

# Slides on the New Zealand economy early 2011

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# Some words about economies and economics

- Remember that economists are human beings who (i) carry around their own strong prior beliefs but (ii) can be recruited as spin doctors
- So beware ideology masquerading as ‘economics’
- Post-Enlightenment progress has rested heavily upon scientific ways of thinking and analysing => science enjoys the sort of authority once possessed by, e.g., the Church. Appropriating that authority in support of claims that are not themselves scientifically grounded is ideological
- The entrenching of a dominant paradigm is a sociological process more than an analytical one. The formation of a self-reinforcing and self-policing intellectual community comes from human nature but stifles thinking about alternatives
- Economics as an intellectual discipline is about analysing and understanding the world. As a policy discipline it can say more about means than about ends. So judgments involving equity or definition of ‘the public good’ should not be passed to economists, nor appropriated by them

- In the real world, market imperfections are pervasive. The history of economics is largely about analysing the nature of those imperfections and what can be done about them
- The 'market efficiency' paradigm works from the presumption that for practical purposes real-world markets cannot be improved upon
- The 'mixed-economy' paradigm starts from the presumption that markets can be improved, and that some things should not be left to the market mechanism to solve but require collective choice, exercised through politics
- Market failures quickly become bound up with issues of power: perfect markets would be democratic in the sense of dispersing power (not of solving distributional questions), but imperfect markets are all about the exercise of power by some at the expense of others
- Even perfect markets leave open the question of the ideal distribution of wealth and income. A fundamental theoretical conclusion of twentieth-century neoclassical economic theory was that disagreements over distribution could not be resolved by *a-priori* reasoning

## What does all that have to do with New Zealand macroeconomics?

- Firstly, if indeed there are fundamental imbalances in the economy as a whole, it is important to understand how those imbalances have emerged from the interplay of market forces with policy and social structure
- Secondly, in thinking about changes that might be made to policy settings, it is important to explicitly sort out
  - what mechanisms you think are at work
  - how particular policy changes would be supposed to deliver desired results
  - whether there is solid evidence for the causal mechanisms being appealed to
- The current government falls short in its advocacy of lower taxes and smaller government – not because it is necessarily wrong but because it offers no good reason to think the policies are driven by analysis rather than ideology
- The previous Labour Government similarly failed to be persuasive about inflation targeting, state-owned enterprises and light-handed regulation....

## What are the 'imbalances' and why have they developed?

- The current account deficit on the balance of payments, which is bound up with (i) the evolution of relative prices and the allocation of resources between tradables and non-tradables; and (ii) the degree of capital inflow into the economy
- The ability of deregulated 'sheltered sectors' to exercise market power while 'exposed sectors' are unable to do so, which drives part of the relative-price story (capital inflow drives another part)
- The external debt, which flows from the current account deficit but itself plays a role in driving the deficit, via the exchange rate and domestic relative prices
- The emergence and persistence of a financial sector with perverse incentives (i) for New Zealand households and firms to consume and borrow without facing the external costs of their decisions; and (ii) for the banks to drive credit expansion on a basis that looks dodgy (potentially 'unsustainable') in the longer run
- The persistent drive by wealthy private interests to appropriate gains, socialise losses, and lessen the taxes they face
- The worsening distribution of income and wealth, closely linked to the political success of neoliberal thinking: both wages/profits, and poor/rich

