

The Economic State of the Nation, 2011

Dr Roderick Deane

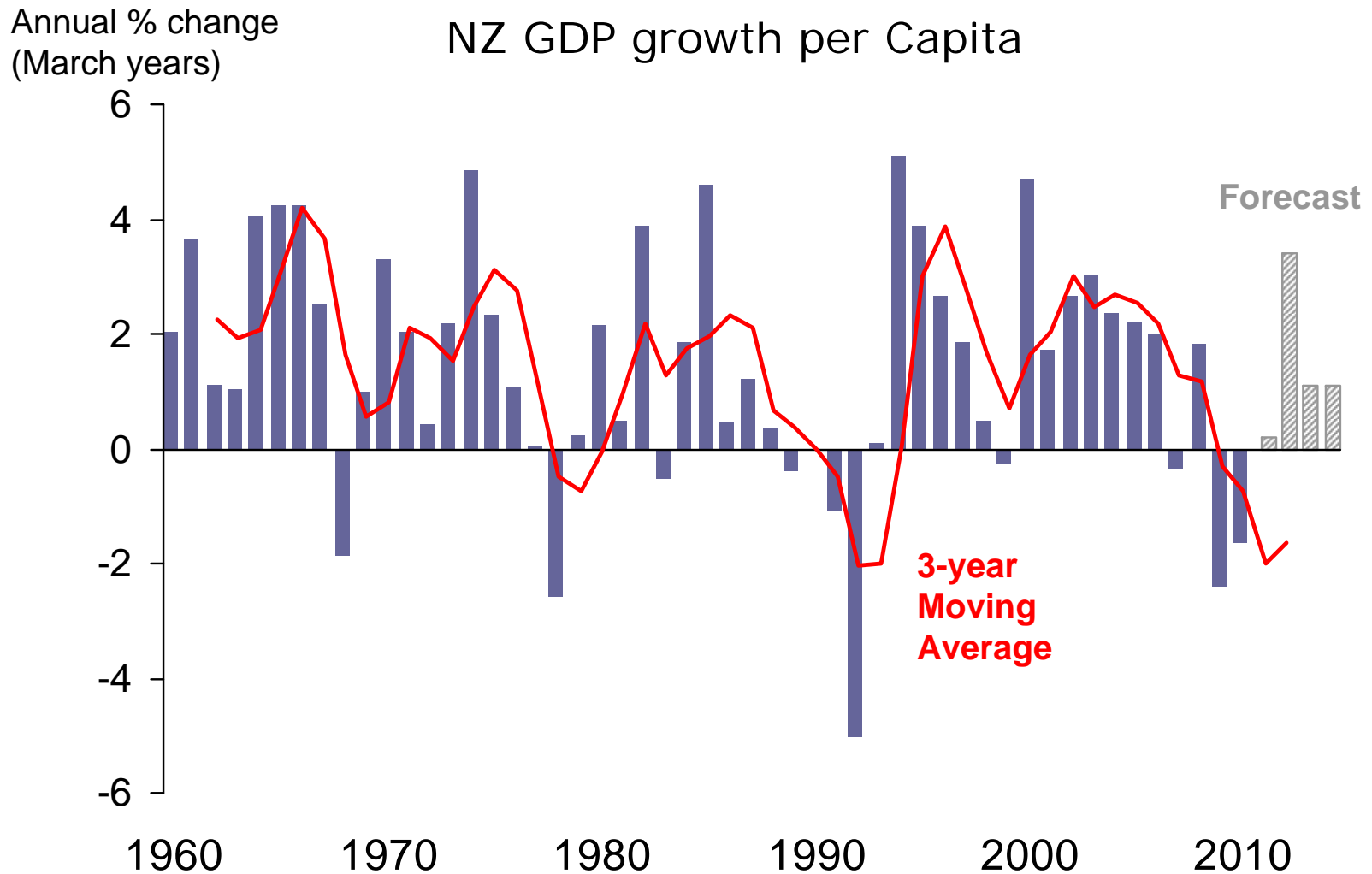
An Address to the New Zealand Business Roundtable
Strategy Retreat

17-18 February 2011

Formosa, Beachlands, Auckland.

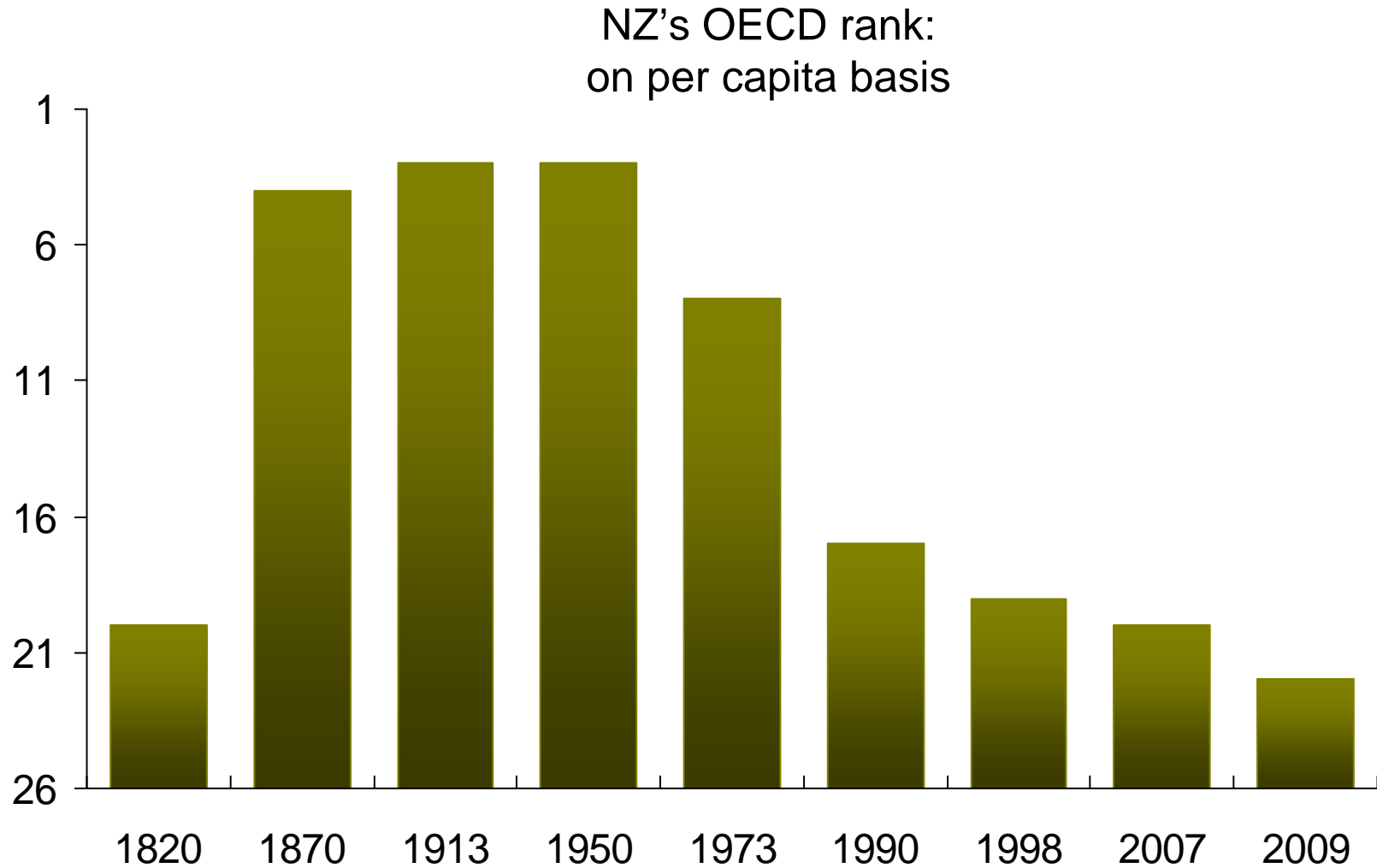
Dr Roderick Deane is Chairman of Pacific Road Group in Sydney & the NZ Seed Fund, & a Director of Woolworths Ltd in Sydney. He is also Patron of IHC & Chairman of the IHC Foundation. He was previously Chairman of Fletcher Building, ANZ National Bank, Telecom NZ, Te Papa Tongarewa (the Museum of NZ), City Gallery Wellington Foundation, & a Director of the ANZ Banking Group in Melbourne. At an earlier stage he was CEO of Telecom NZ, Electricity Corporation of NZ, Chairman of the State Services Commission, & Deputy Governor of the Reserve Bank of NZ. He was also Professor of Economics and Management at Victoria University of Wellington & a Director of TransAlta Corporation in Canada for some years. Dr Deane is very appreciative of the assistance he was given in preparing this material by Stephen Edwards of the Economics Group of the ANZ National Bank, Bryce Wilkinson of Capital Economics, Bruce Parkes of MED and Dan Brenninkmeyer of Fonterra.

New Zealand: a story of fluctuating economic growth rates





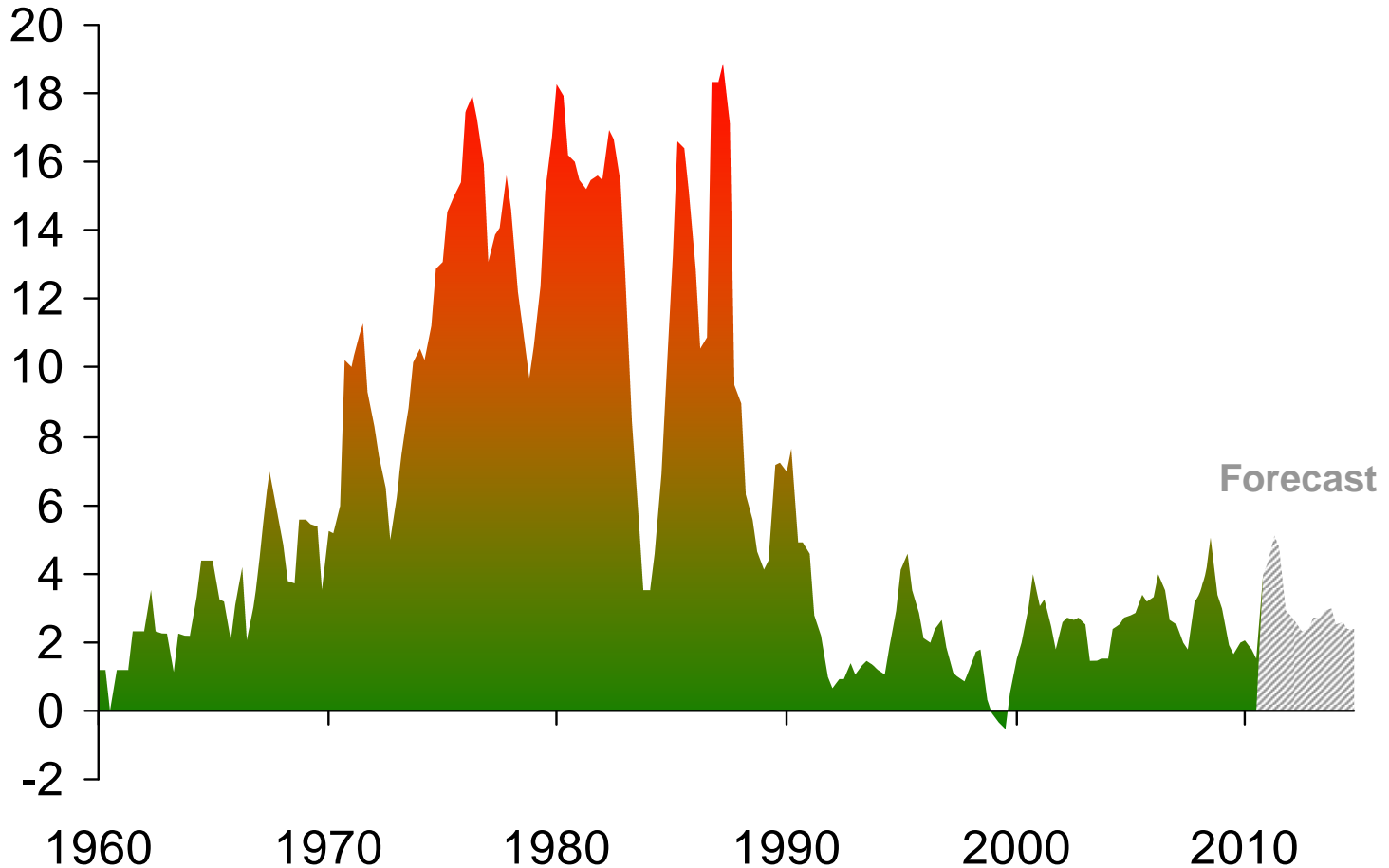
And a poor performer relative to the rest of the world



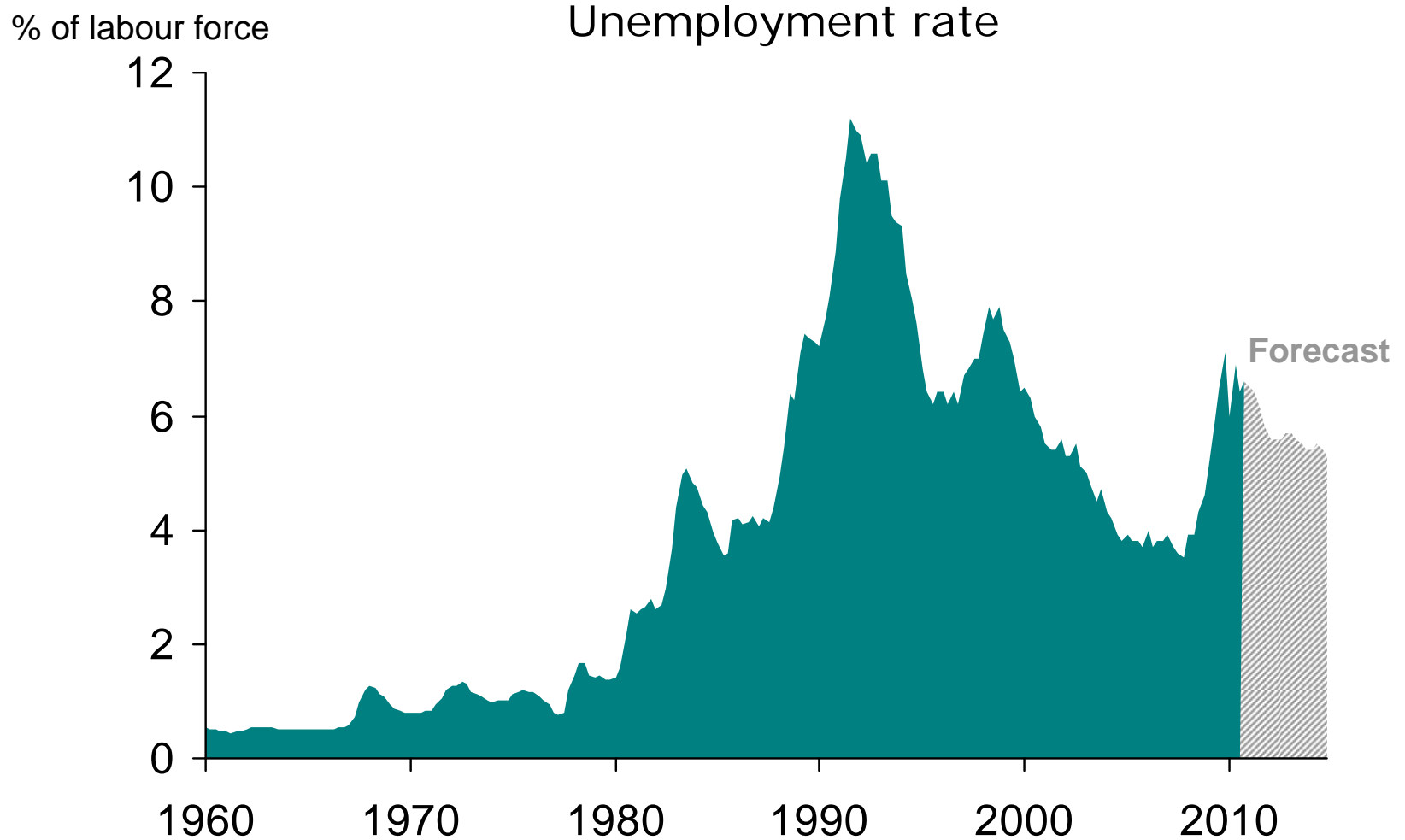
Inflation tamed but performance deteriorating

