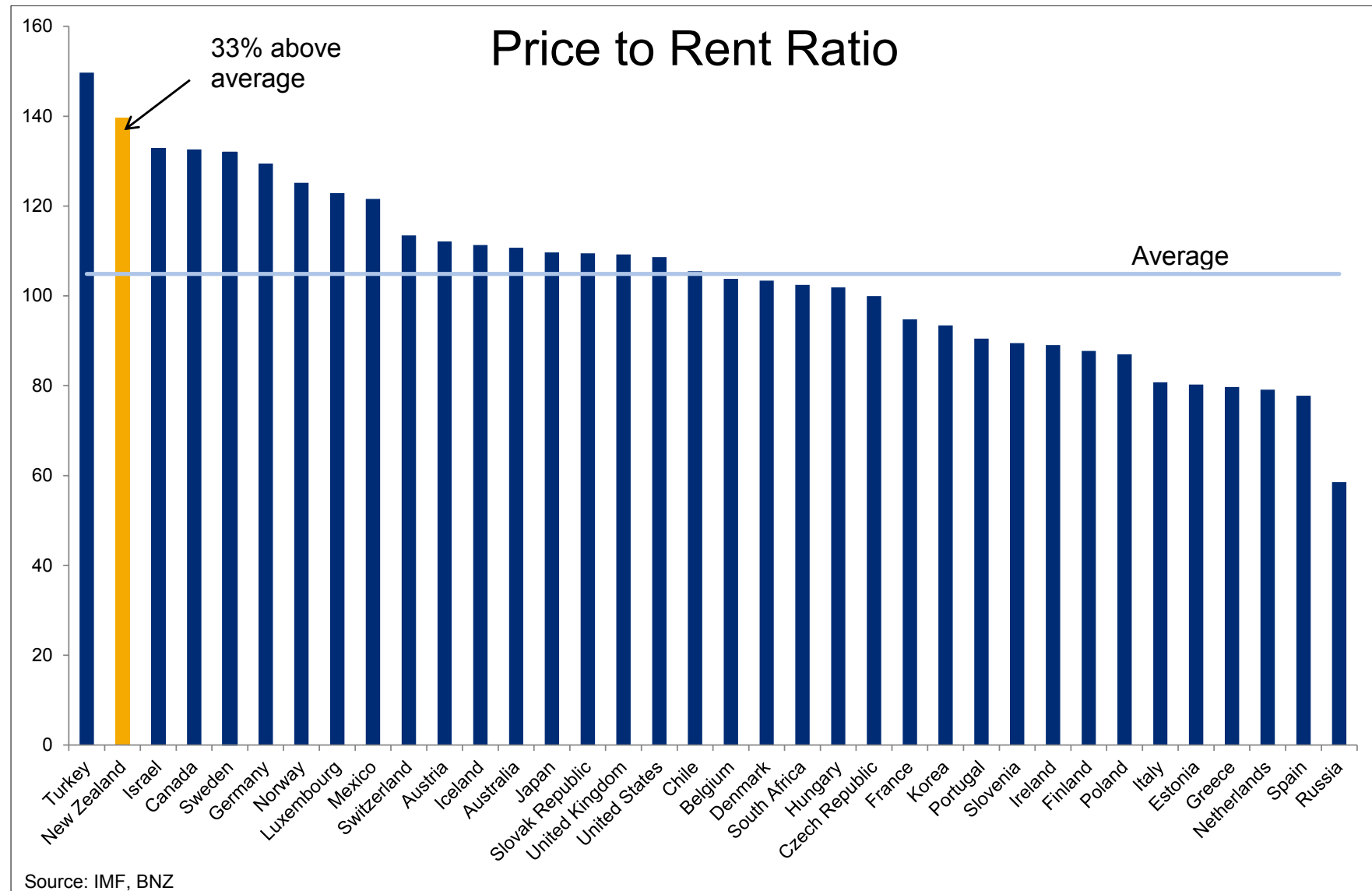
Unaffordable