# Nominal and real exchange rates

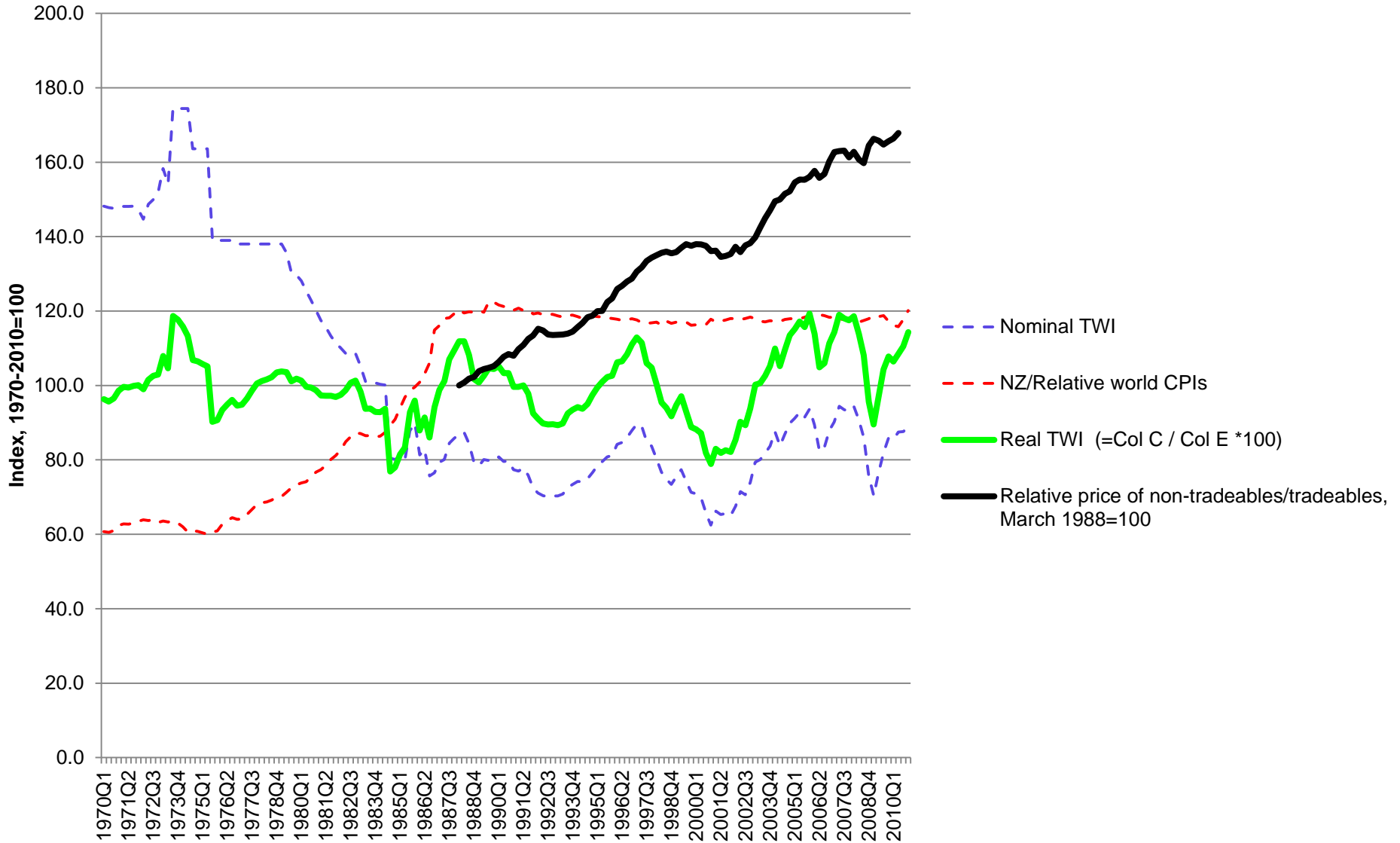
(indices based to long run average 1970-2012Q1 = 100)