Annual % change

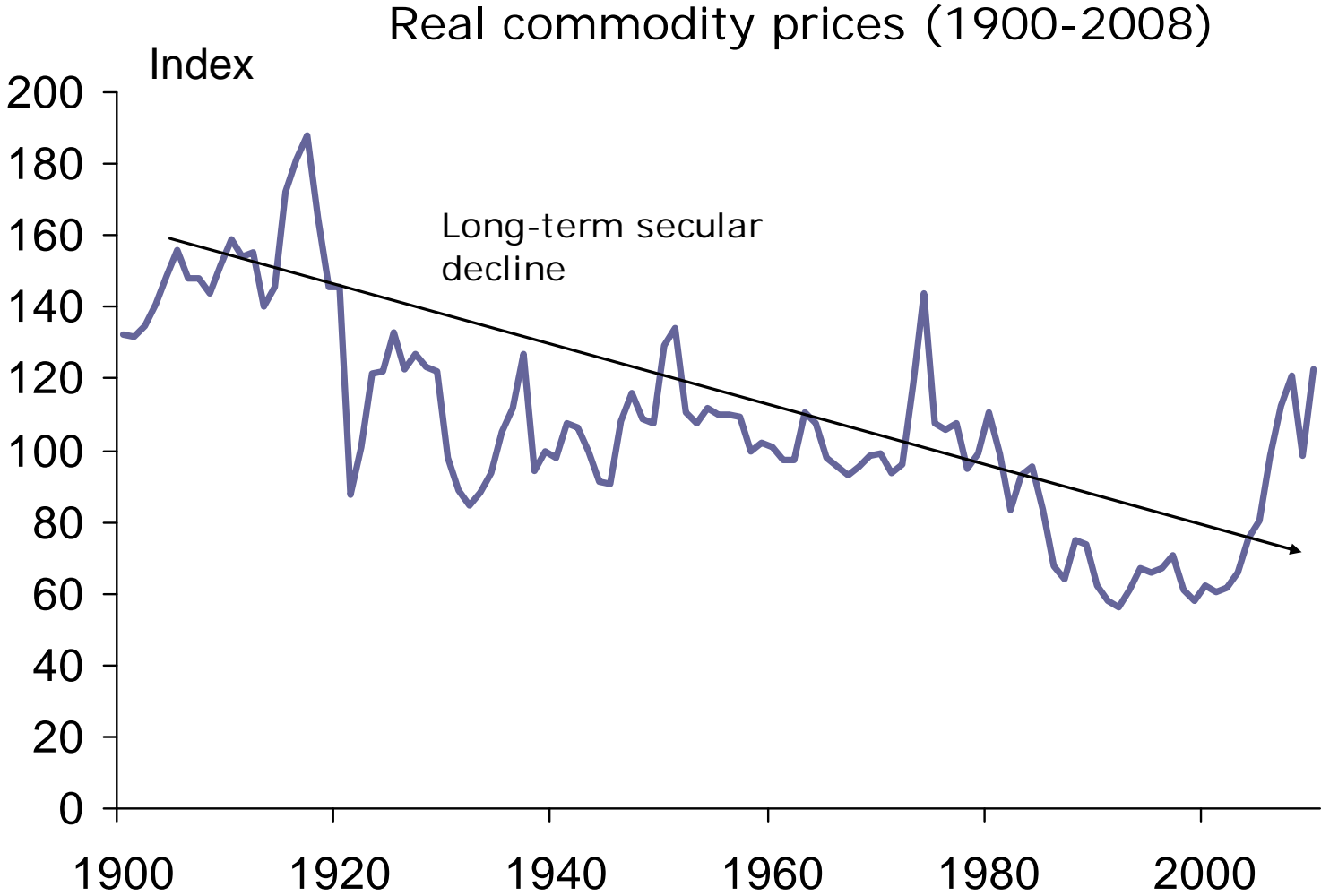
Consumer price inflation



Unemployment higher than it should be or needs to be

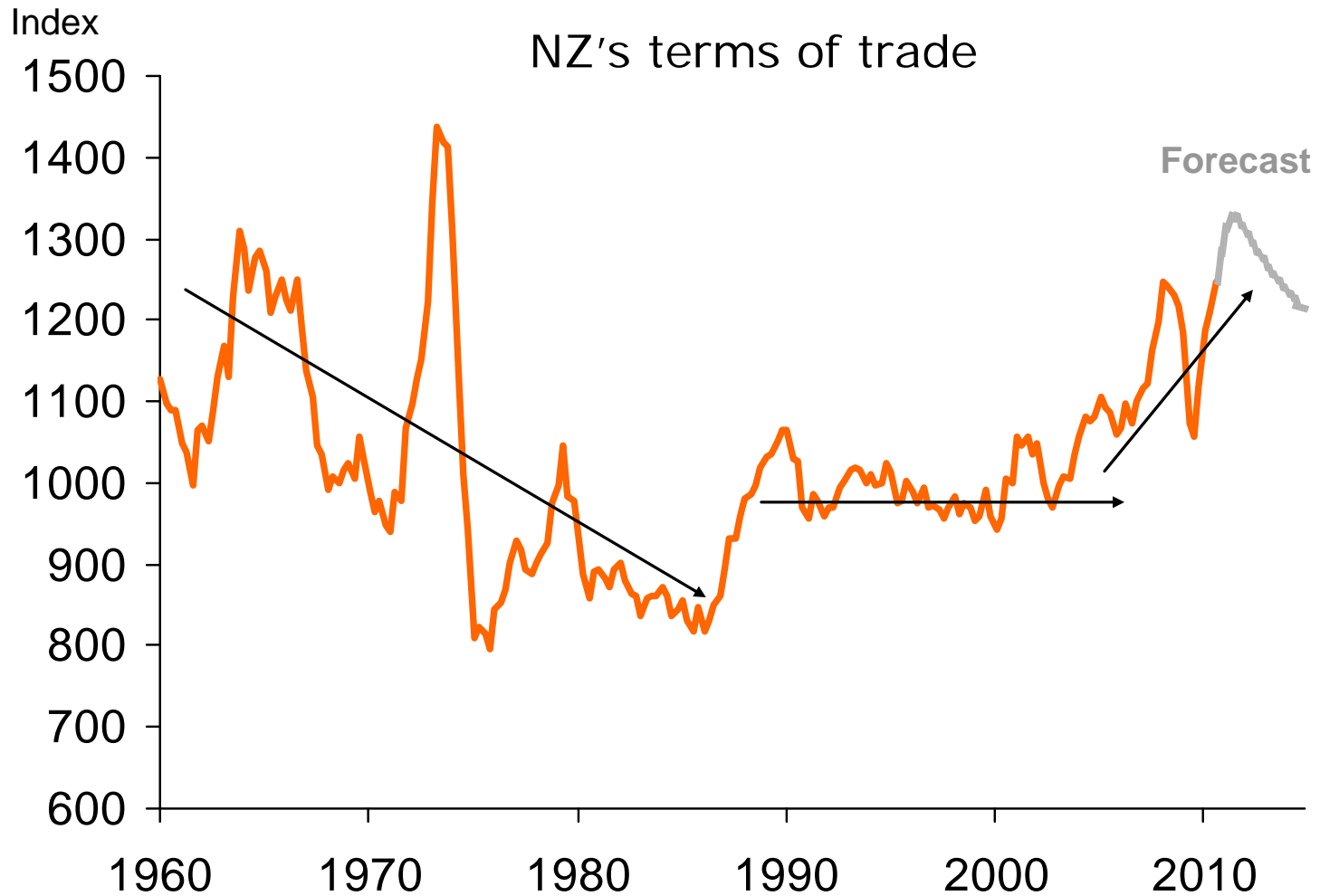


Commodity prices are part of the economic growth story

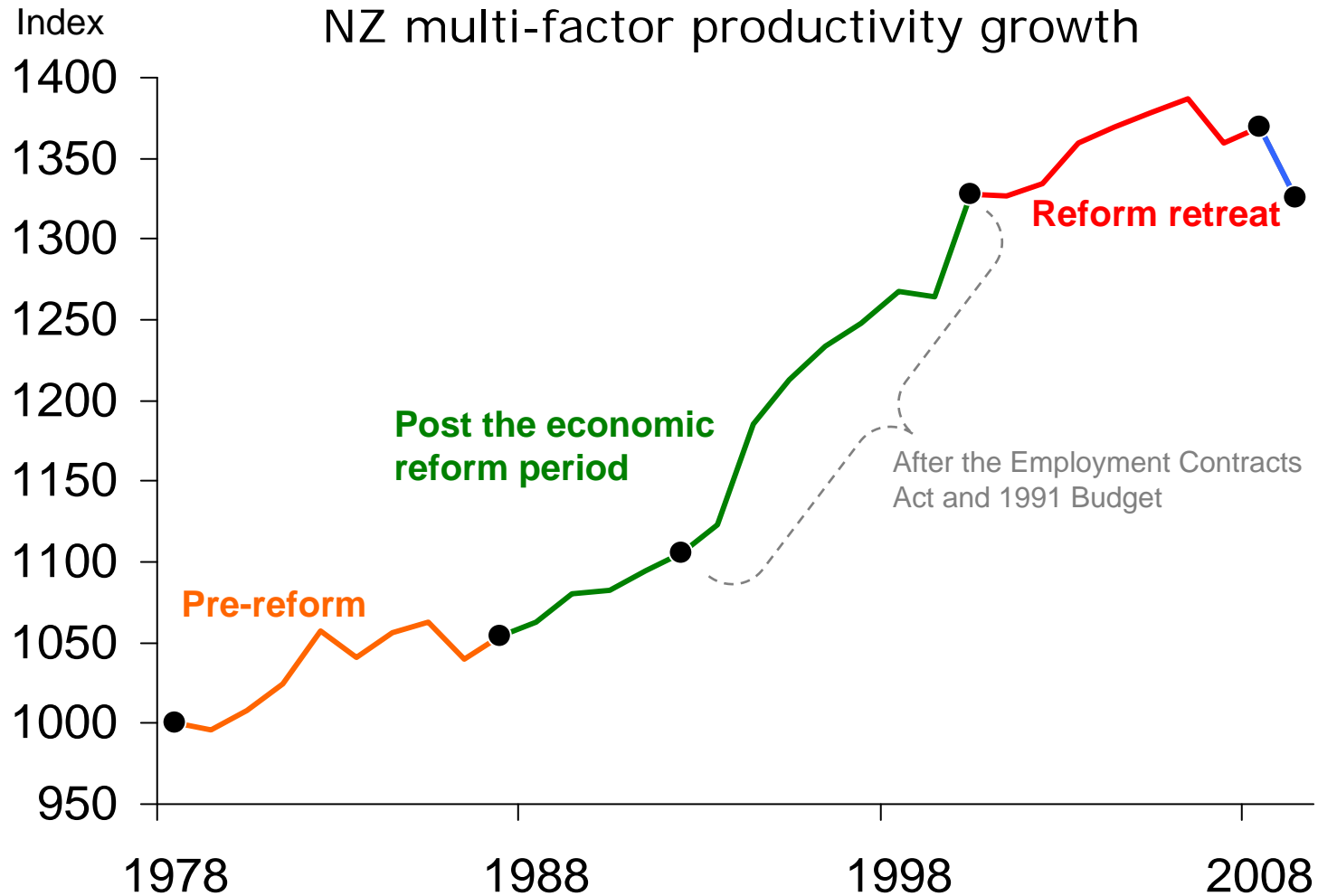


Sources: IMF; ANZ.

Likewise the terms of trade (ratio of export to import prices)

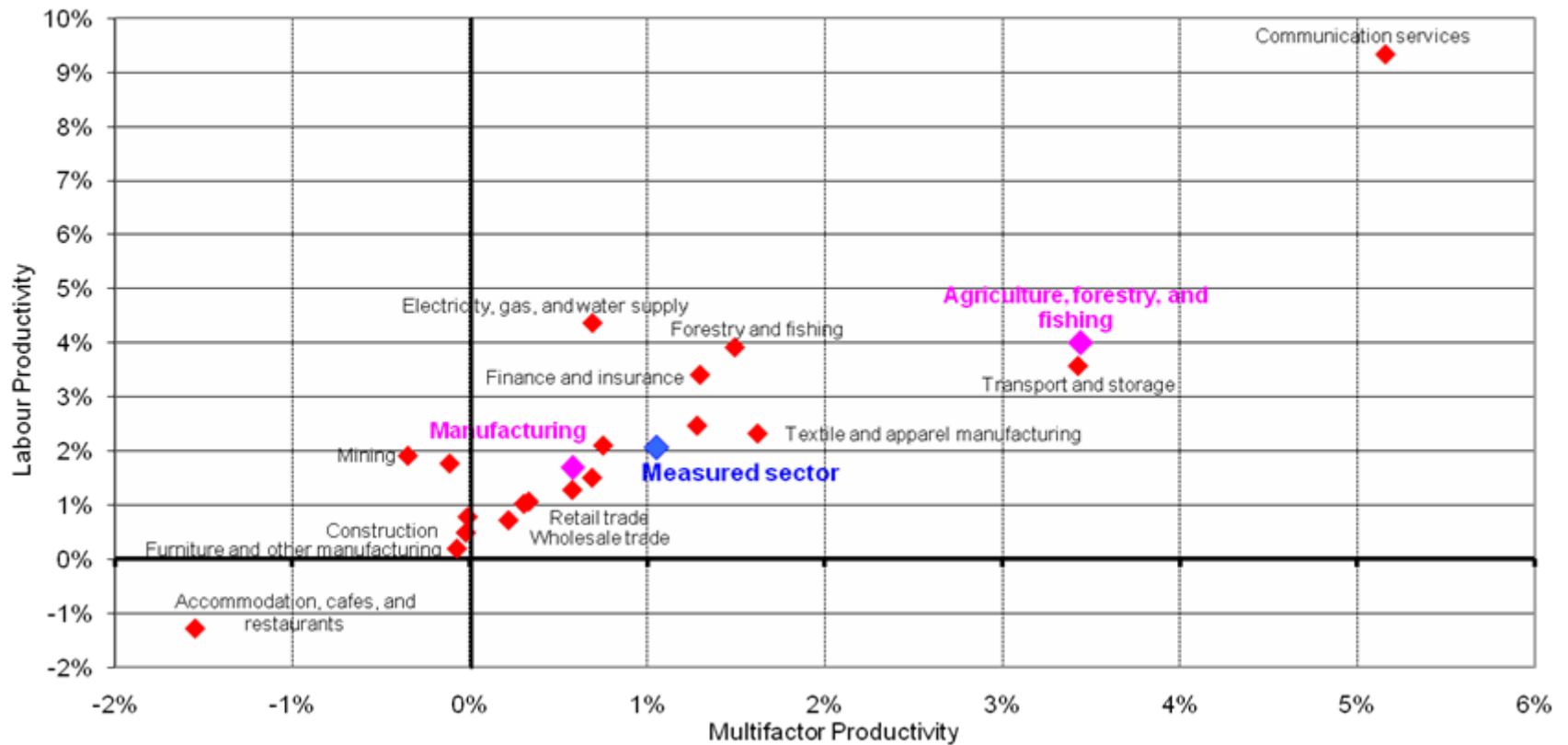


Slow productivity growth is the price of backing off reforms

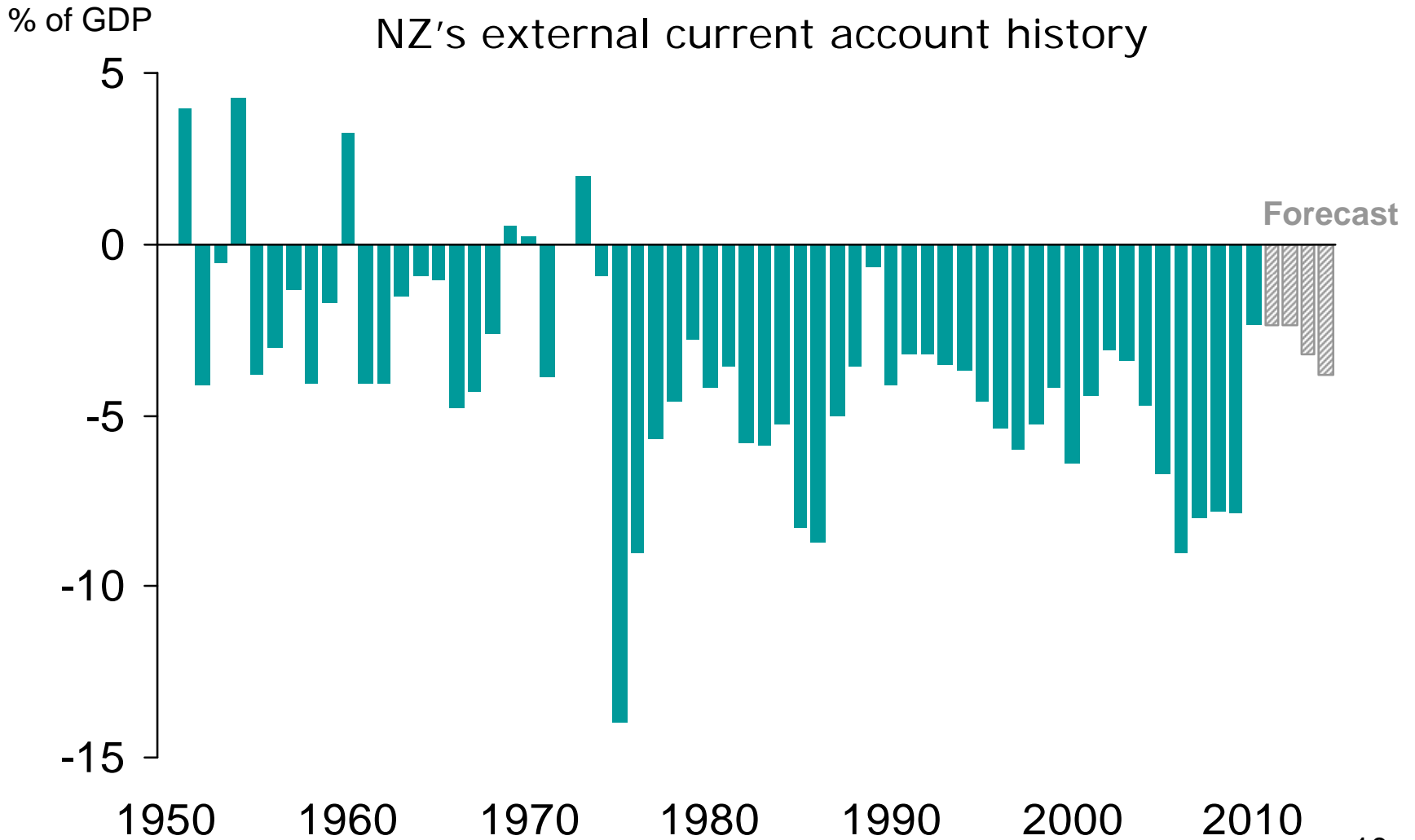


Dilemma: communications has fastest productivity growth; now ended up as the most regulated industry

Labour and Multifactor Productivity in the New Zealand Measured Sector
Average annual compounded growth rates 1978-2008



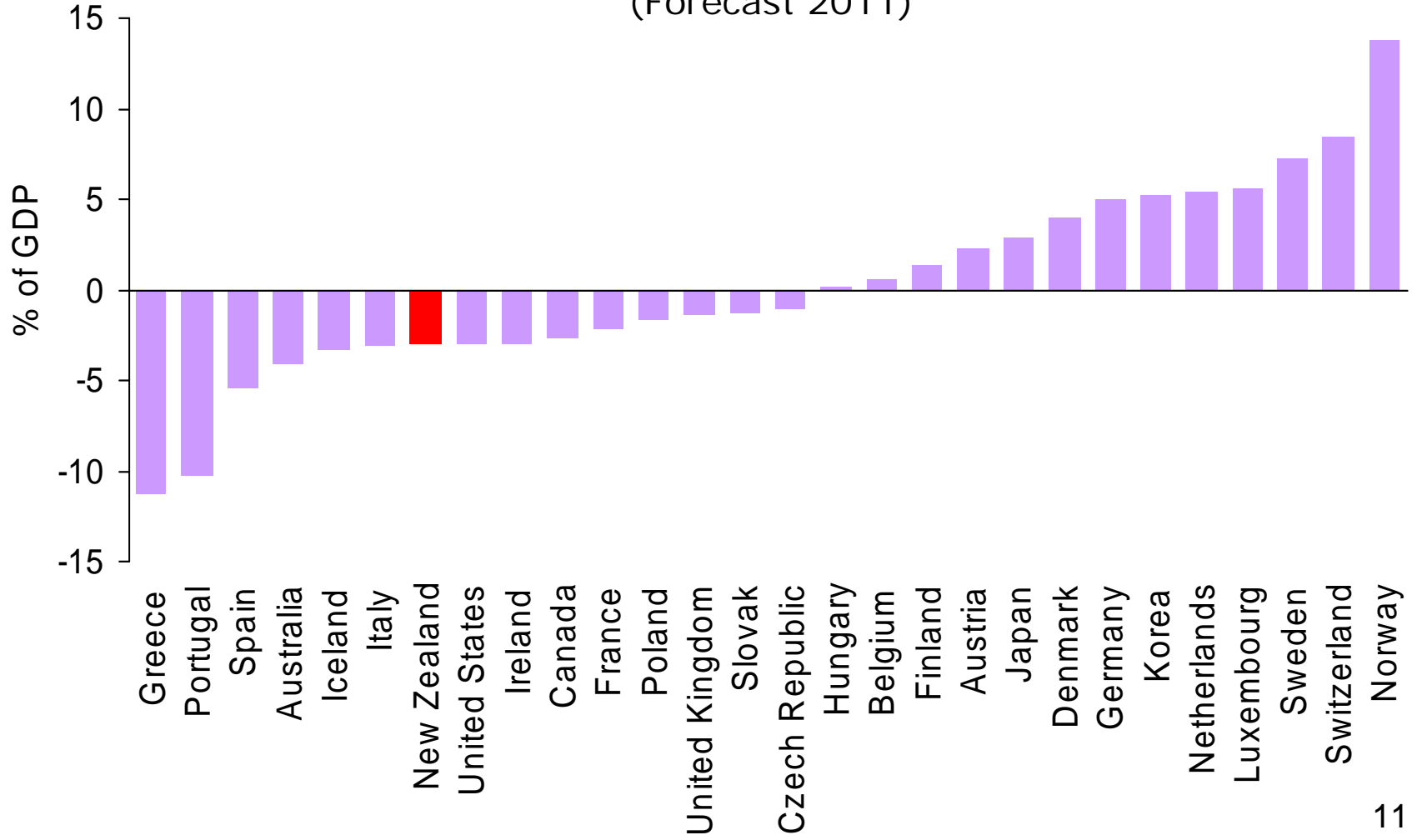
A persistent risk factor is the external constraint



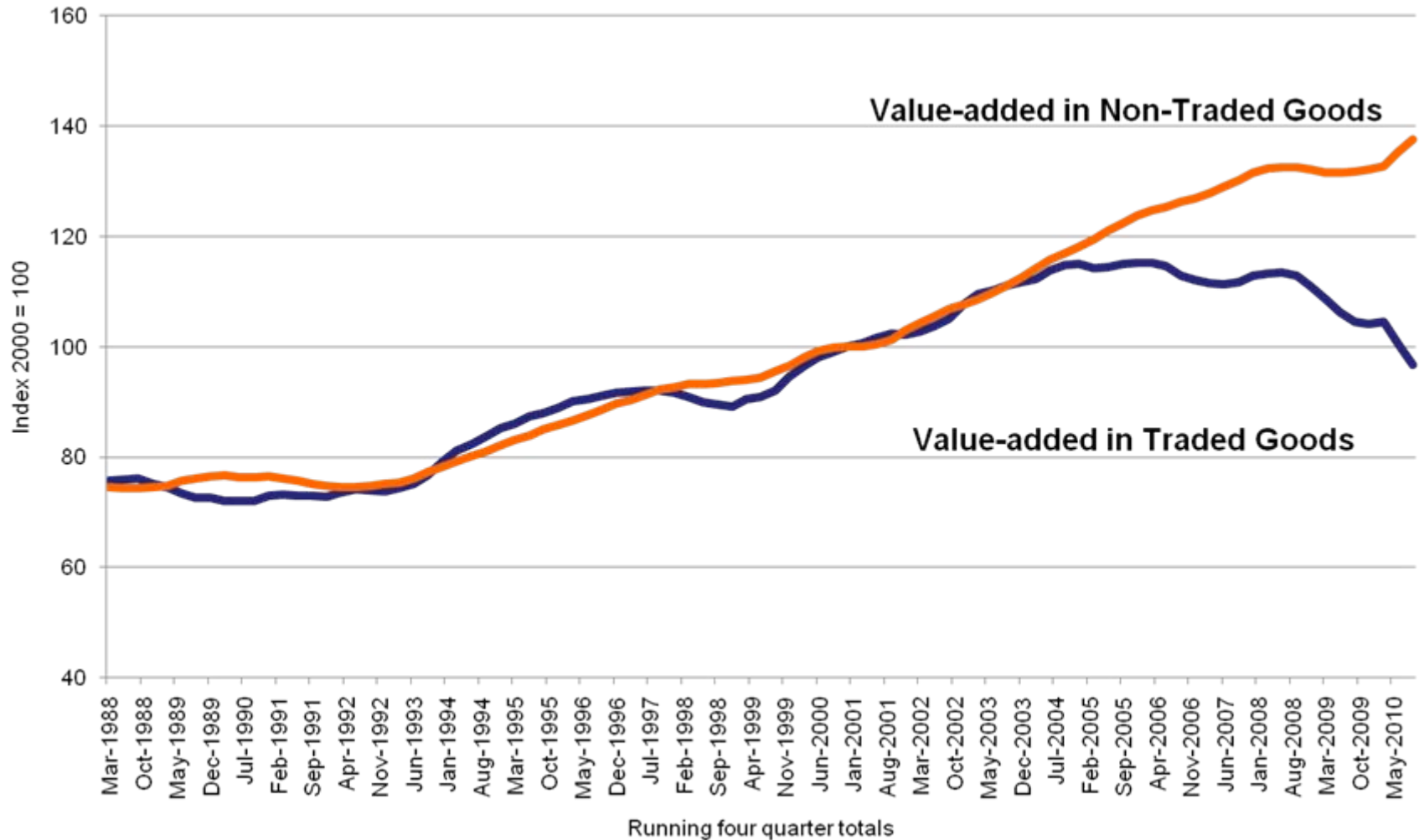


Not the worst, but not a happy ranking

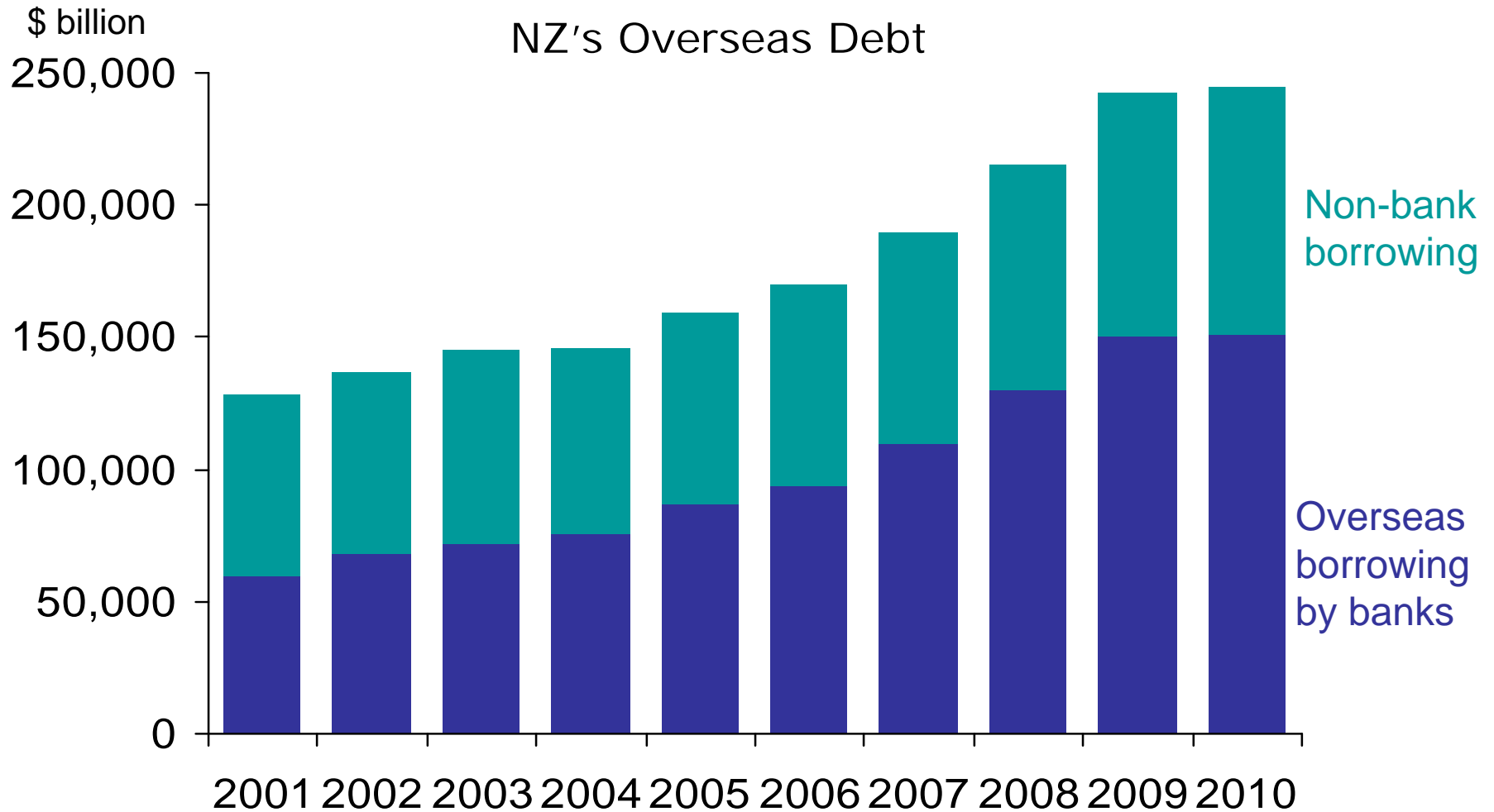
Current Account Balances of OECD nations (Forecast 2011)