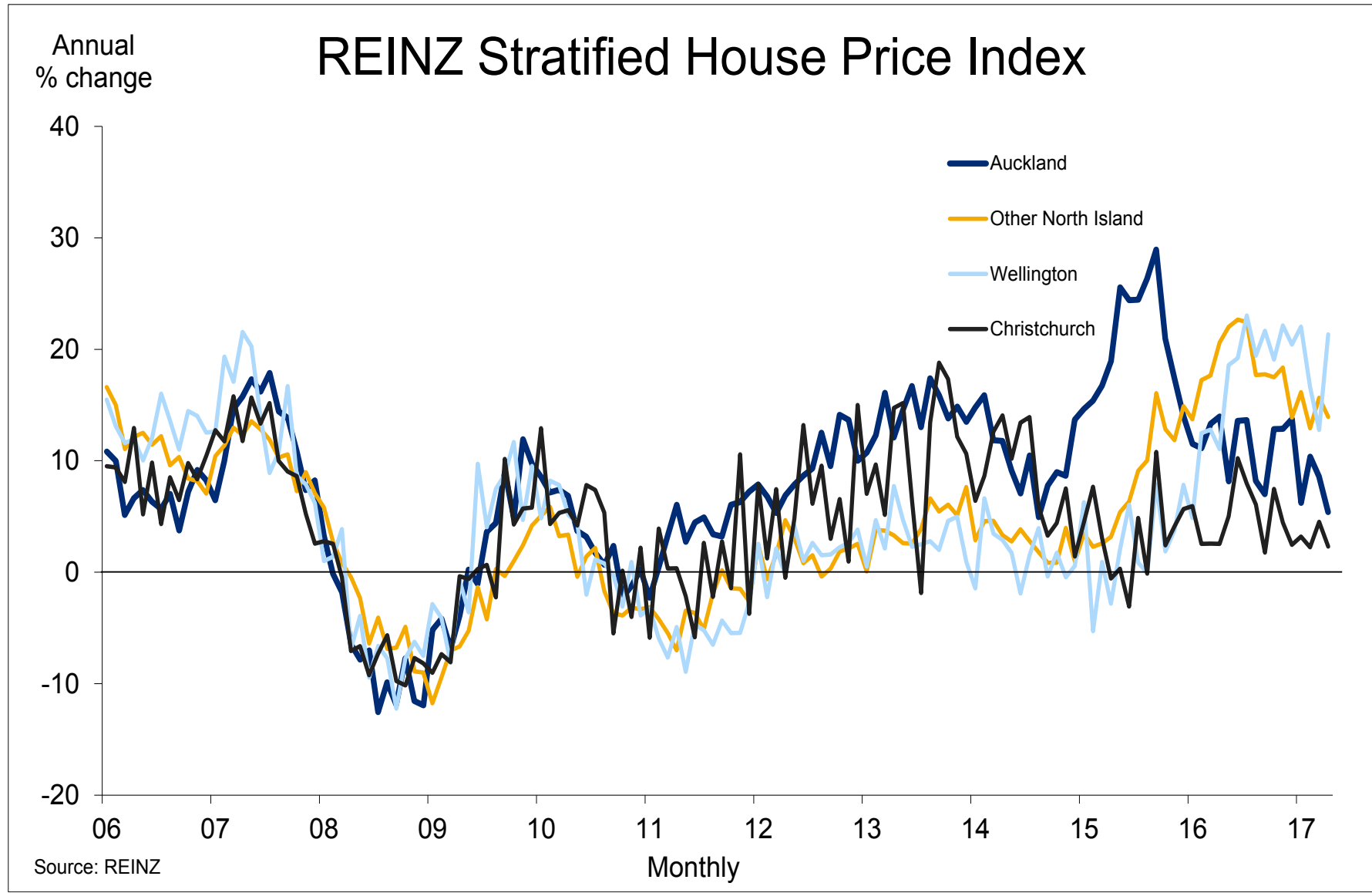
Overvalued



Overvalued