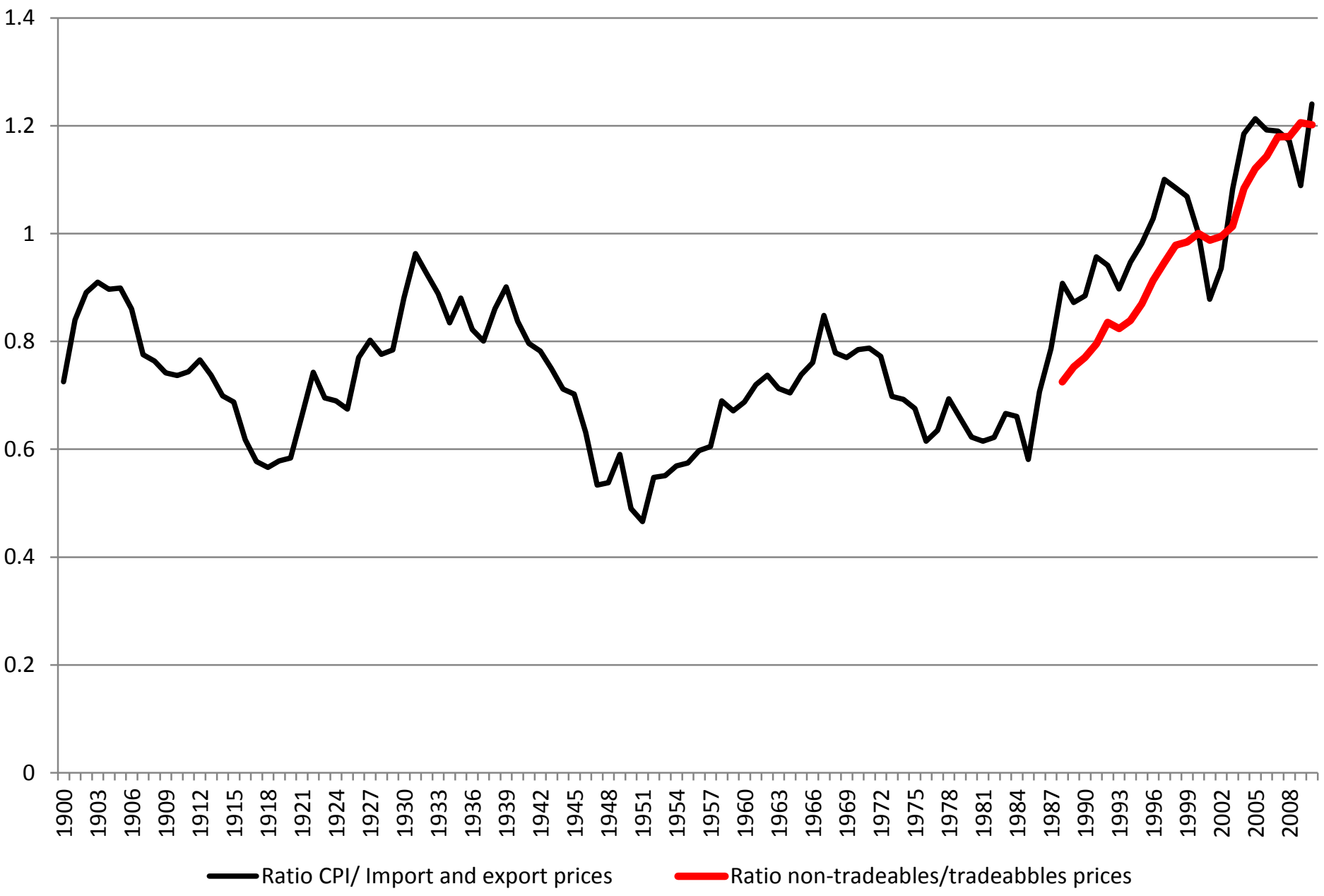
Source: RBNZ

<http://www.rbnz.govt.nz/keygraphs/Fig8b.html>

# New Zealand Real Exchange Rate: Two Versions



# Salter-Swan Real exchange rate: two estimates, 2000=1

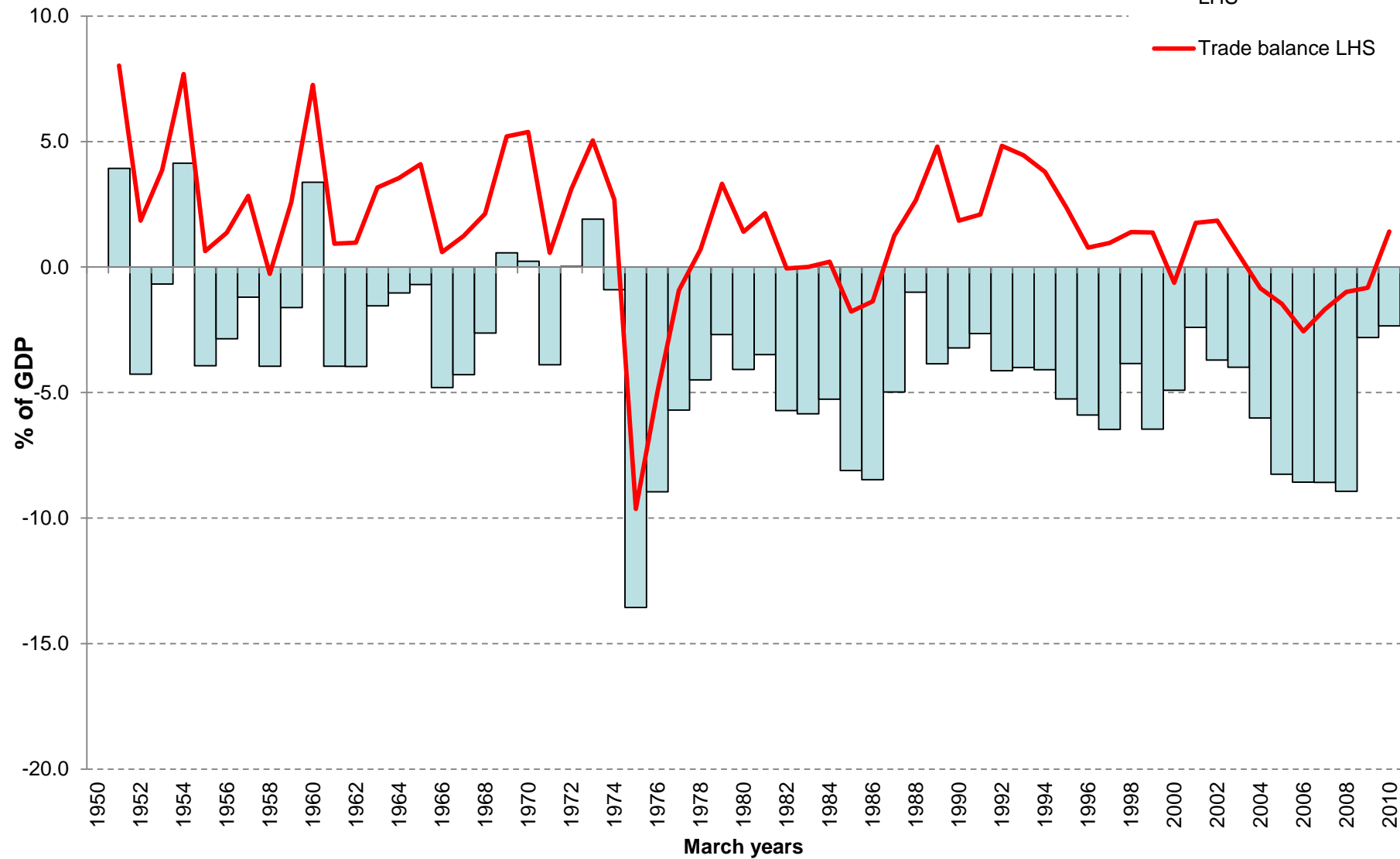




# New Zealand Current Account Balance and Merchandise Trade Balance, annual data 1951-2010

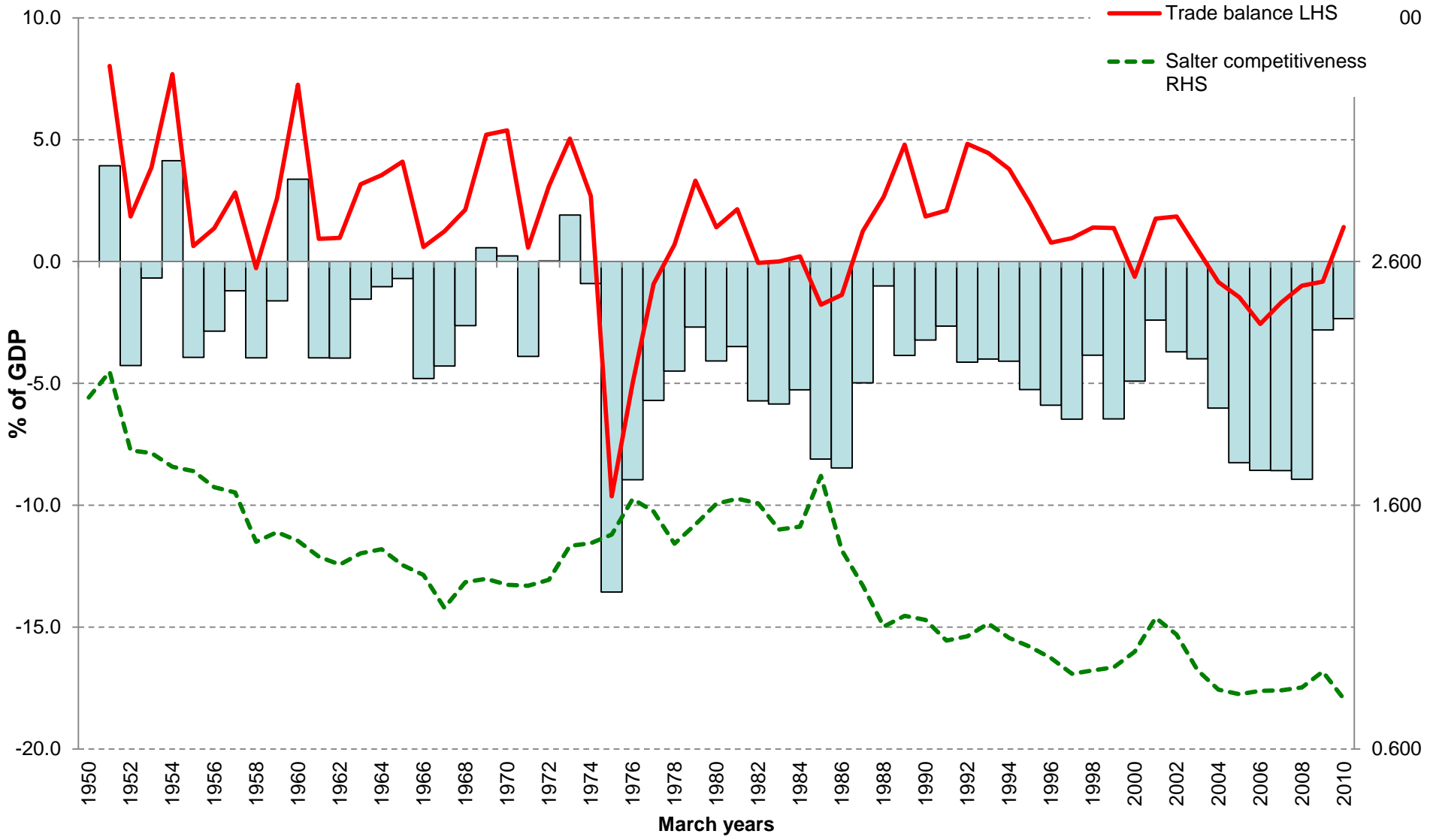