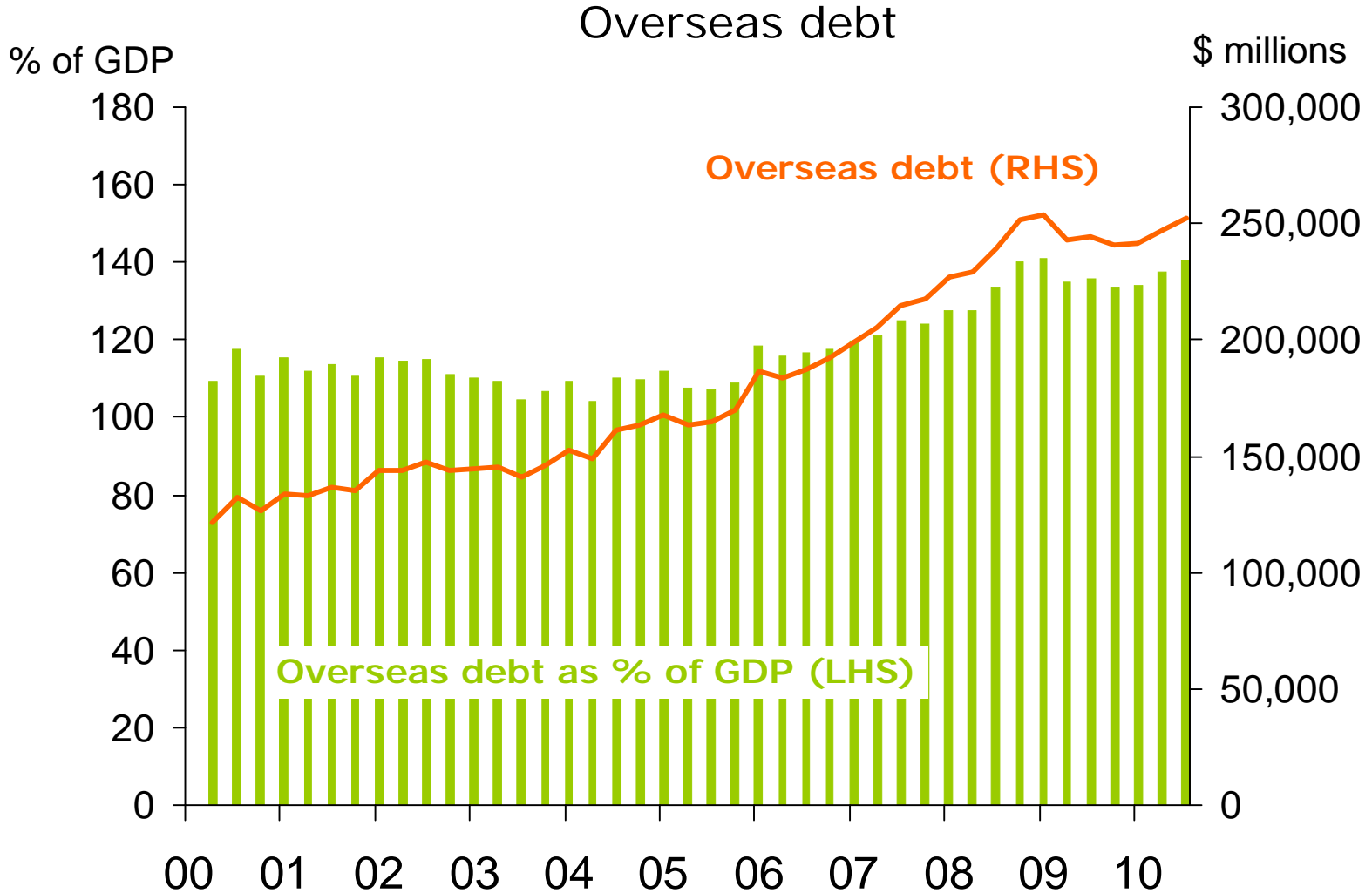
The traded goods sector has been squeezed from 2004



The elephant in the room: overseas debt



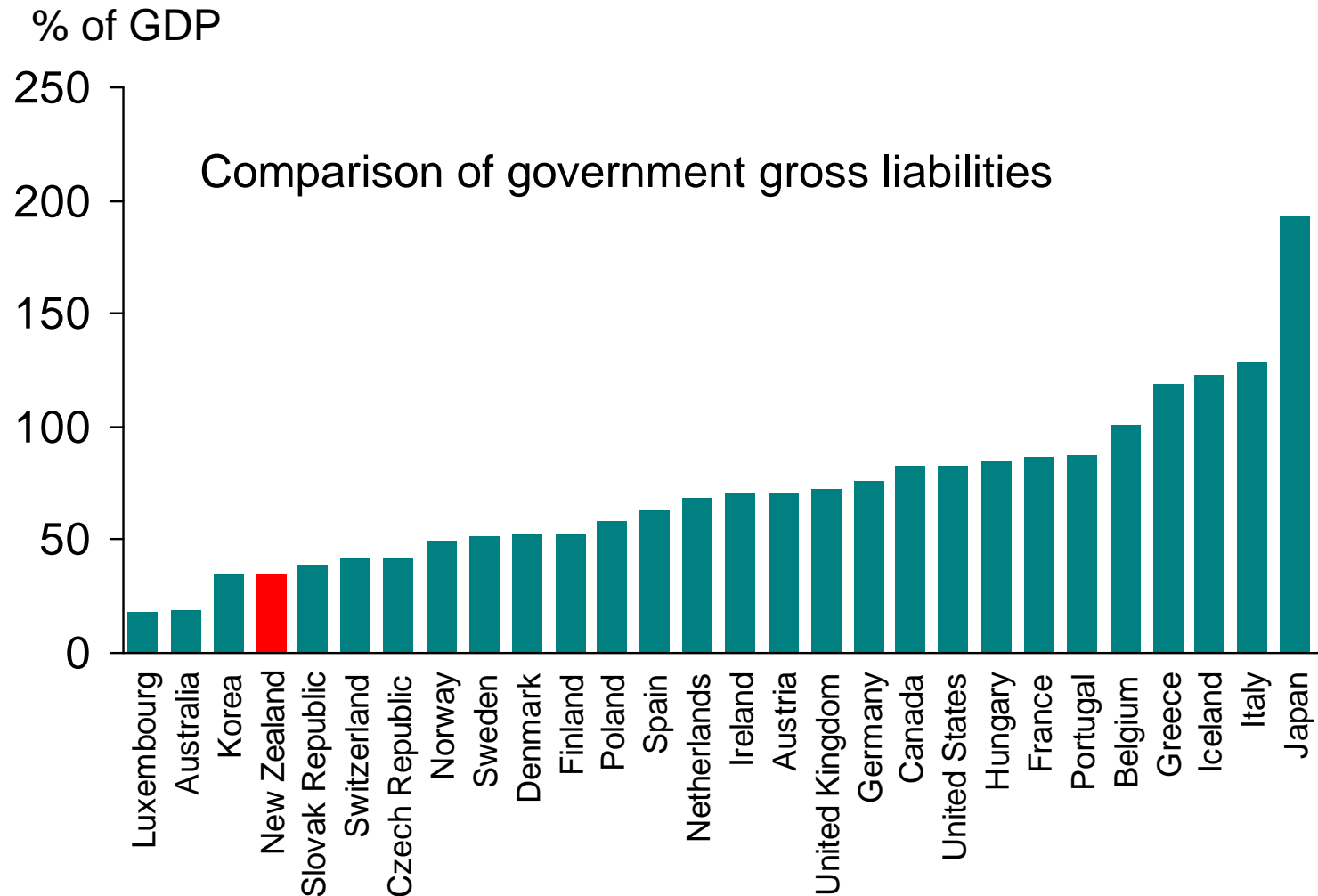
NZ's total overseas debt rising rapidly again



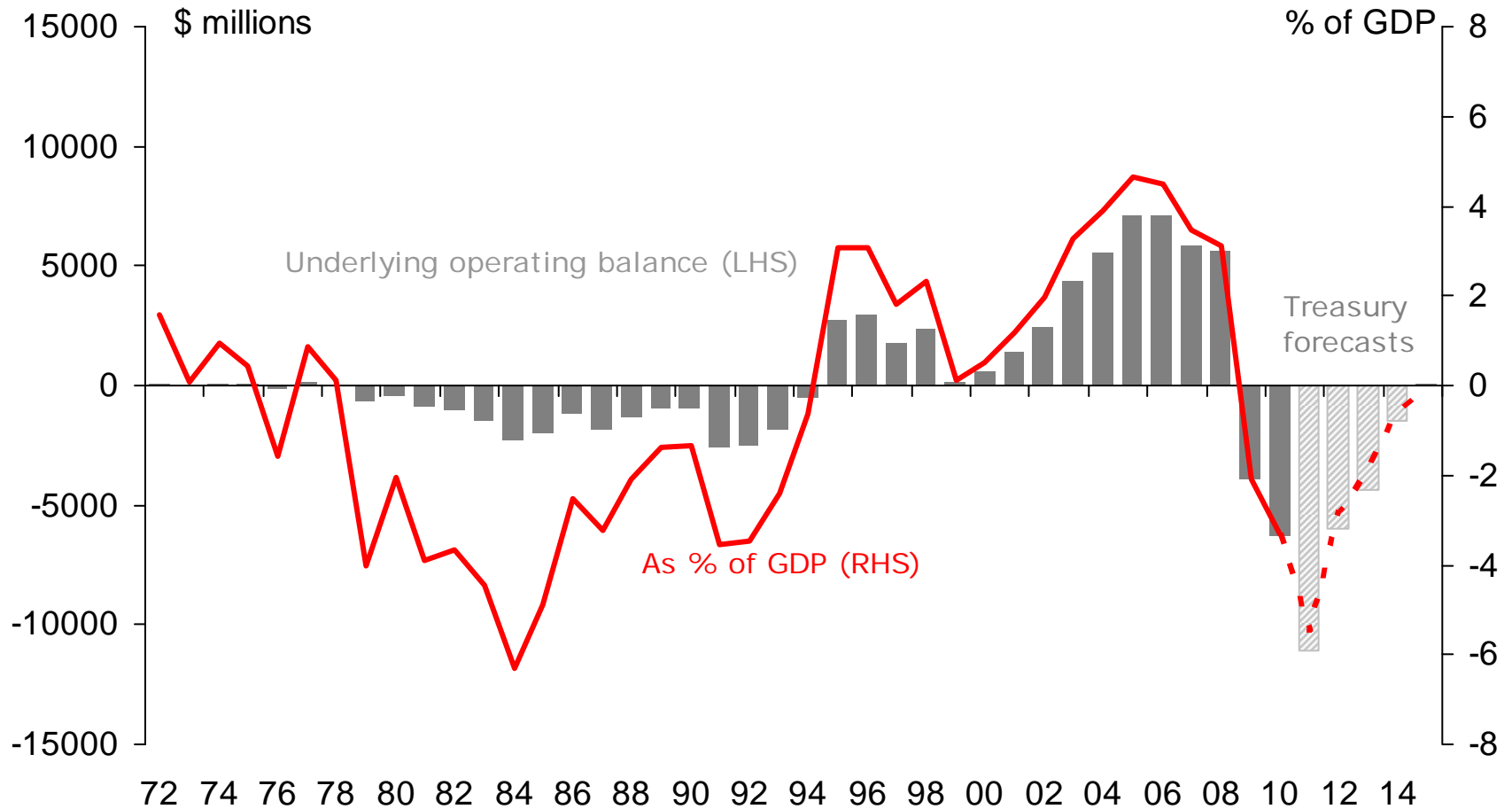
THE POLITICIAN



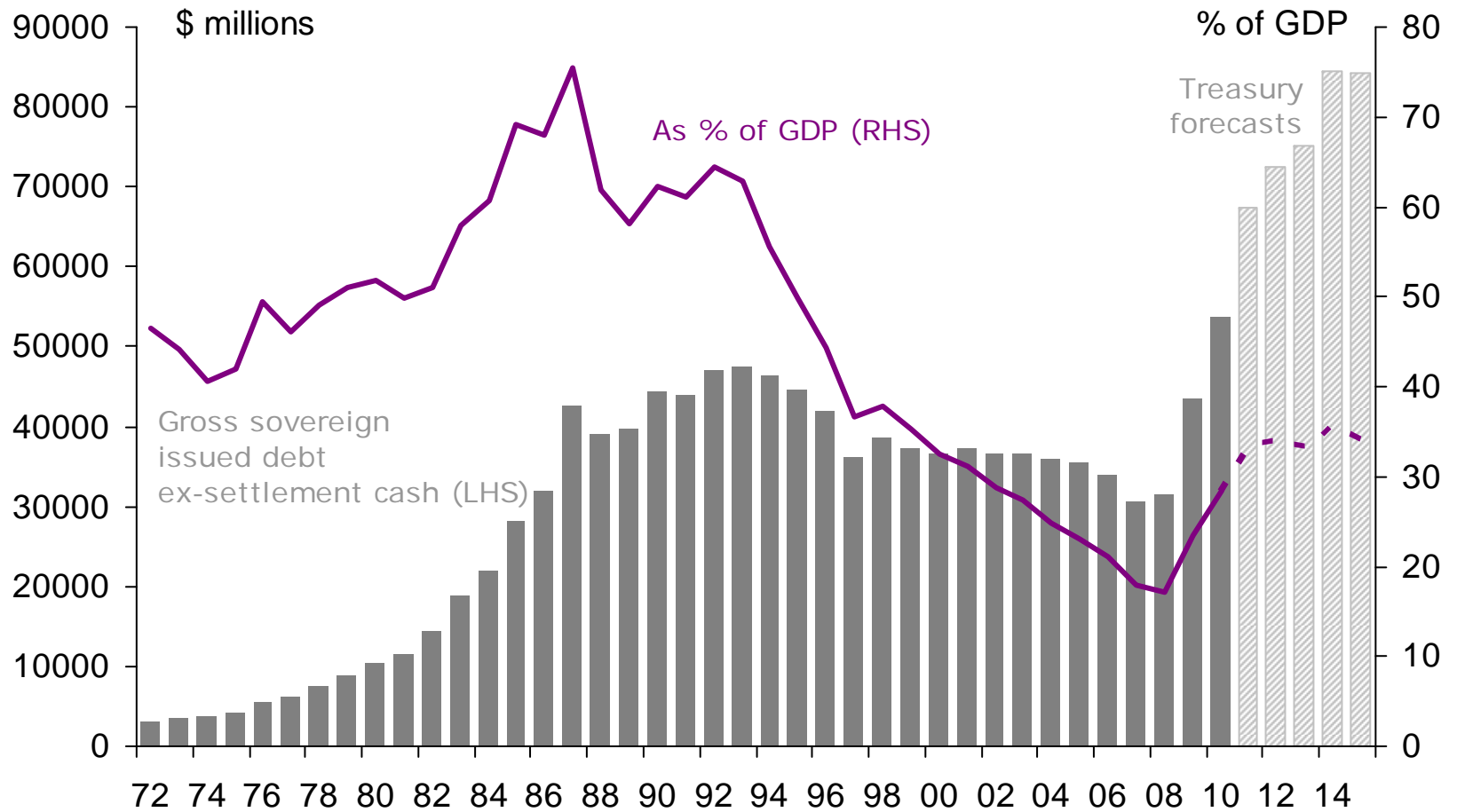
A favourable relative ranking for Government debt



