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CEO Comment

Imagined recovery could do further damage

There has been some talk about 'green shoots' appearing in the economy. In New Zealand the argument for a recovery has been based around stabilisation in the housing market. It is thought that the housing market was one of the first areas to be hit by the economic crisis and therefore may be one of the first areas to recover. However, the argument that the housing market has stabilised is based around statistics that show the decline has merely slowed, and many forecasters are predicting a further reduction in prices.

'Green shoots' in the US economy have seen demand for high returning currencies such as New Zealand, Australia and Canada increase. The appreciation of the New Zealand dollar combined with a perception of a recovery could do further damage to the economy. The obvious problem for New Zealand will be that exporters will have to deal with the 'perfect storm' of weak markets and small margins compressed by an inflated exchange rate. This makes the prospect of any export led recovery seem very remote. Increased spending in the domestic economy could cause further damage. The high dollar is likely to increase spending on imported products, and if the housing market also picks up, this would lead New Zealand down the same path of debt fuelled consumption and inflation that has hammered our real economy.

We have already seen statistics showing that the decline in imports is largely due to a 30 percent decrease in imported capital goods rather than a decrease in imported consumer products. These are concerning figures given that capital goods generally indicate business investment in new productivity capacity and improving technology. It indicates that little has been learnt from the debt fuelled consumption of the last economic cycle.

The lessons also seem to have been lost on our political leaders. There has been no impetus to change any of the rules surrounding investment incentives or to control our money supply. The tax system continues to incentivise investment in non-productive assets and there has been no consideration given to changing the monetary policy framework to restrict access to foreign credit. Adding to the problem, Reserve Bank Governor, Dr Alan Bollard, has continued with a highly conservative monetary policy despite the obvious limitations of this approach and the actions of the huge northern economies.

The problems caused by a high dollar, low productivity growth, low export growth and debt fuelled consumption are obvious. The strength of our recovery will depend on the rebalancing of our economy, and policy makers need to lead this change. Economic behavior will not change if the rules remain the same.