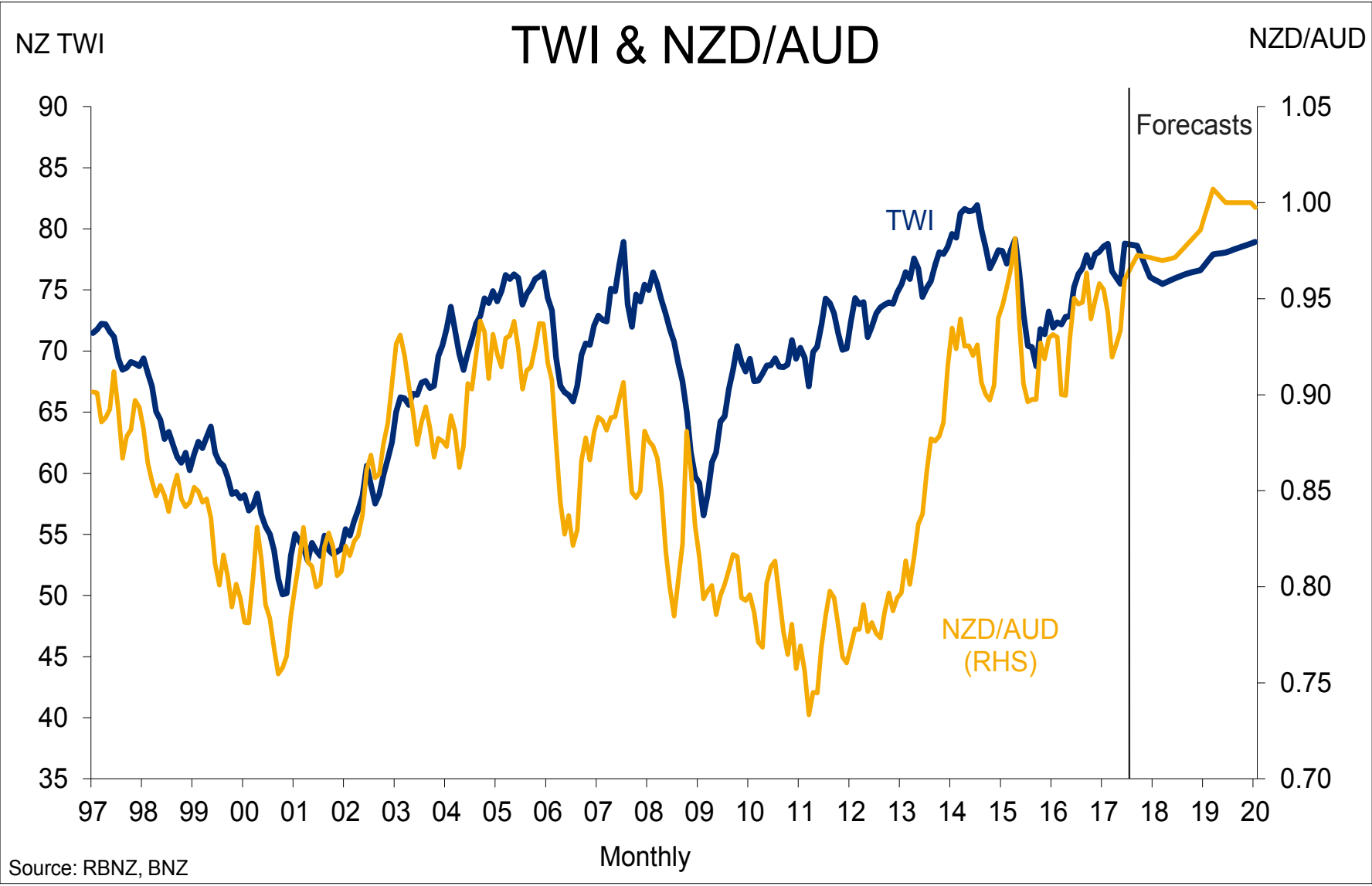


The Worm Turns?