Another elephant: NZ fiscal balance has deteriorated rapidly

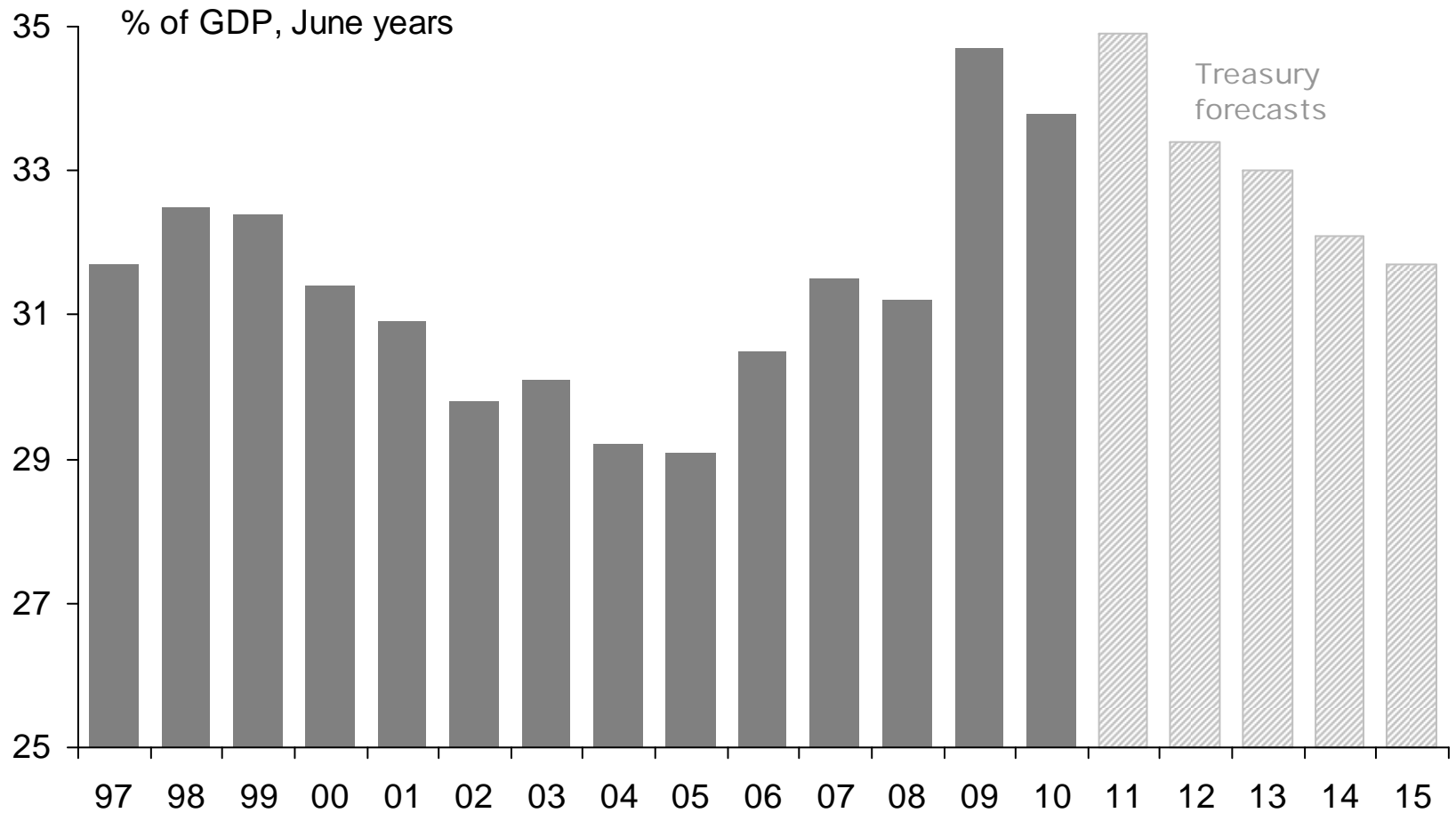


NZ Government public debt rising rapidly

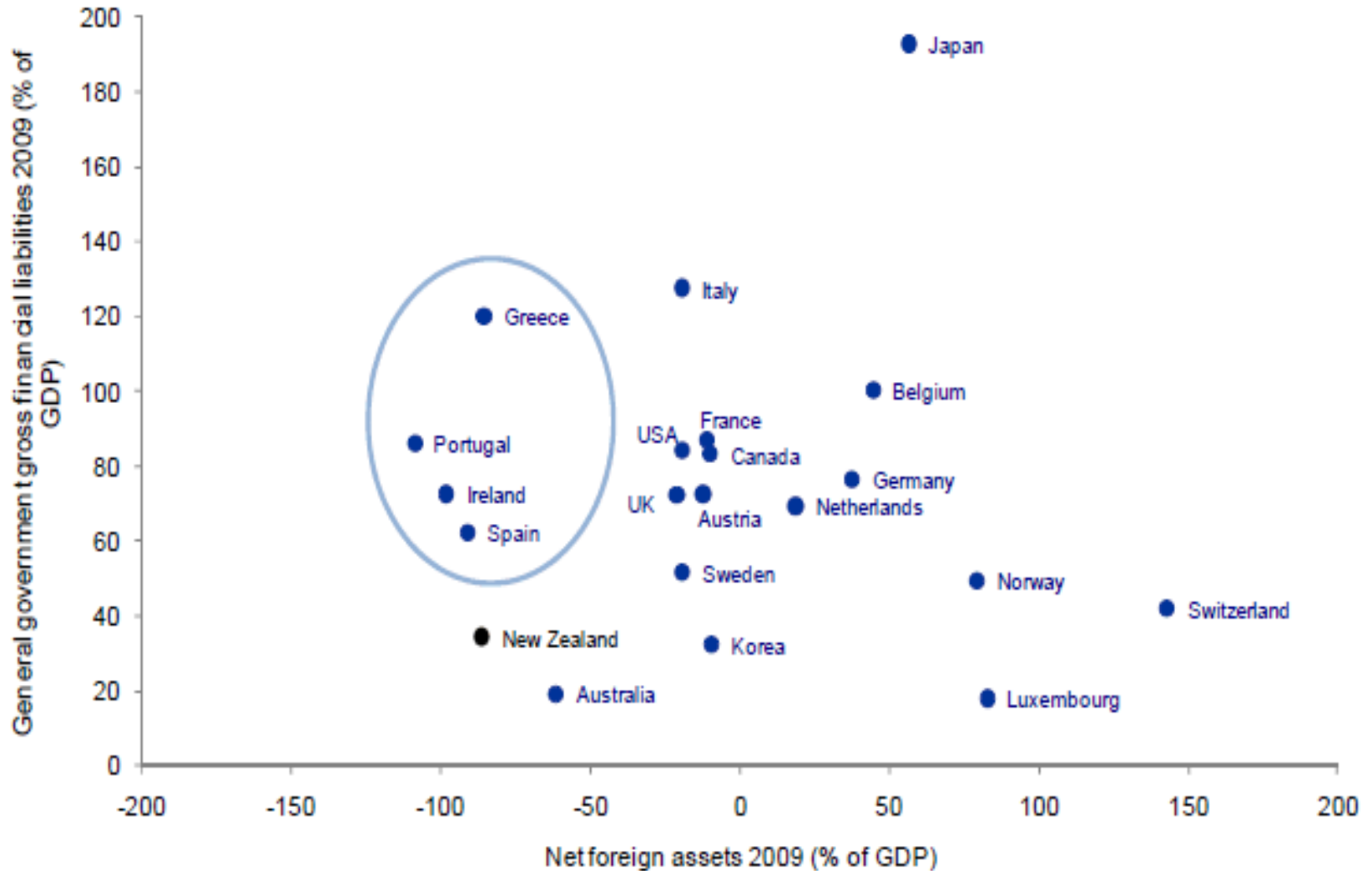


Government spending worryingly high

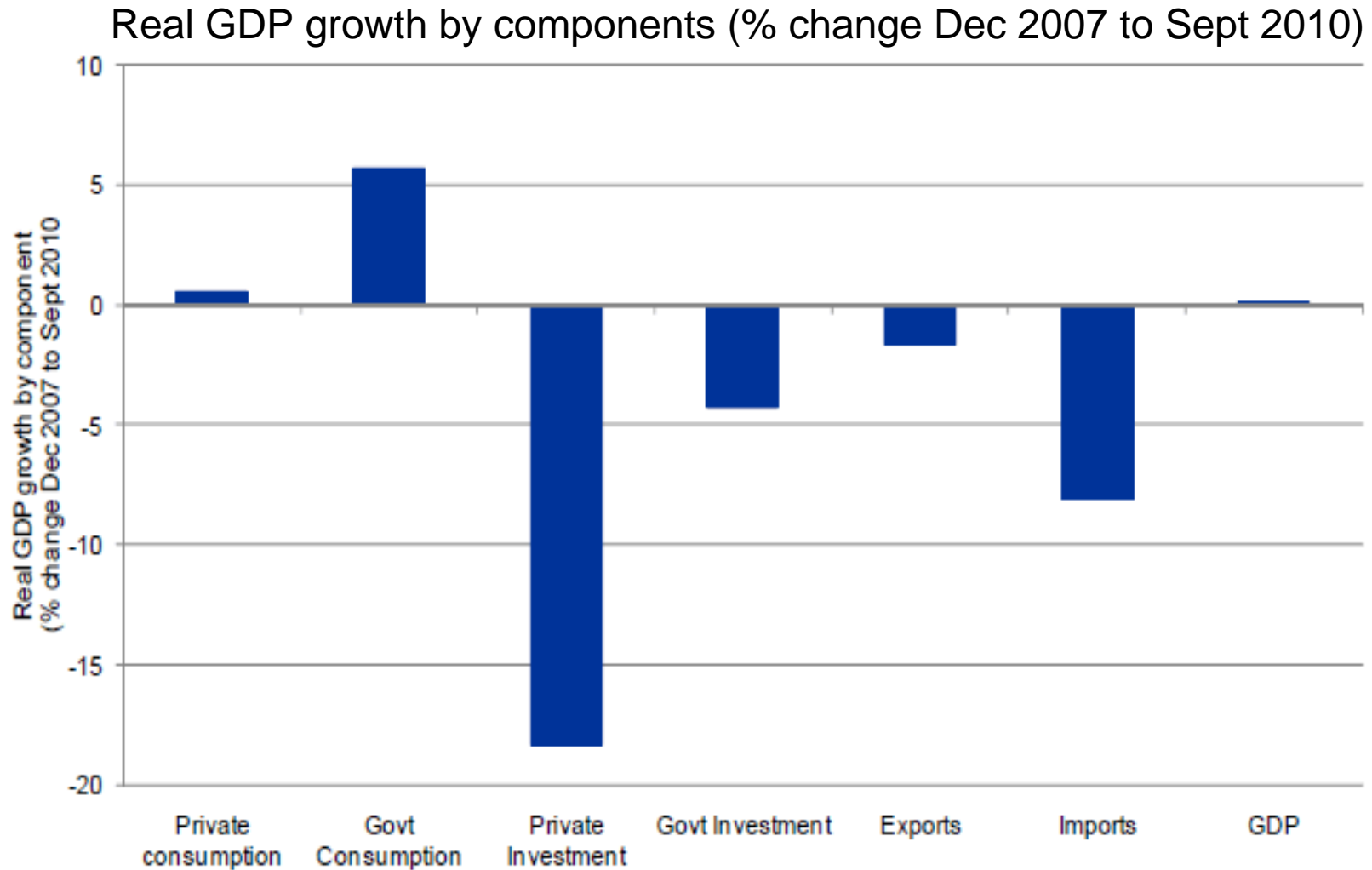
Core Crown spending



Government debt and net foreign asset position, 2009

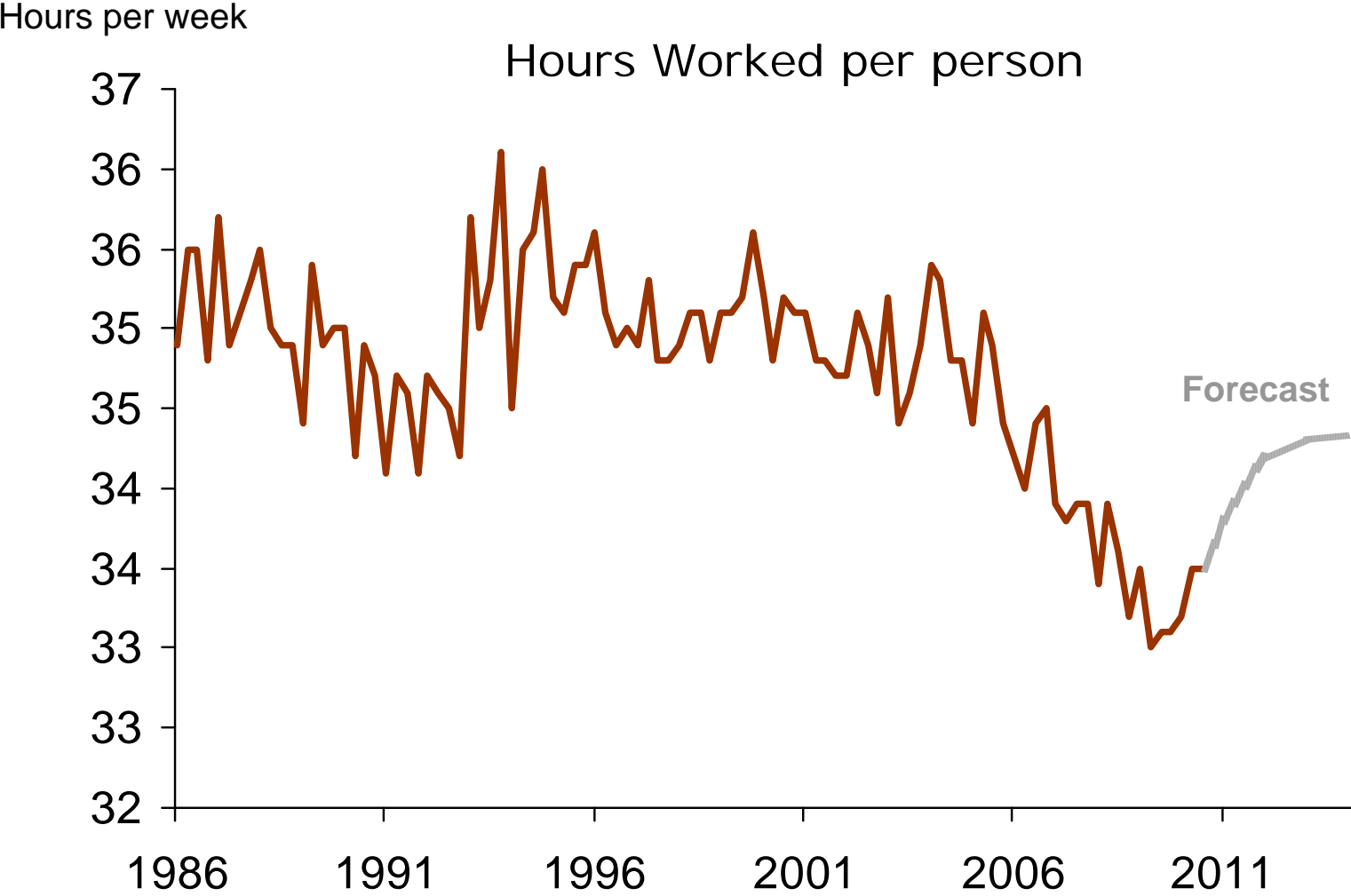


Government consumption grows; private investment sinks



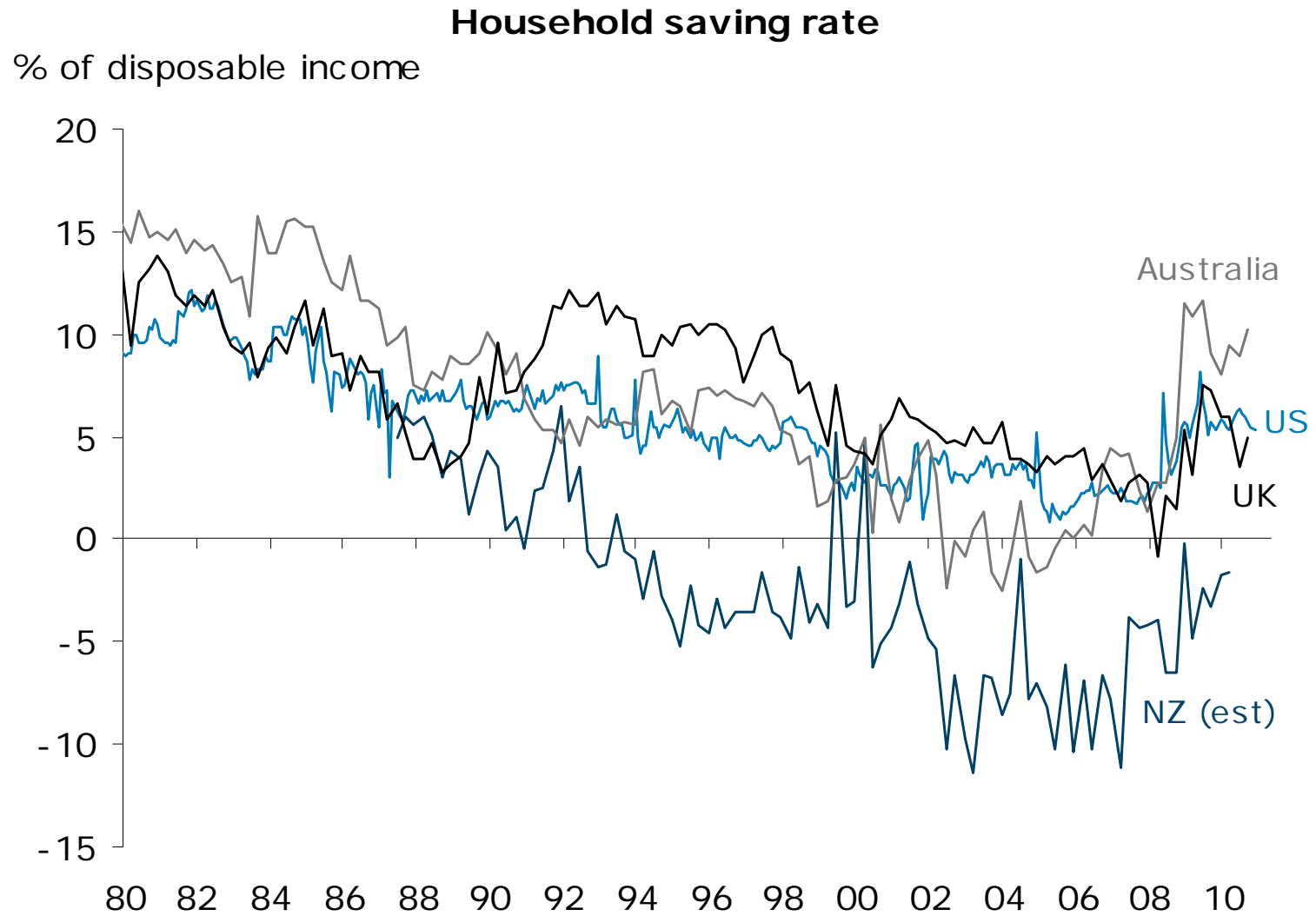
Source: Statistics NZ, Savings Working Group 2011

We do not work as much as we used to



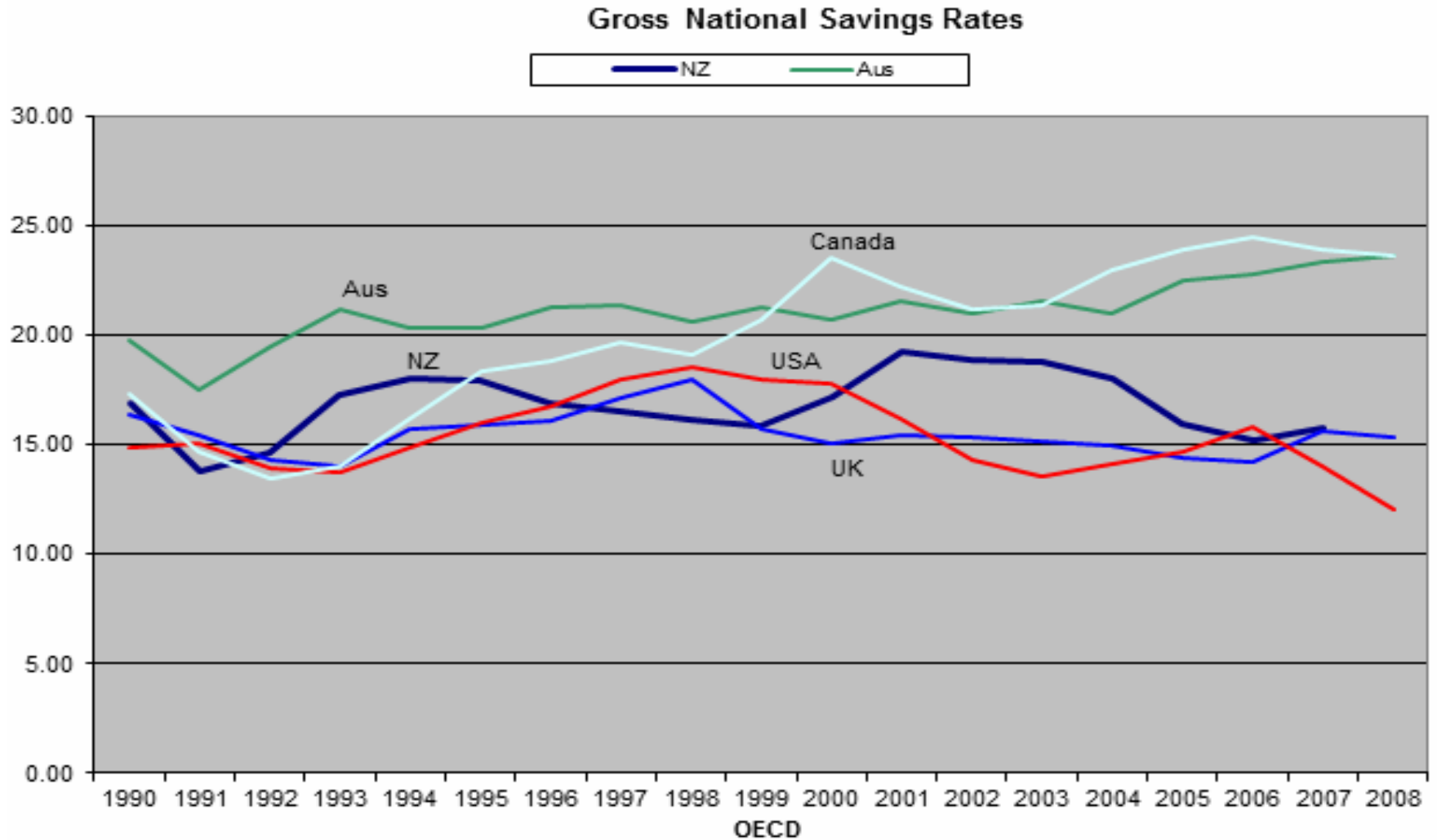
Sources: Statistics NZ; ANZ

And the household sector is not great at saving



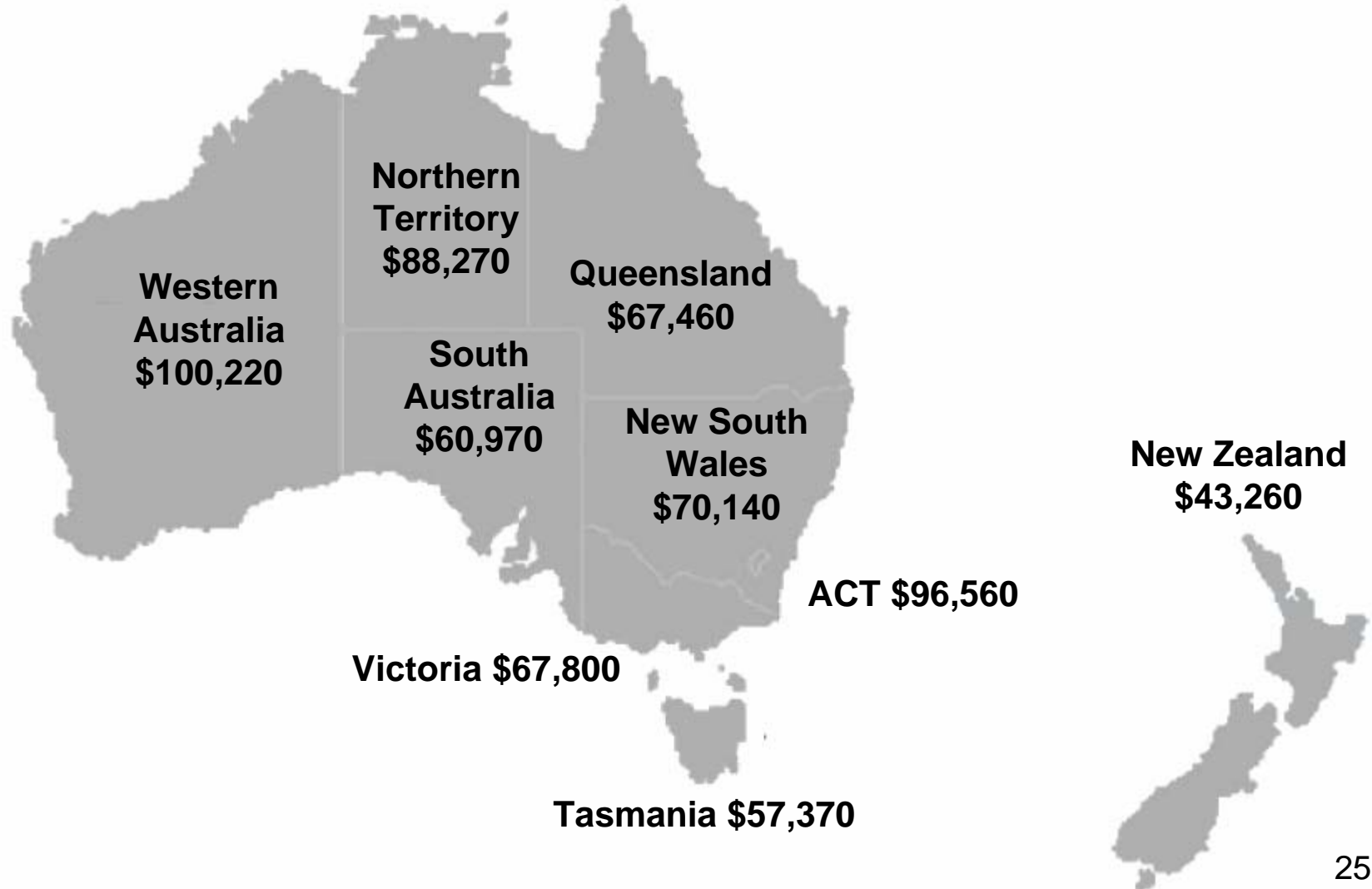
Sources: ANZ, Statistics NZ, Bloomberg, ABS

But is overall savings not such a big deal as sometimes portrayed ?



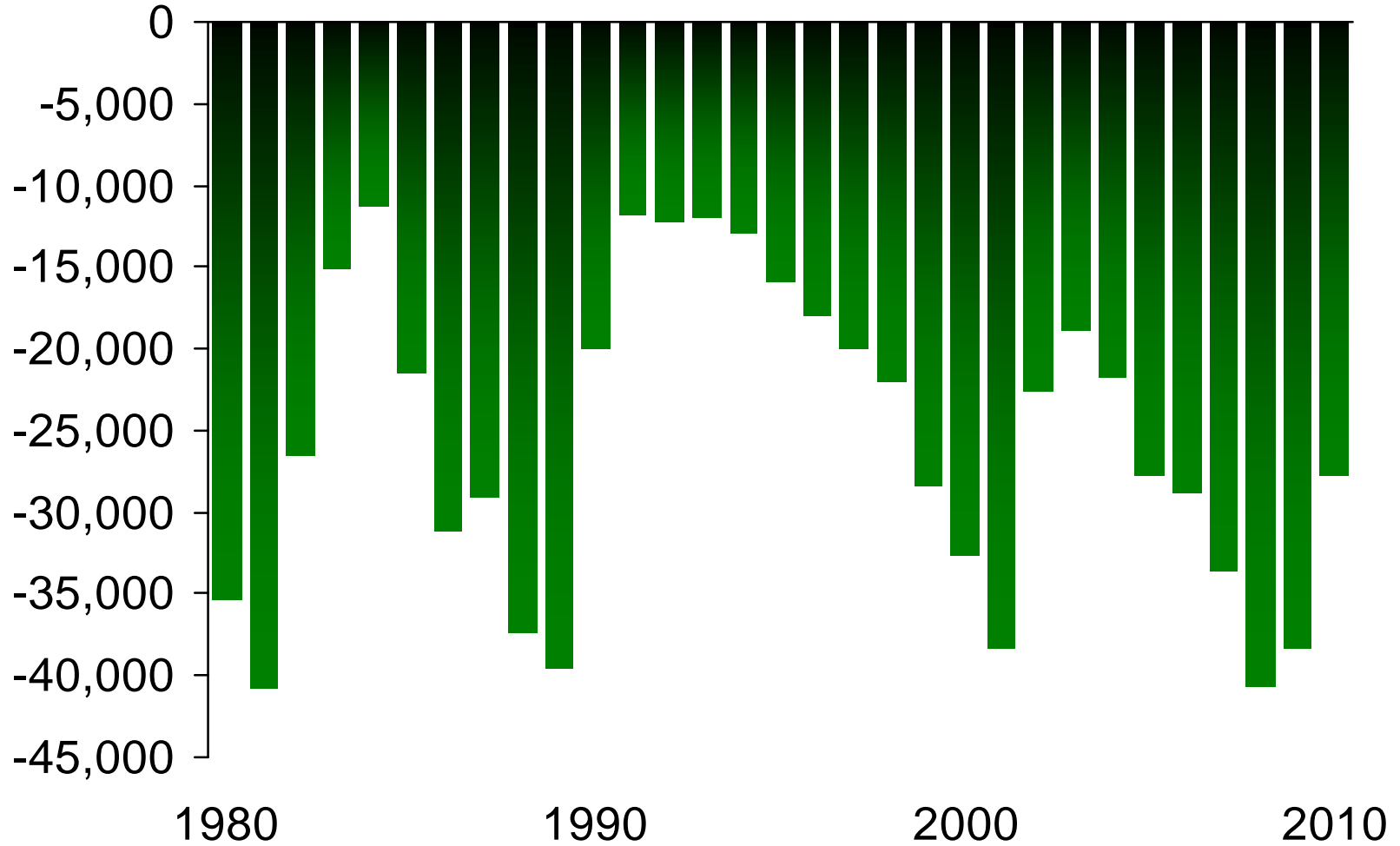
Kiwis have a much lower income than even Tasmania

Trans-Tasman Per Capita Incomes
Year Ended June 2010, \$NZ



So many of us are heading for Australia

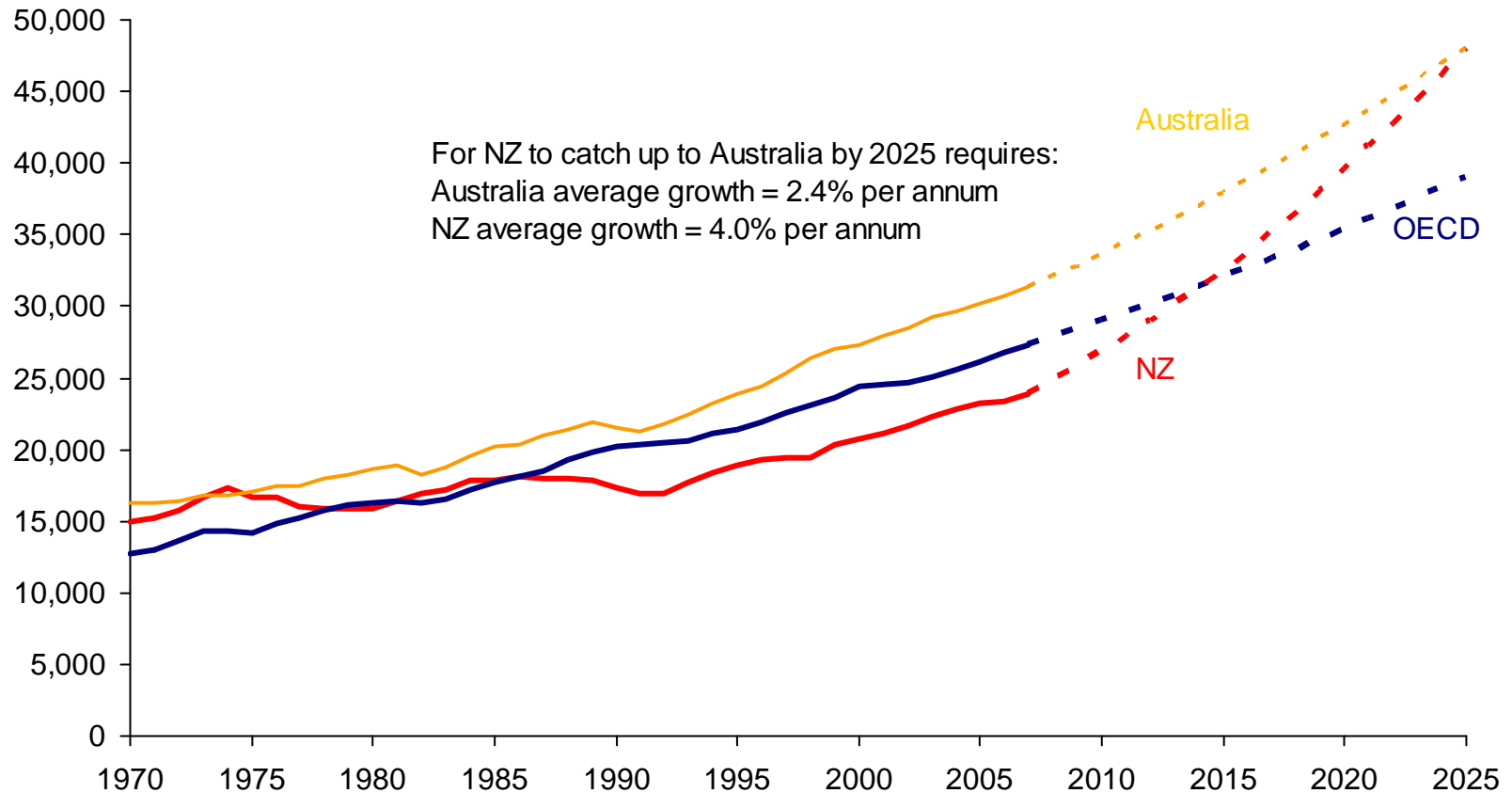
Net Migration to Australia
Years Ended June



To catch up to Australian growth rates is a huge challenge

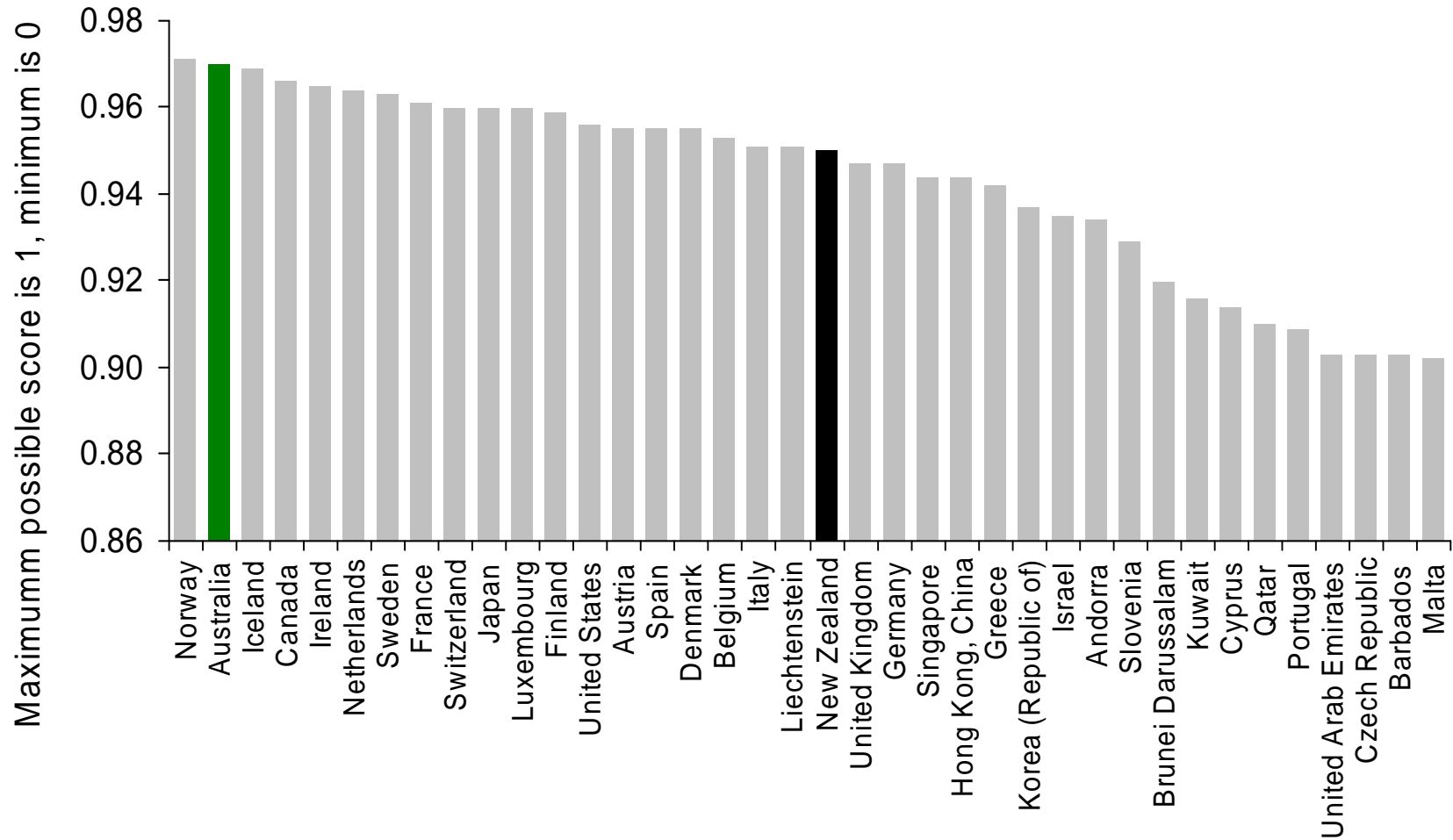
NZ's per capita GDP was similar to Australia's in the mid 1970's. In 2007, NZ's per capita GDP is around 24% below Australia's. In order for NZ to catch up to Australia by 2025, per capita GDP growth has to average 4% per annum, almost twice what has been achieved in the past decade.

GDP per capita (US\$)



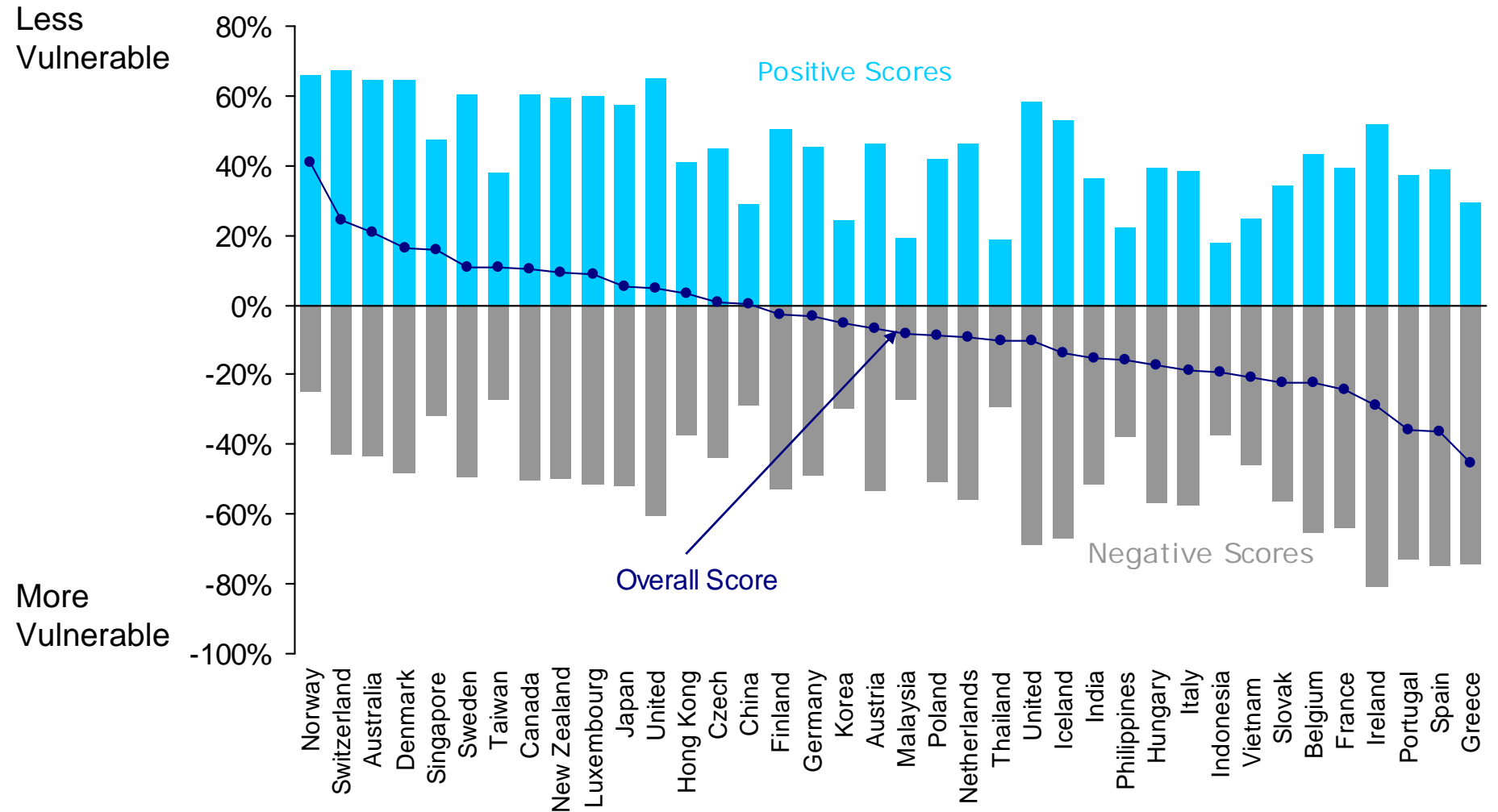
The “great little country” is actually not so great at No. 20

UN Human Development Index, top 30 nations
(encompasses longevity, health, knowledge and GDP per capita)



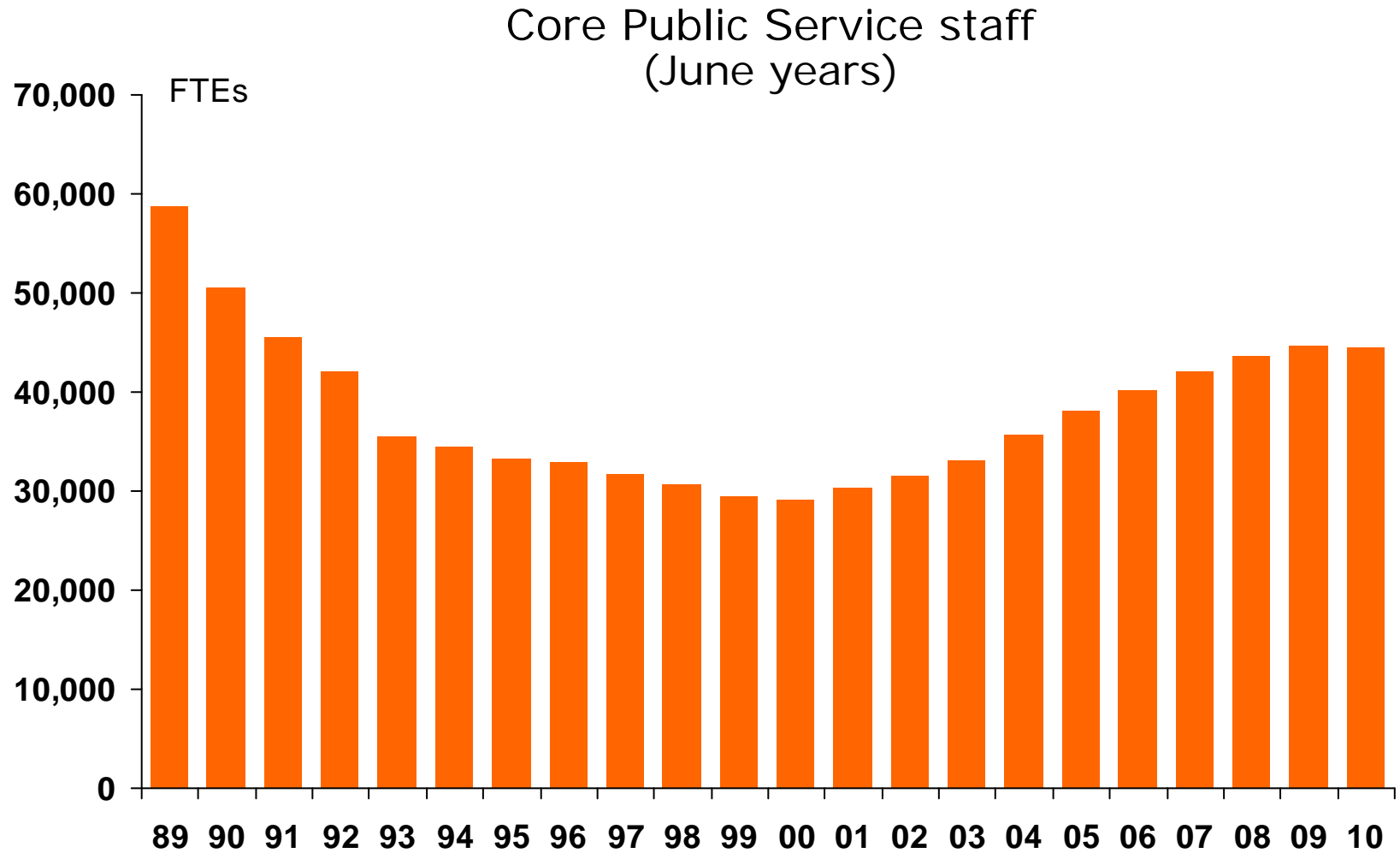
Moderate vulnerability ranking, a net positive but only just

Sovereign Debt Vulnerability Scores

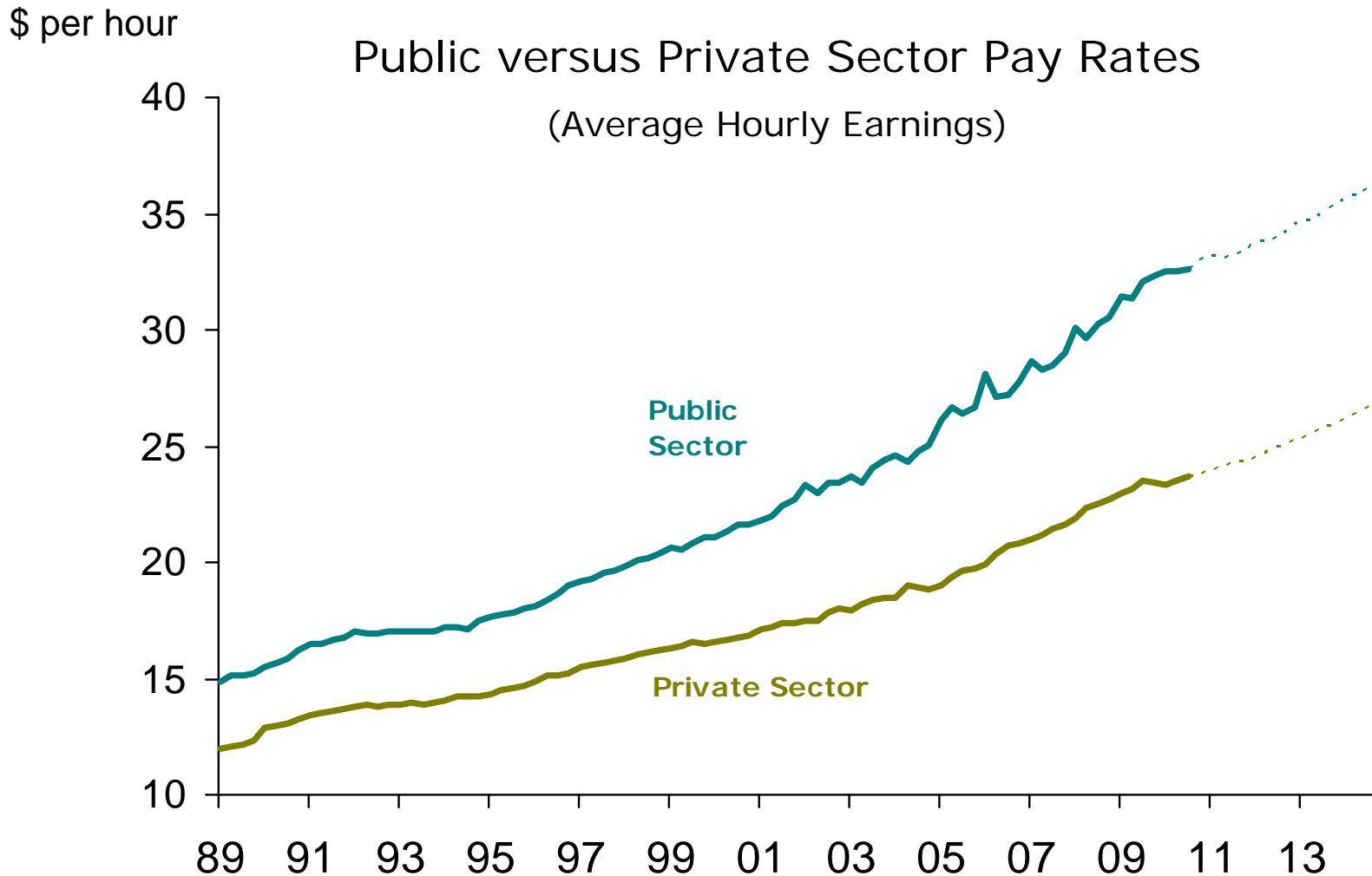




The rebirth of growth in the core public service

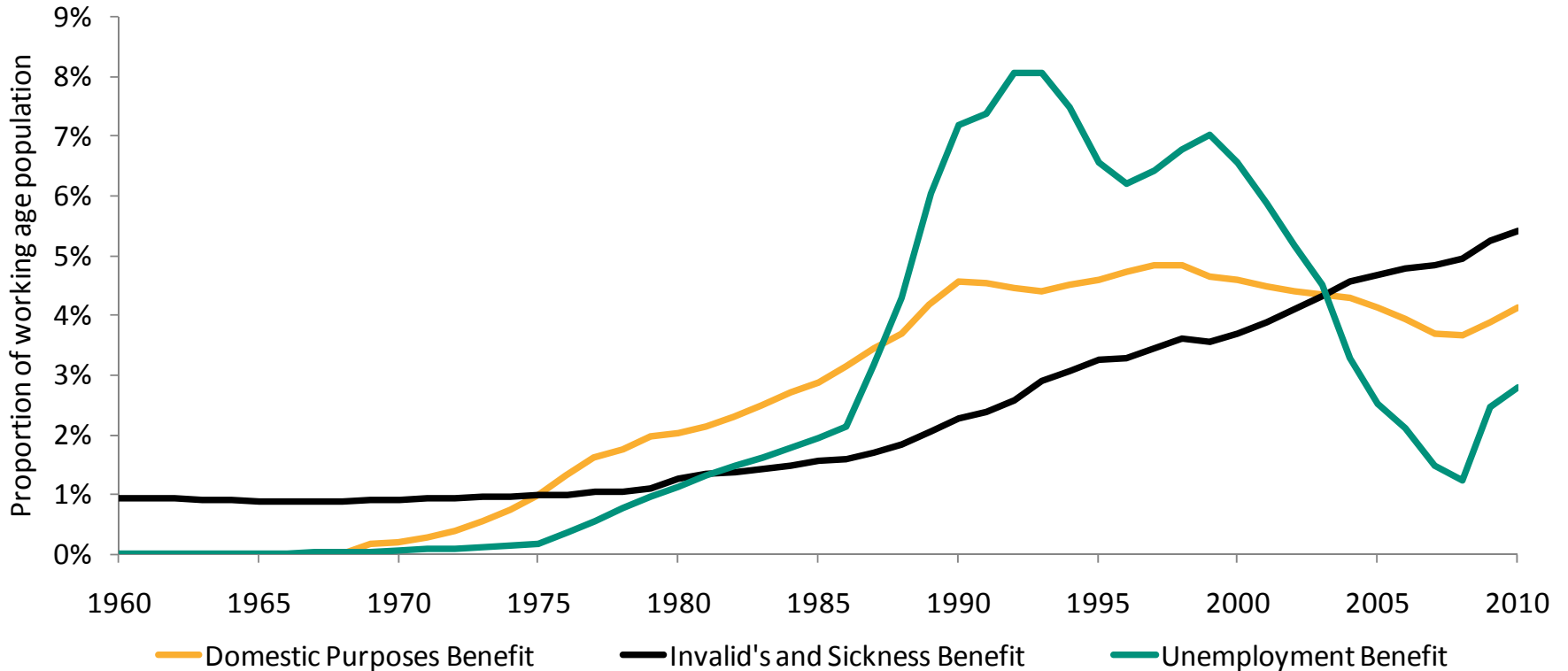


Government pay rates are higher than private sector and increase faster



Are Kiwis really this sick ?