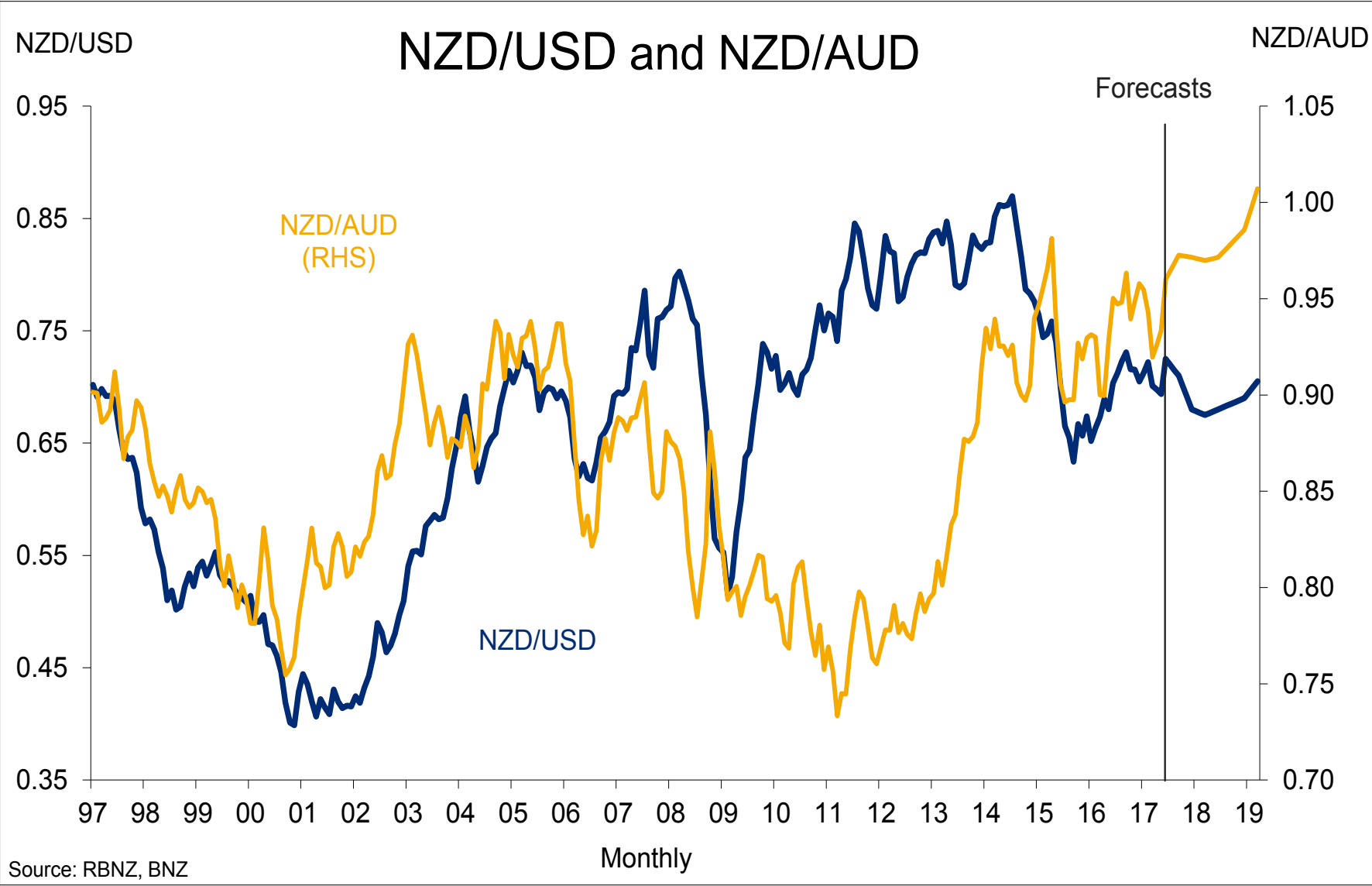
NZD Outlook

NZD Stronger For Longer



Source: RBNZ, BNZ

NZD Stronger For Longer



New Zealand and Australia Different

NZ and Australia Very Different

- NZ terms of trade approaches record high
- NZ commodities expected to outperform
- NZ delivers expansionary fiscal policy
- NZ labour market much tighter

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