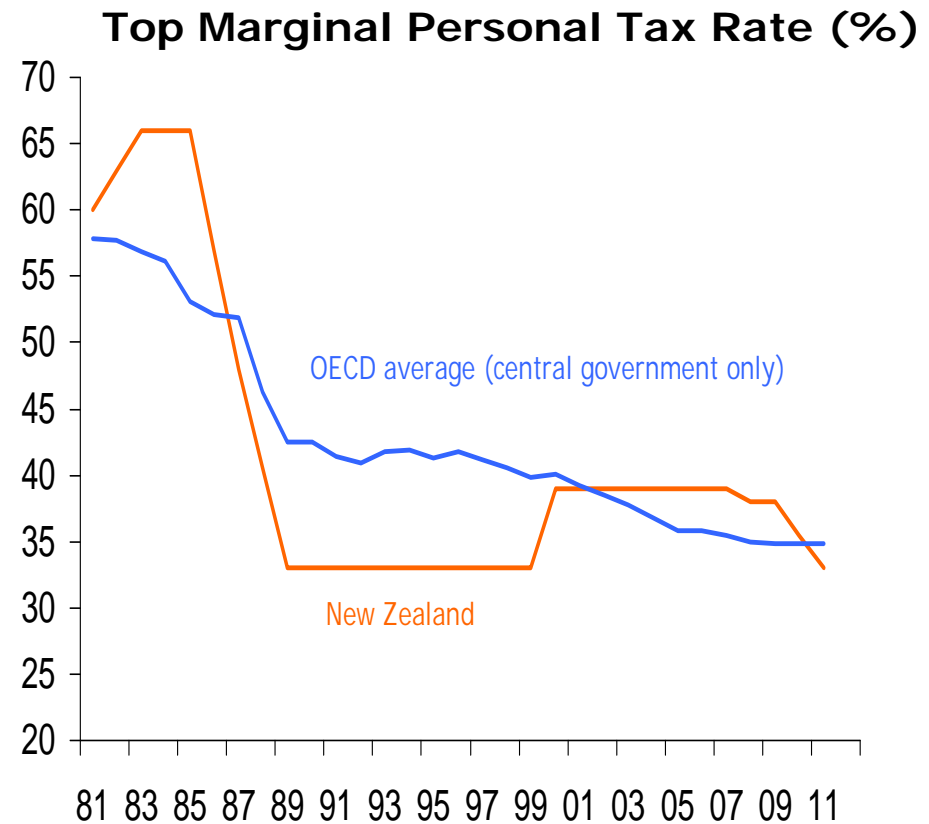
Trends in main benefit types among the working age population, 1960-2009



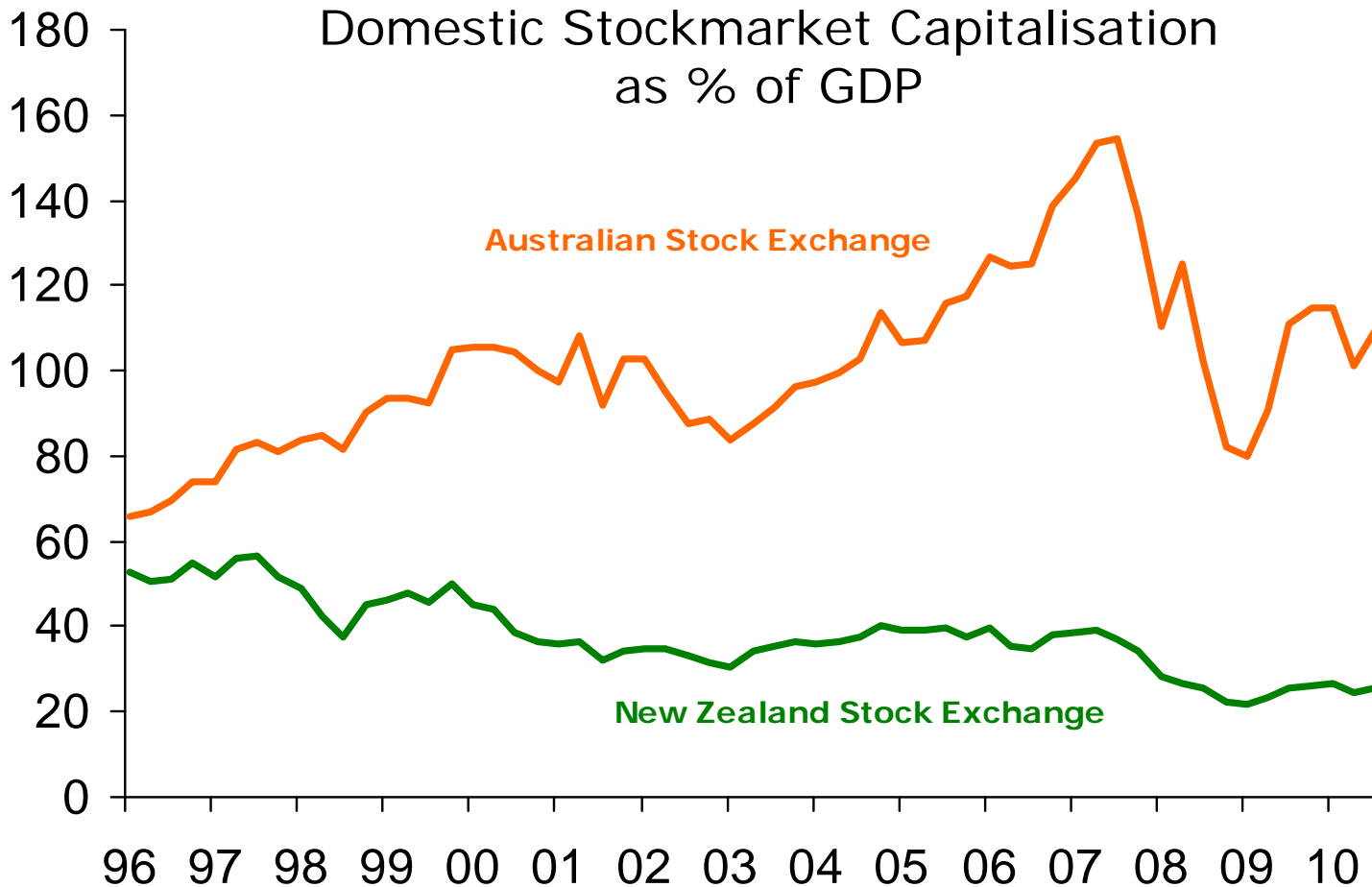
Source: Ministry of Social Development Statistical Reports and Statistics New Zealand population estimates.

NZ has allowed its tax rate competitiveness to be eroded

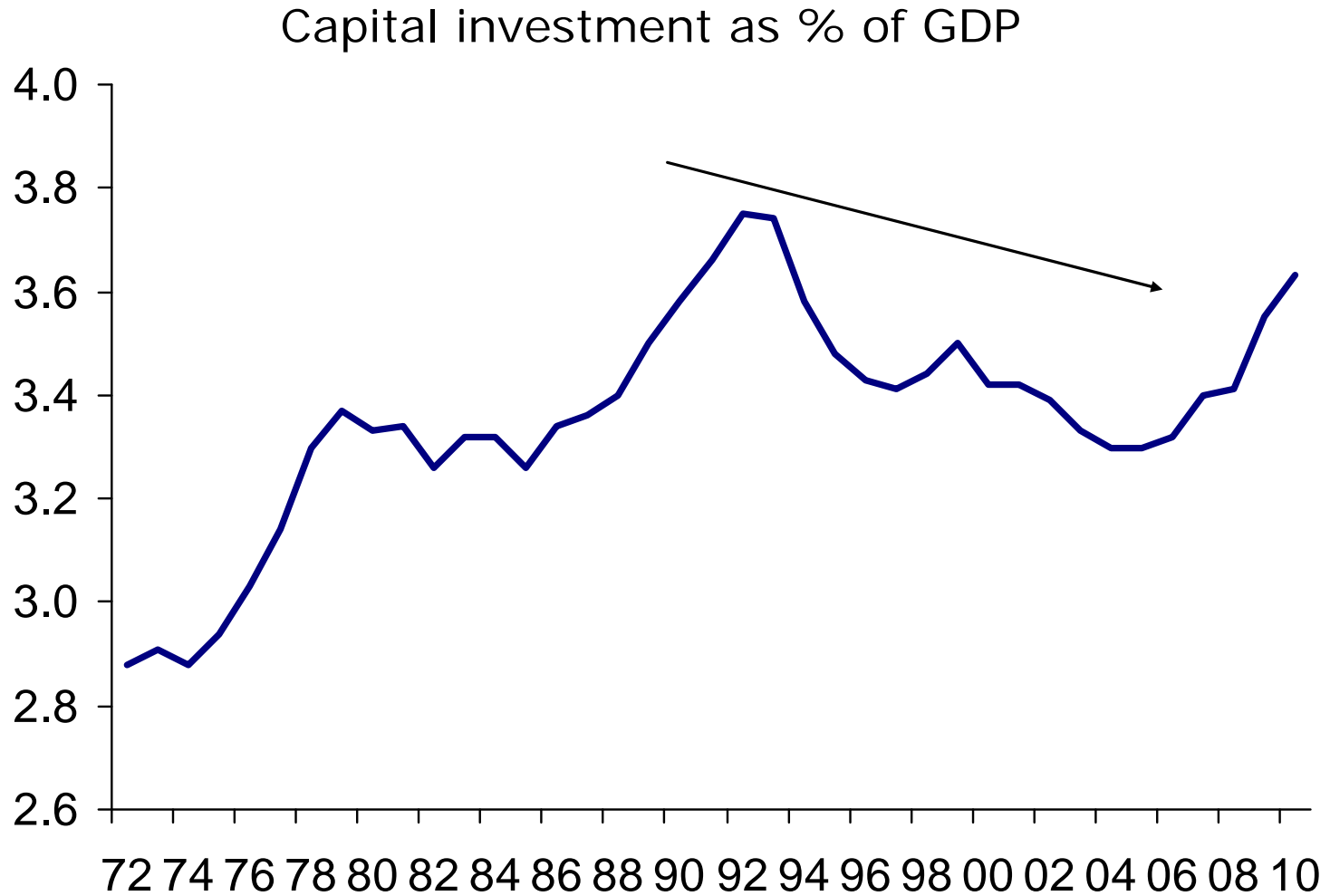
NZ's Tax Rates versus the OECD



NZ has an inadequate capital market

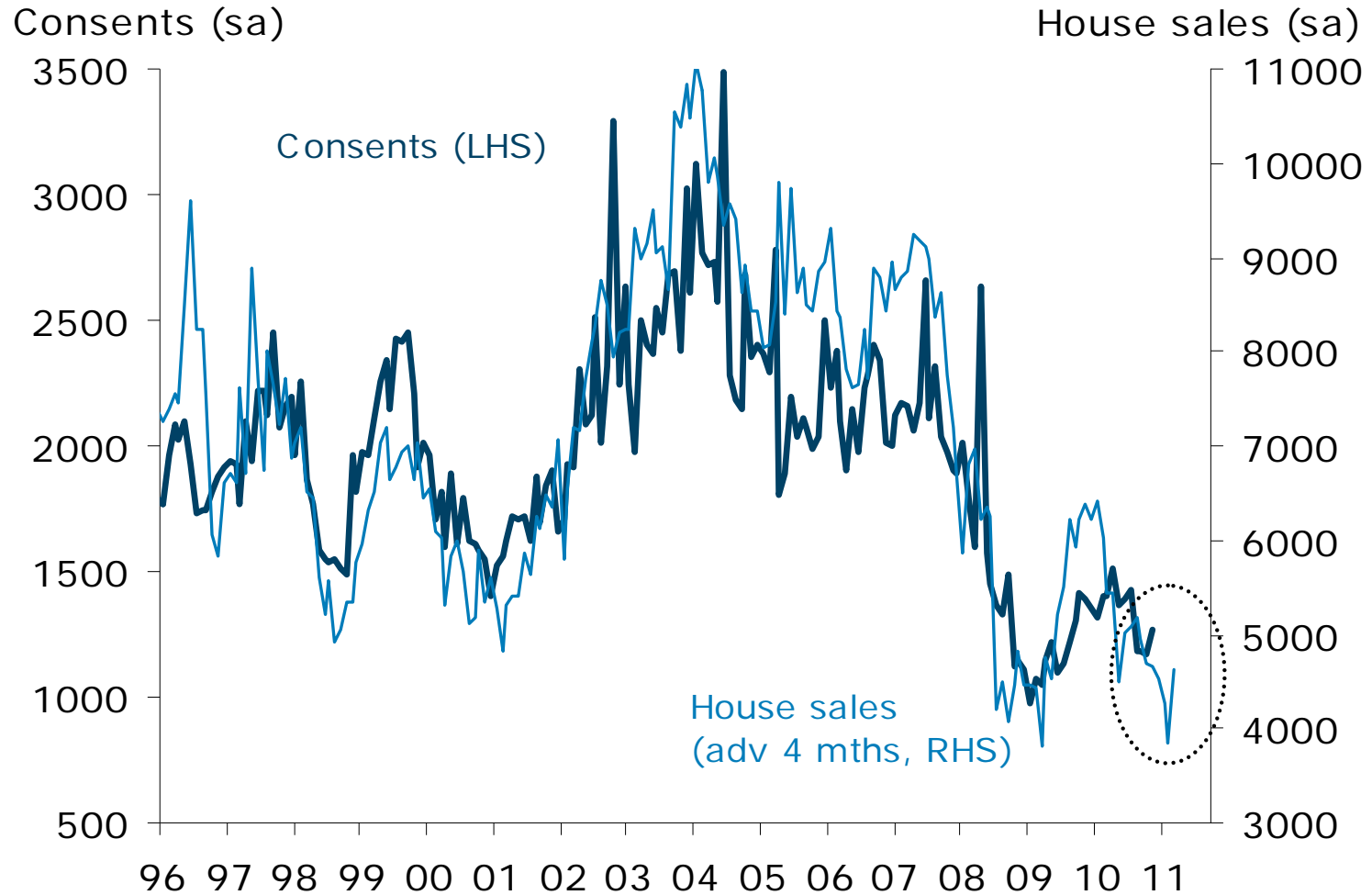


Have we been investing less ?



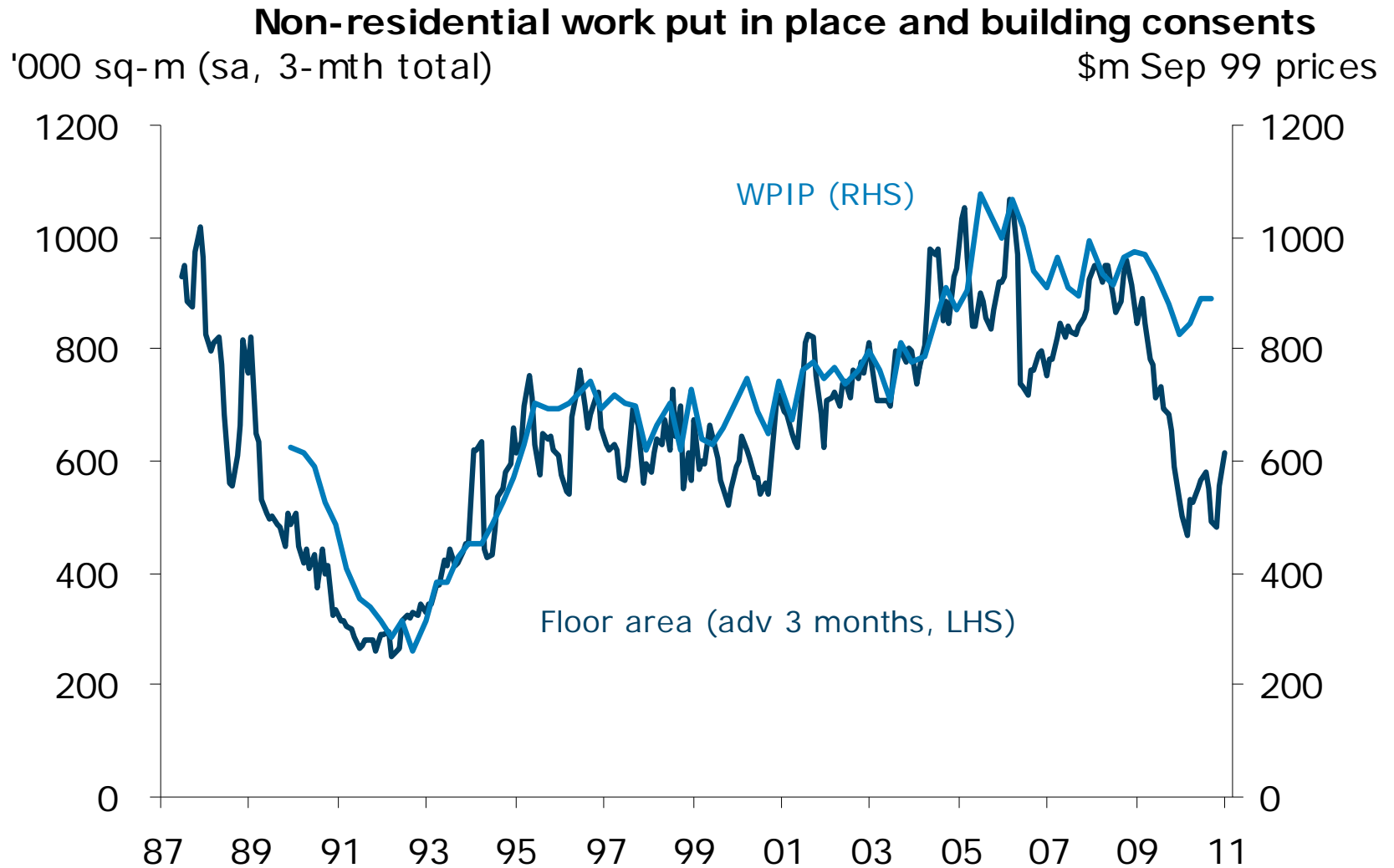
Housing in the doldrums

New Dwelling Consents and House Sales



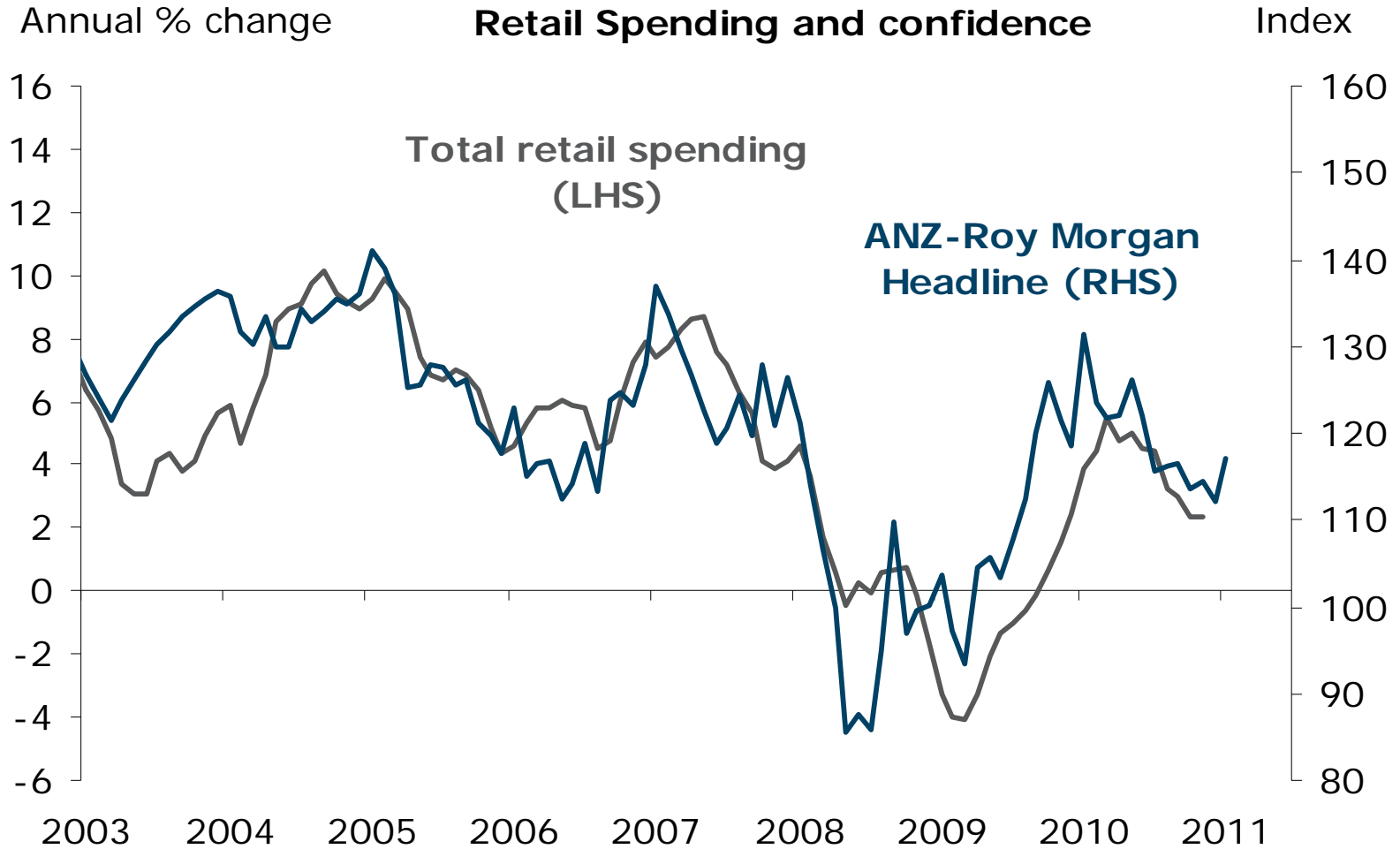
Sources: ANZ, National Bank, Statistics NZ, REINZ

And non-residential work likewise



Sources: ANZ, National Bank, Statistics NZ

Personal consumption has been slack too

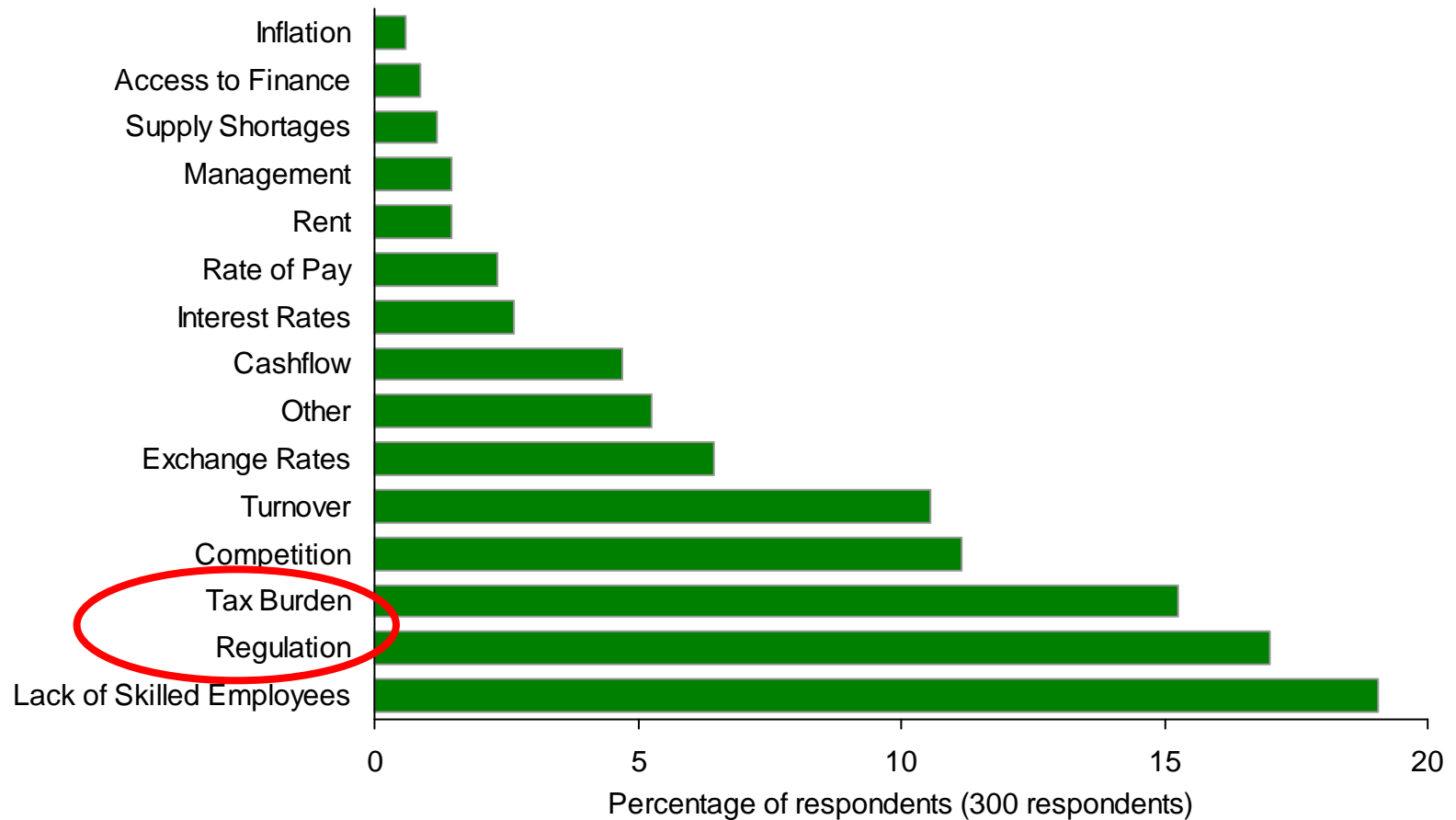


Source: ANZ, National Bank, Statistics NZ



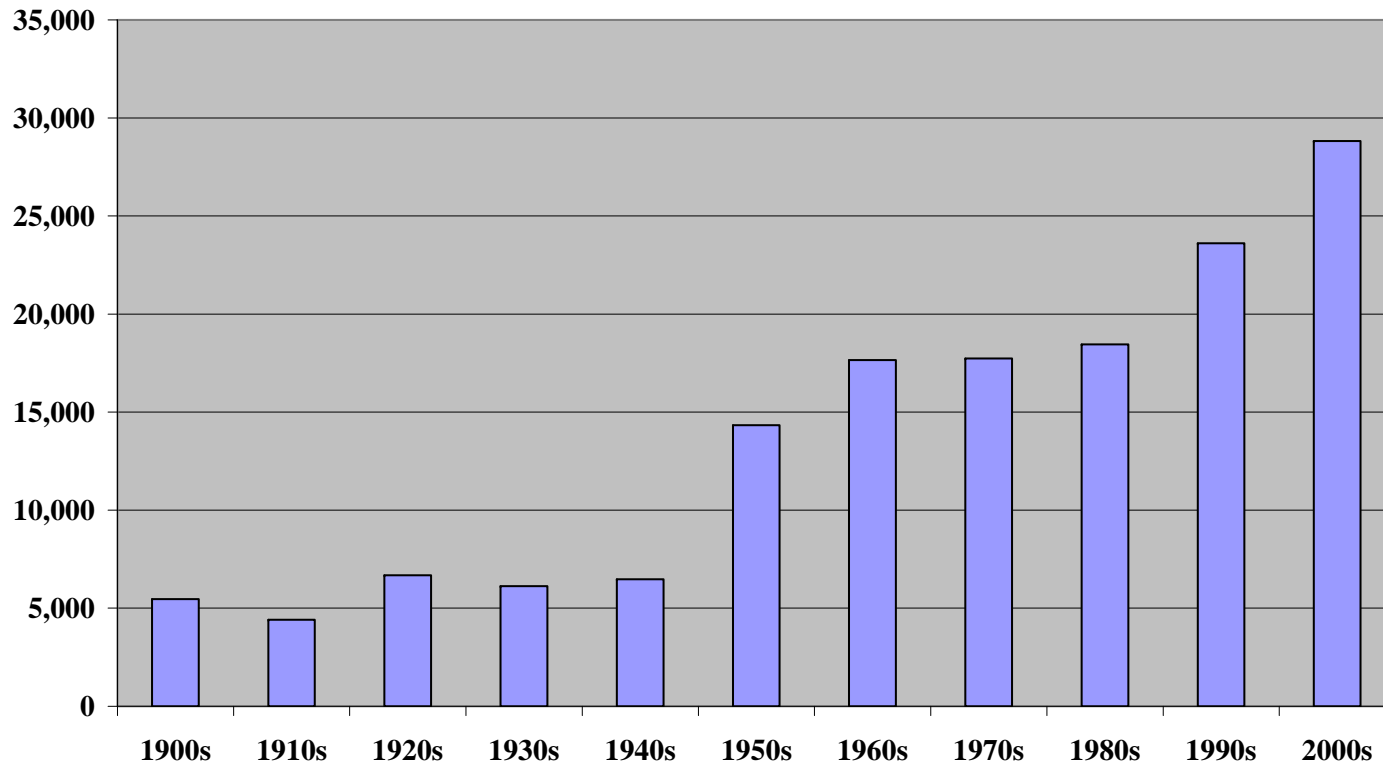
Regulation and taxes are the biggest problems

Biggest problem facing small business



Regulatory creep is an ever accumulating problem

Number of Pages of New Primary Legislation by Decade
1900s to 2000s



Business adaptability has been severely eroded

Regulatory Dilemmas

- Regulation begets regulation
- Regulation overrides commercial solutions
- Regulation and changes induce uncertainty
- It imposes high transactions costs
- Diverts energy into rent seeking behaviour
- And away from focussing on winning in the market
- Regulation always has unintended consequences
- It concentrates on past issues rather than future growth
- Success ironically attracts regulation
- Regulation reduces flexibility
- It ultimately impedes the competition it pretends to promote
- Reduces attractiveness of NZ for foreign direct investment

Reflect on these illustrative worry zones

- NZ income per person 38 % less than Australia & gap growing
- Net 412,000 people predicted to leave NZ over next 15 years
- So 1 in every 10 will leave yet they cost \$30 b. to educate etc.
- Govt outlays are 45% of GDP v 35% in Australia (OECD 2010)
- 2004 to 2009 - GDP up 30% v core Crown expenses up 56%
- Total Govt assets \$223 b. or 118% GDP v 66% in 2001
- Total overseas debt \$167 b. or 90% of GDP
- 15% of total employed are on welfare benefits
- 1 in 5 kids are in benefit dependent families
- In past decade invalids benefits up 70%, population up 12 %
- DPB costs \$1.7 billion p.a.
- 21 DHB's for 4.3 m. of us
- \$174 m. costs imposed on IHC by Courts

Some more worry zones

- State subsidy per student in private schools is 20% of what it is in public schools
- If we did as Australia does, savings would be \$1.2 billion p.a.
- \$1.5 b. spend on broadband – no business case; no cost/benefit study
- Studies indicate no discernable economic benefit from faster broadband
- Telecom value drop from regulatory intervention – over \$4 billion
- R & D spend in NZ is 0.5% of GDP, one third of OECD average
- Govt spend \$700 m. in R & D but no proper measurement of benefits
- Major reason for higher house prices in NZ than Aust is regulatory costs
- Another major reason is council limits on residential land
- Auckland residential land 10 X higher priced than adjacent rural land
- NZ is one of the most restrictive countries on foreign direct investment

And some more worry zones

- Crown's net worth was zero in the mid 1990's
- But by 2010 it reached \$95 billion, or 50% of GDP
- By 2015, Govt will have debt of \$107 billion
- Interest will cost 8.3 % of the annual tax take in 2015
- KiwiRail will not have any surpluses over next five years
- Yet rail network by 2015 will be valued at \$14.5 billion
- In 2009 NZ super recipients totalled 522,000, cost 4.3% of GDP
- By 2050, recipients will increase to 1.3 million, cost 8% of GDP
- Crown SOE portfolio: 18 companies valued at \$19 billion
- By comparison, NZX market cap is \$57 billion
- Student loans total over \$7 billion
- 50% of student loan borrowers have no repayment obligation
- How much better could we do if we addressed these issues ?

Opportunities abound
But we need the right environment for them to prosper

Here are some illustrations:

We are richer in minerals than we realise

The dairy industry is a great growth engine

Education has heaps of potential

Tourism is fast growing and now sizeable

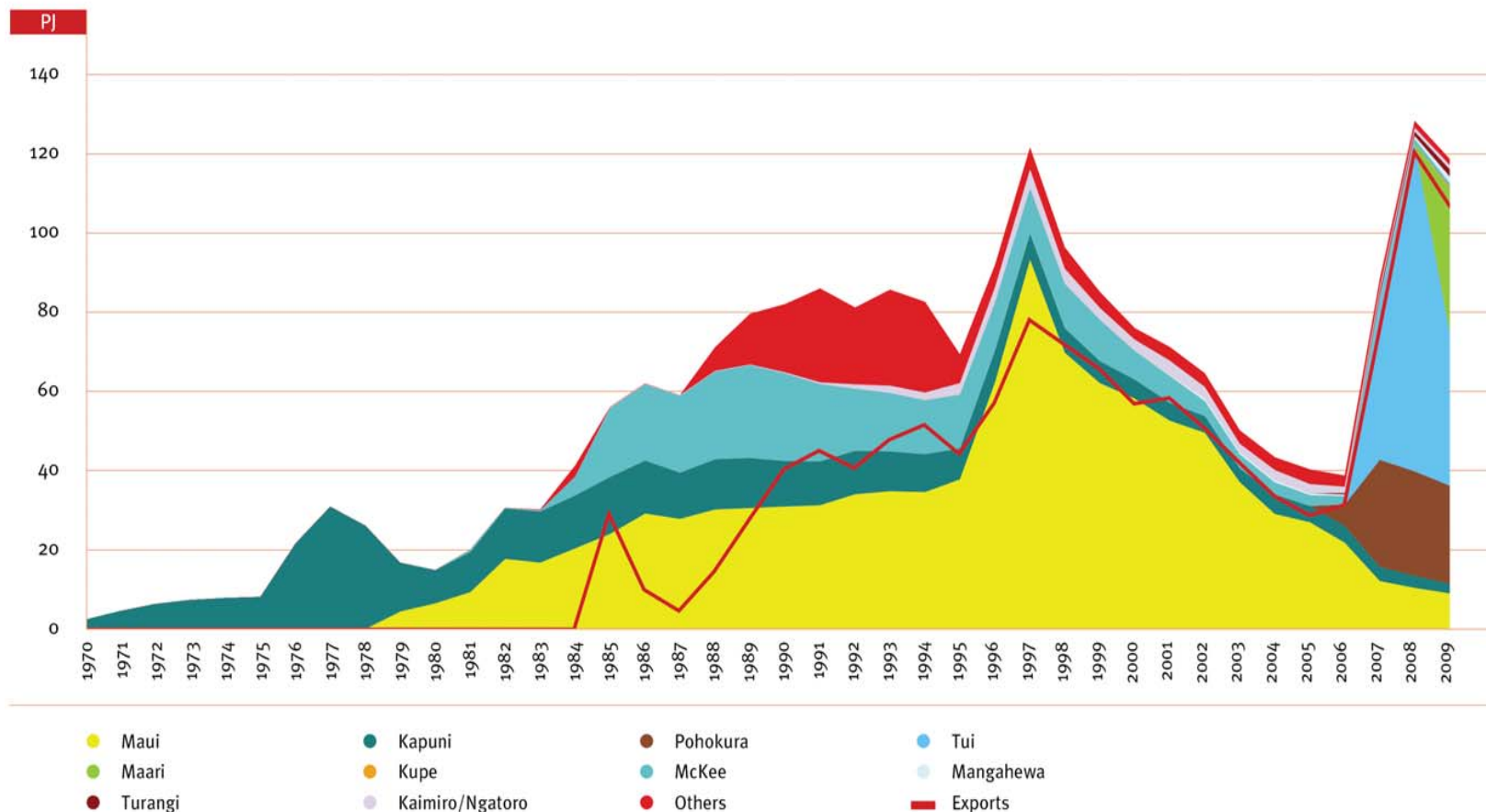
Australia, China, India and Asia are the future for us

New Zealand is resource rich

- Royalty payments for petroleum and minerals was \$400m in 2009/10
- In 2009/10 petroleum exports were \$1.7 billion – 4.4% of total exports
- Gold at record production levels – 13 million ounces of gold last year, with major expansion plans (Waihi, Reefton, Otago)
- 2010 was the busiest ever drilling season for petroleum with 41 wells drilled
- Global players are being attracted into frontier petroleum basins
 - Petrobas into the Raukumara (East Coast) Basin
 - Origin and Anadarko – Canterbury Basin
 - OMV, PTTEP, and Mitsui – Great South Basin
- Buller Bathurst opencast coal mine – (2 million tonnes pa - double Pike River) - scheduled for construction this year.
- Significant potential exists in ironsands deposits – 2 million tonnes produced in 2010. Major offshore Taranaki exploration underway.

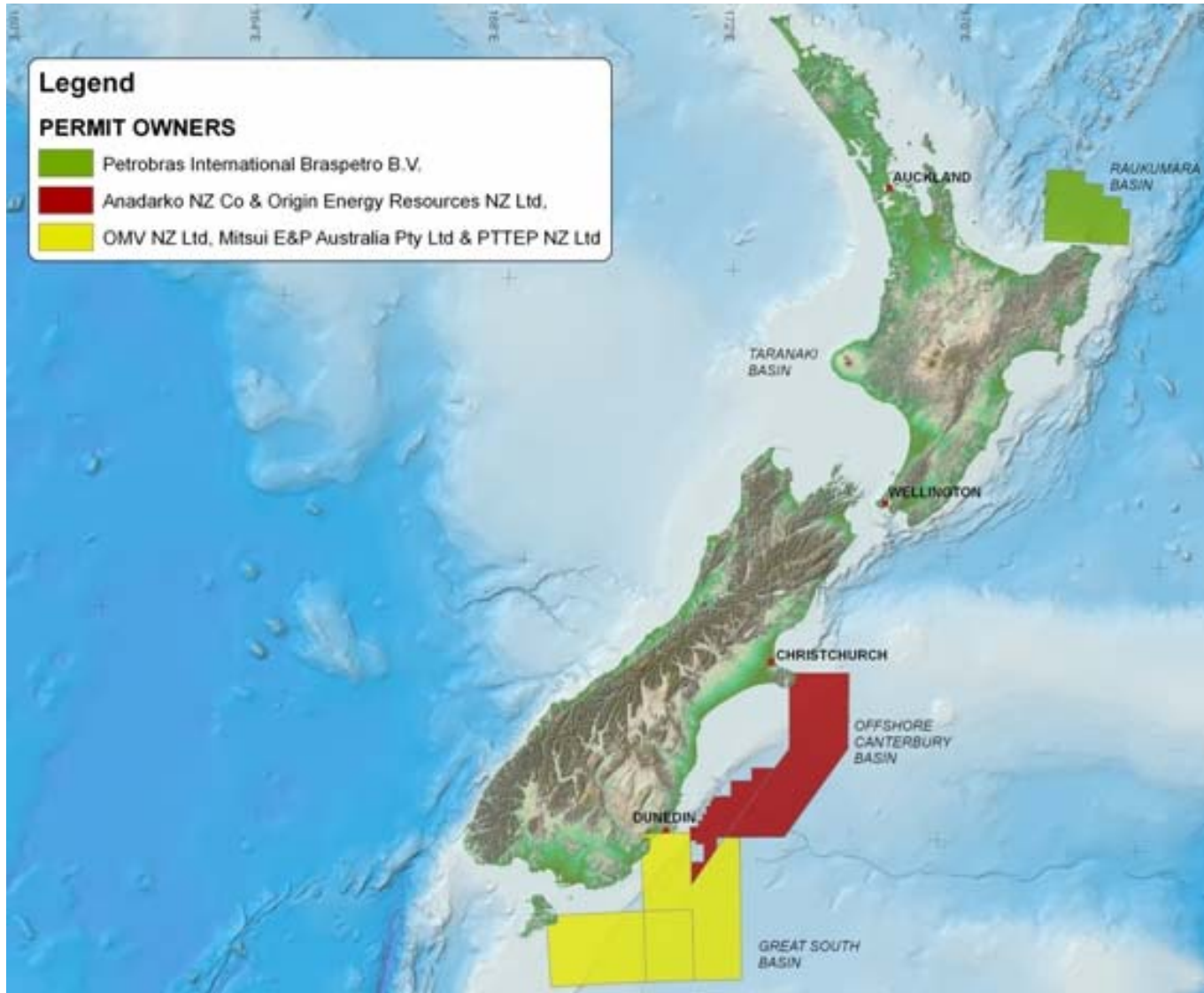
NZ: Oil production back to 1997 record of 21.3 million barrels

Figure D.2: Annual Crude Oil, Condensate, Naphtha and Natural Gas Liquids Production by Field



Source: Ministry of Economic Development

New global players in the Frontier Basins

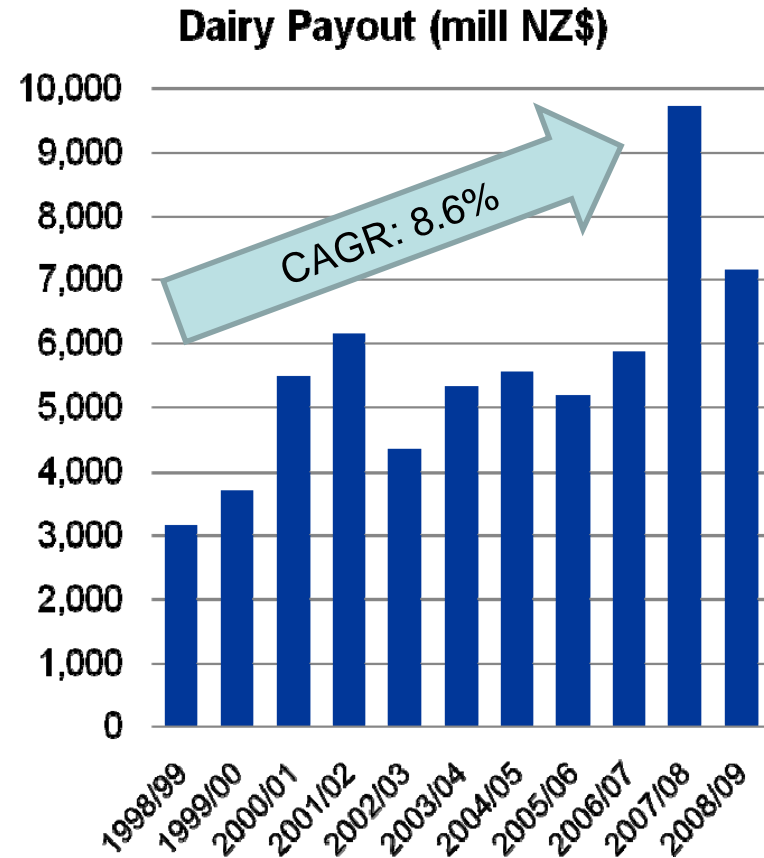
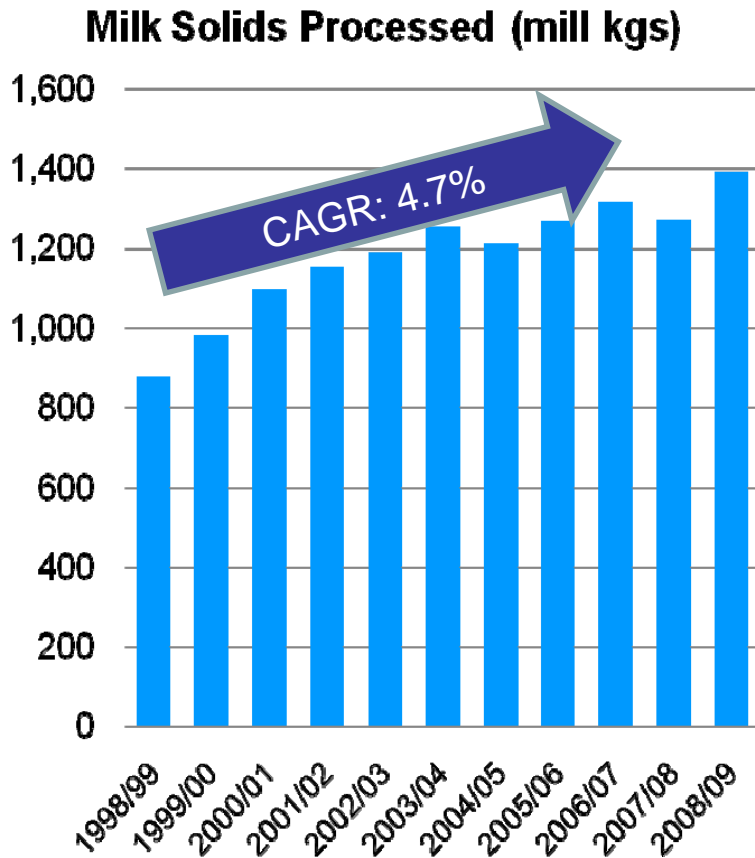


Source: Ministry of Economic Development

NZ: Highest gold production in over 20 years



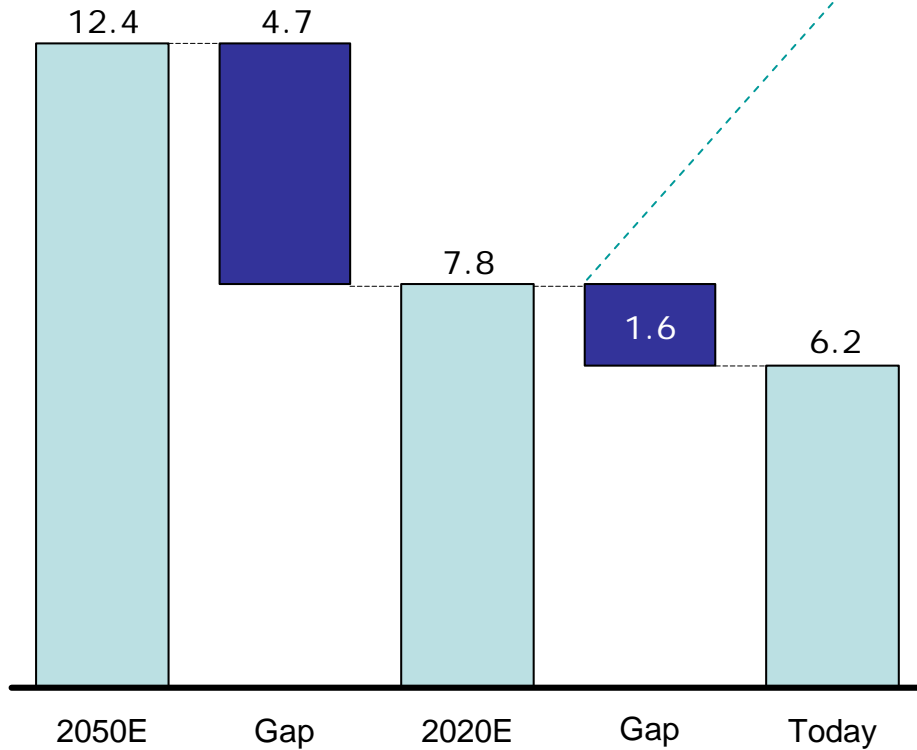
Strong milk production and dairy payout growth 5% and 9% p.a. over the past 10 years



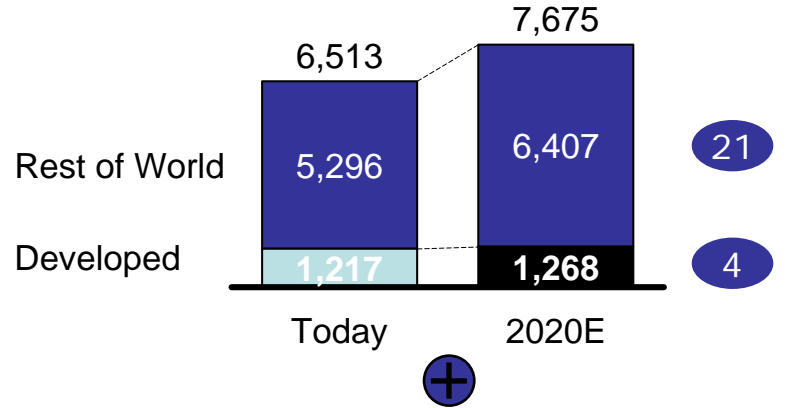
Note: Total Dairy Payout is in nominal dollars and assumes the average weighted dairy company total payout multiplied by total milk solids processed
Source: Fonterra and NZ Dairy Statistics, www.lic.co.nz; CAGR is compound average growth rate.

World food demand will double by 2050, driven by growing population and rising incomes in the developing world

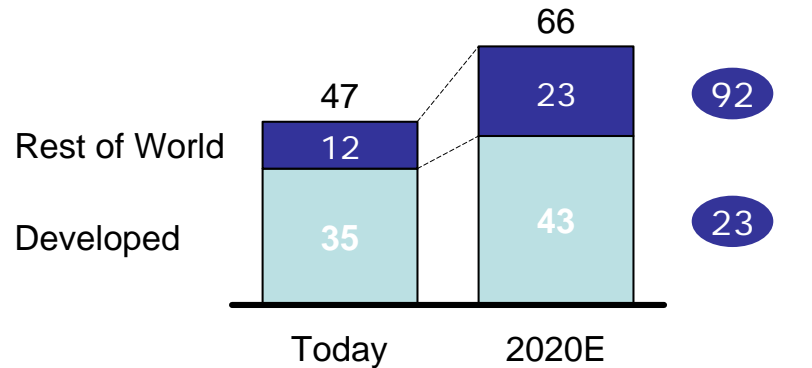
Global food consumption
Billions; MT



World population
Millions



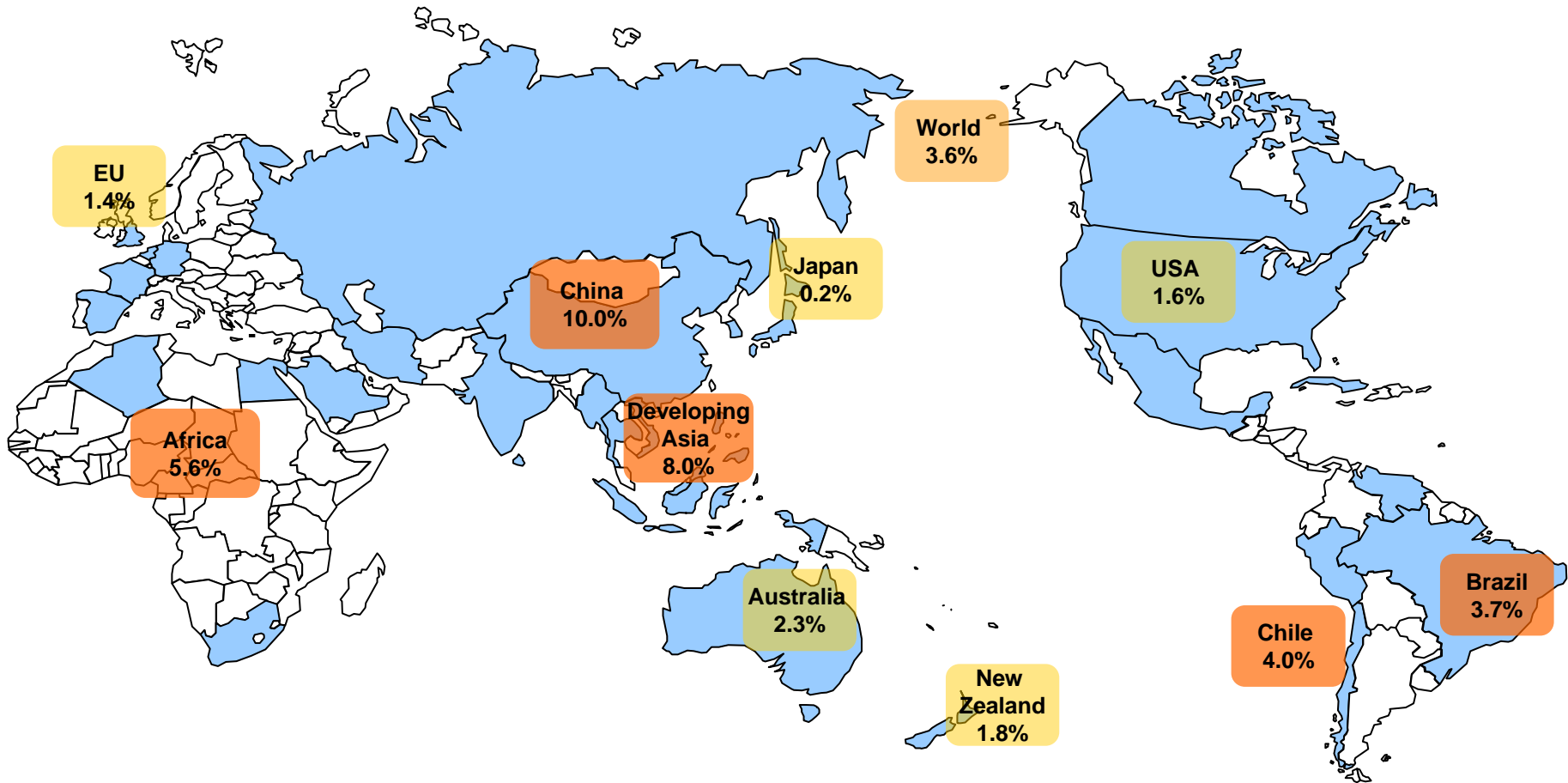
Real GDP
USD, Trillions



Source: Fonterra and McKinsey

Why Fonterra is so positive on dairy for the long term

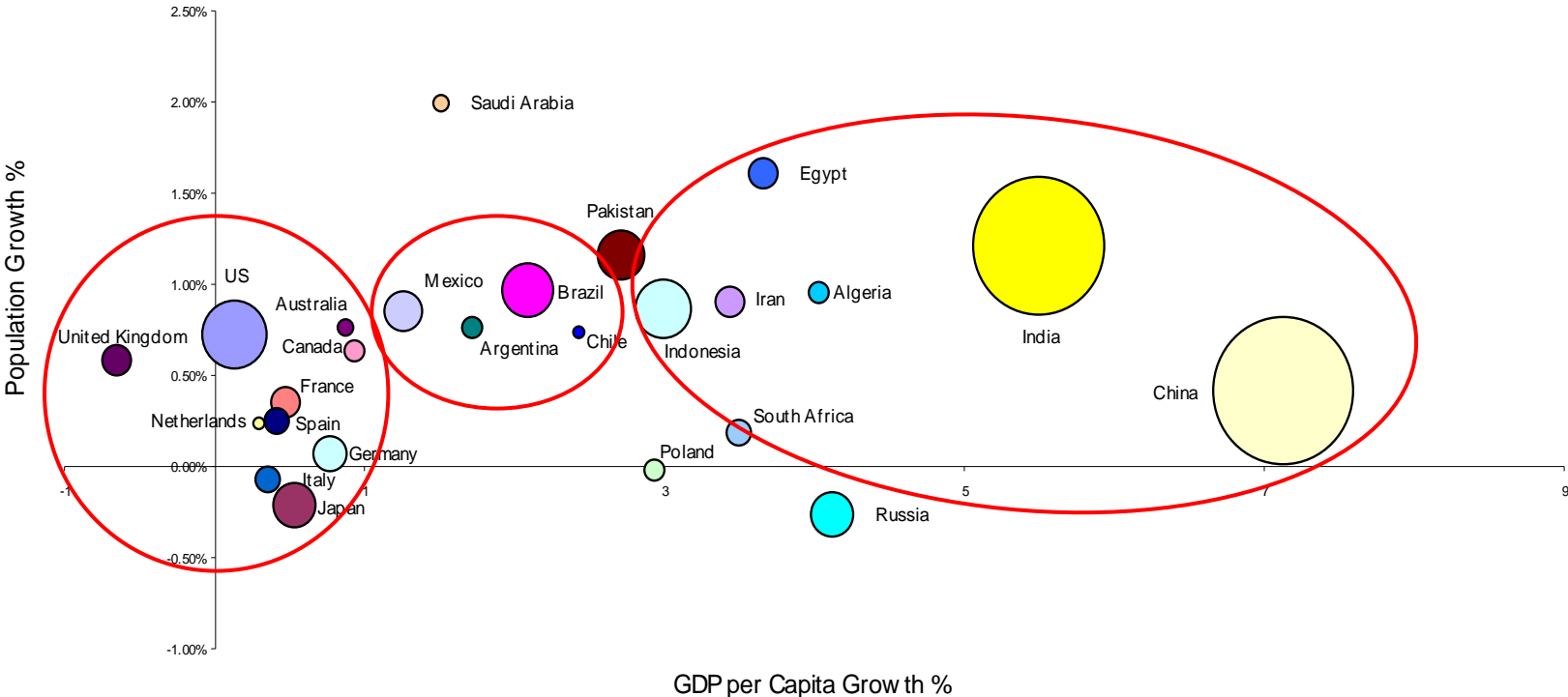
Real GDP Growth 2004-2009 (average annual)



Especially in developing nations with rapid GDP growth and growing populations

'First World' Latin America

Asia/Africa/Middle East

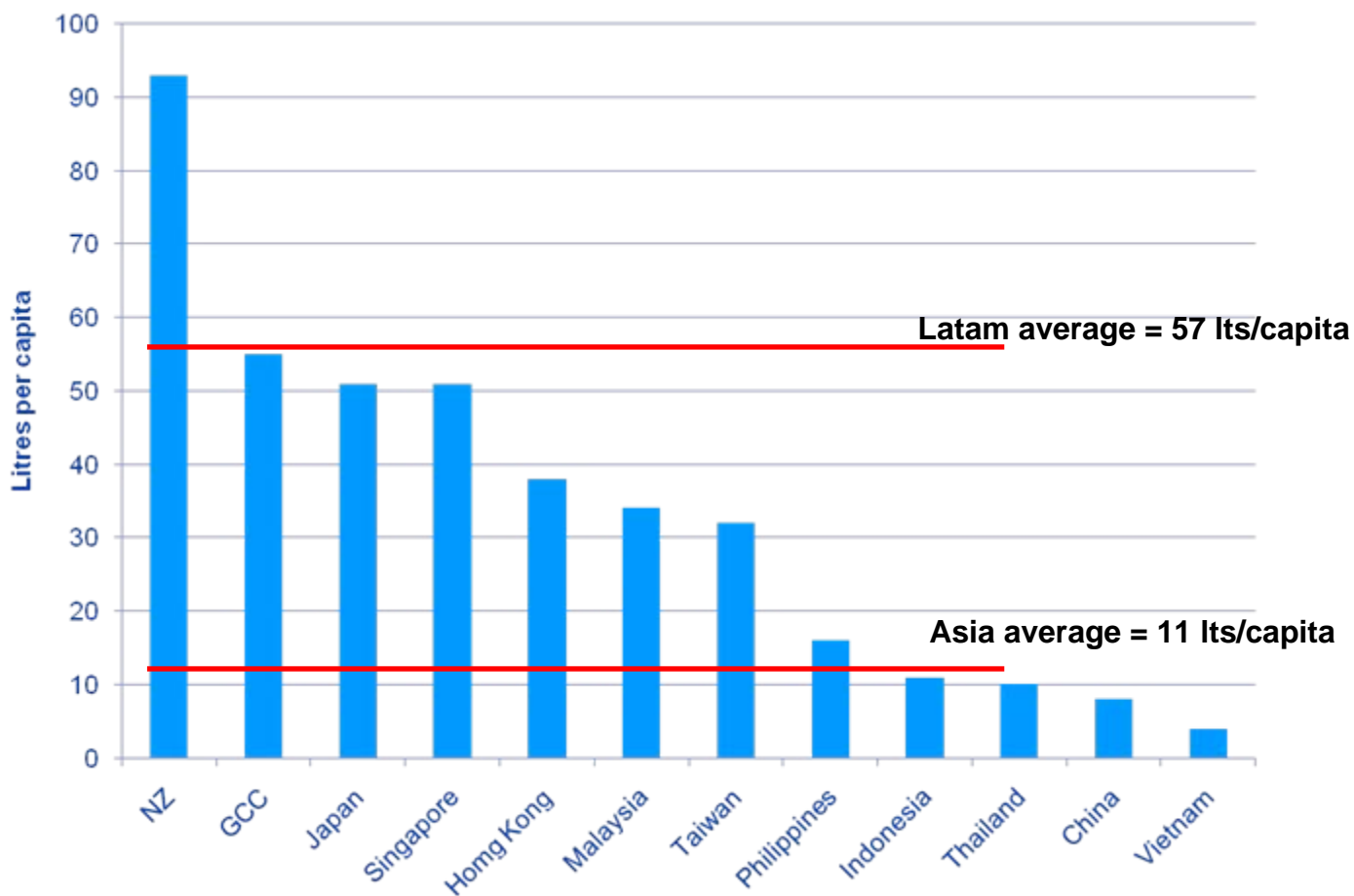


Growth rates based on 2009-2013 forecasted data - EIU

Source: EIU

Dairy consumption in Asia has significant room for growth

Per capita milk consumption



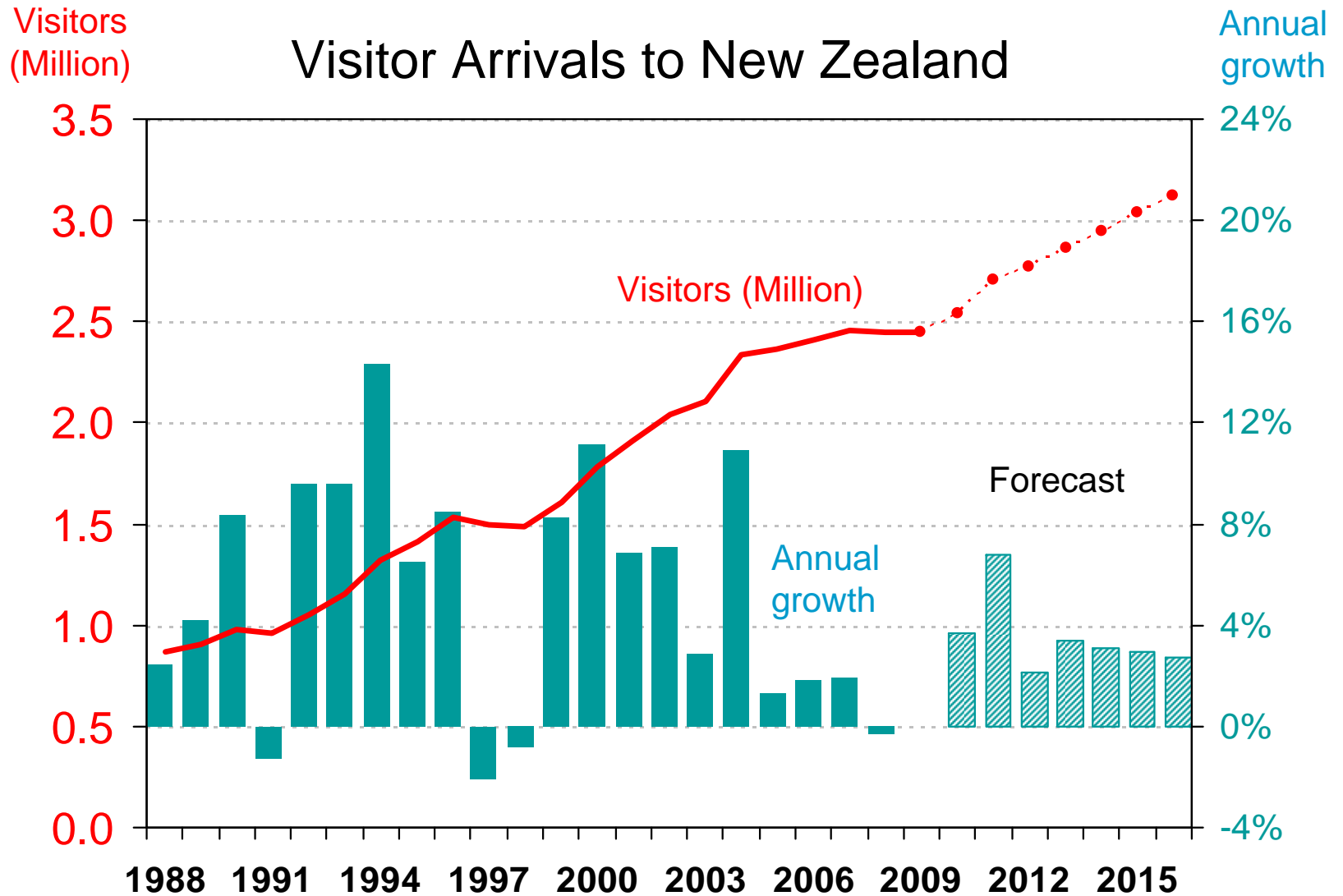
Note: GCC represents the Persian Gulf nations

Source: Euromonitor, powder converted to its rate of 1kg = 8.33 lts; 2005 data

Opportunities in Education for Growing Exports

- 861 providers in NZ in 2010
- 93,500 fee paying students
- 10% revenue growth in 2010
- Industry aim is 10% p.a. income growth
- 70% from Asia, mainly China, South Korea, India, & Japan
- India the fastest growing at 44% in 2009
- Export receipts to exceed \$3 b. by 2011

Tourism is another strong export growth industry



Sources: Ministry Of Tourism, ANZ.

Prime Minister's January 2011 Announcements

- In 2011 the economy will be better than 2010
- Treasury predicts growth of 3% but with bumps on the road
- Since 2004, 60% of new jobs in government sector
- Government needs to borrow \$300 m. per week
- Private sector is being “crowded out”
- Net foreign debt 85% of GDP; only Greece, Portugal, Spain & Ireland are worse in OECD
- Govt **new** spending will be reduced from \$1.1 b. to \$800-900 m.
- Labour's average over its last 5 years was \$2.8 b. p.a.
- Fiscal surplus by 2015 v 2016 previous projection i.e. 1 year earlier
- Partial privatisations for 4 govt. Energy companies & sell-down for Air NZ
- Govt will retain 50% interest and sales will be predominantly to NZ'ers
- Total value of the companies is about \$16 b. but proceeds only partial
- Proceeds will be re-invested in govt. assets

In summary

- The post reform period proved we could grow faster
- We were among the best for productivity growth
- But then we eroded the gains
- Government sector grew much faster than private sector
- The fiscal surplus became a deficit
- Overseas debt and government internal debt have been rising rapidly
- Regulations again became widespread and constraining
- The global financial crisis added to our woes
- We failed to address the big policy challenges
- These relate to taxes and government spending
- Particularly in social welfare, health and education
- Infrastructure and the regulatory environment
- **The private sector is getting crowded out**
- **Yet that is the source of growth and productivity gains**

The essence for stronger economic growth

- **Lower taxes**
- **Smaller government**
- **Less intrusive regulation**
- **Privatise SOE's**
- **Protect property rights**
- **Stable fiscal and monetary policies**
- **Do not try to pick winners**
- **Get closer to Australia**
- **Grow with China, India and SE Asia**