Current account balance  
LHS

Trade balance LHS



# New Zealand Current Account Balance and Merchandise Trade Balance, annual data 1951-2010

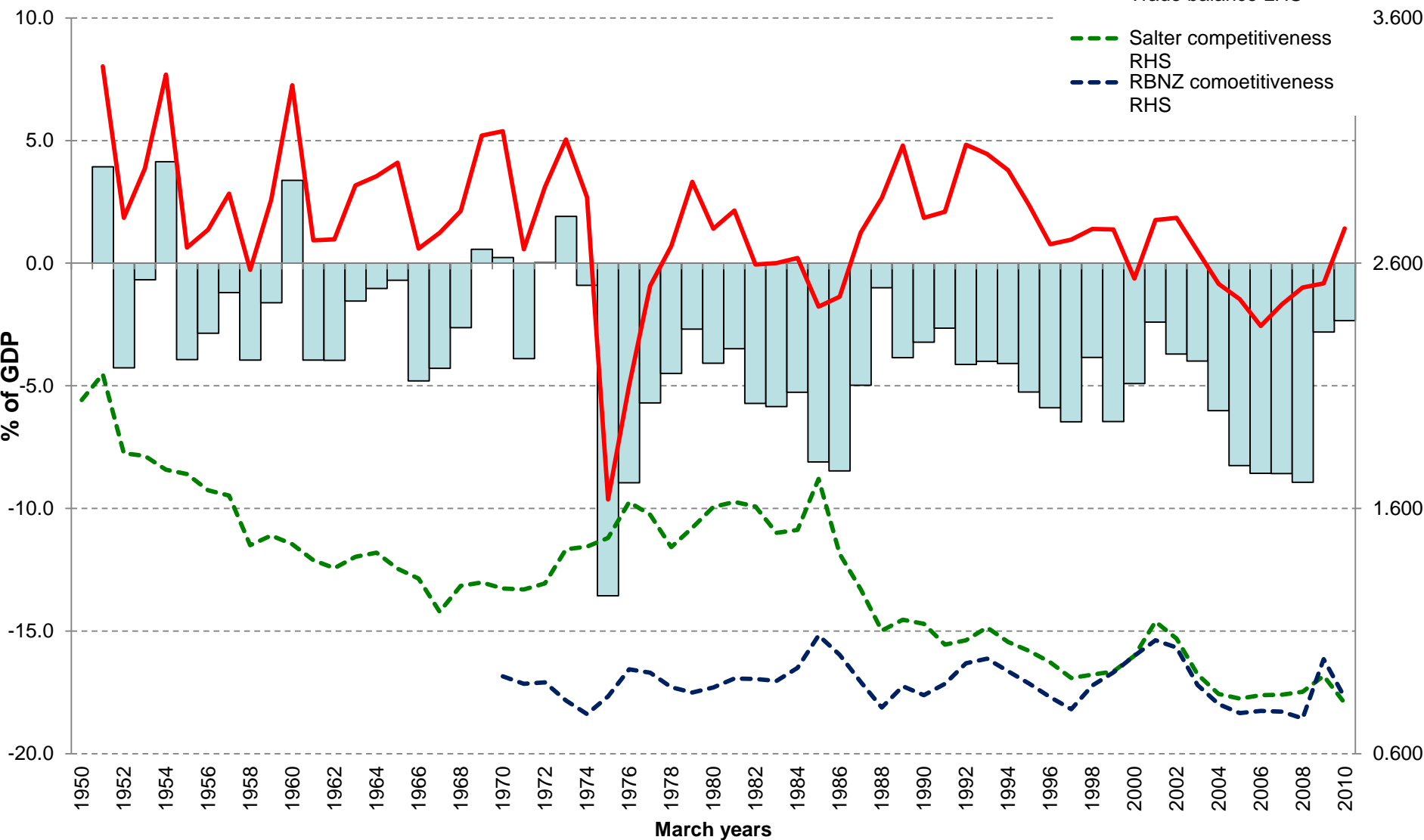
- Current account balance LHS
- Trade balance LHS
- - - Salter competitiveness RHS



# New Zealand Current Account Balance and Merchandise Trade

## Balance, annual data 1951-2010

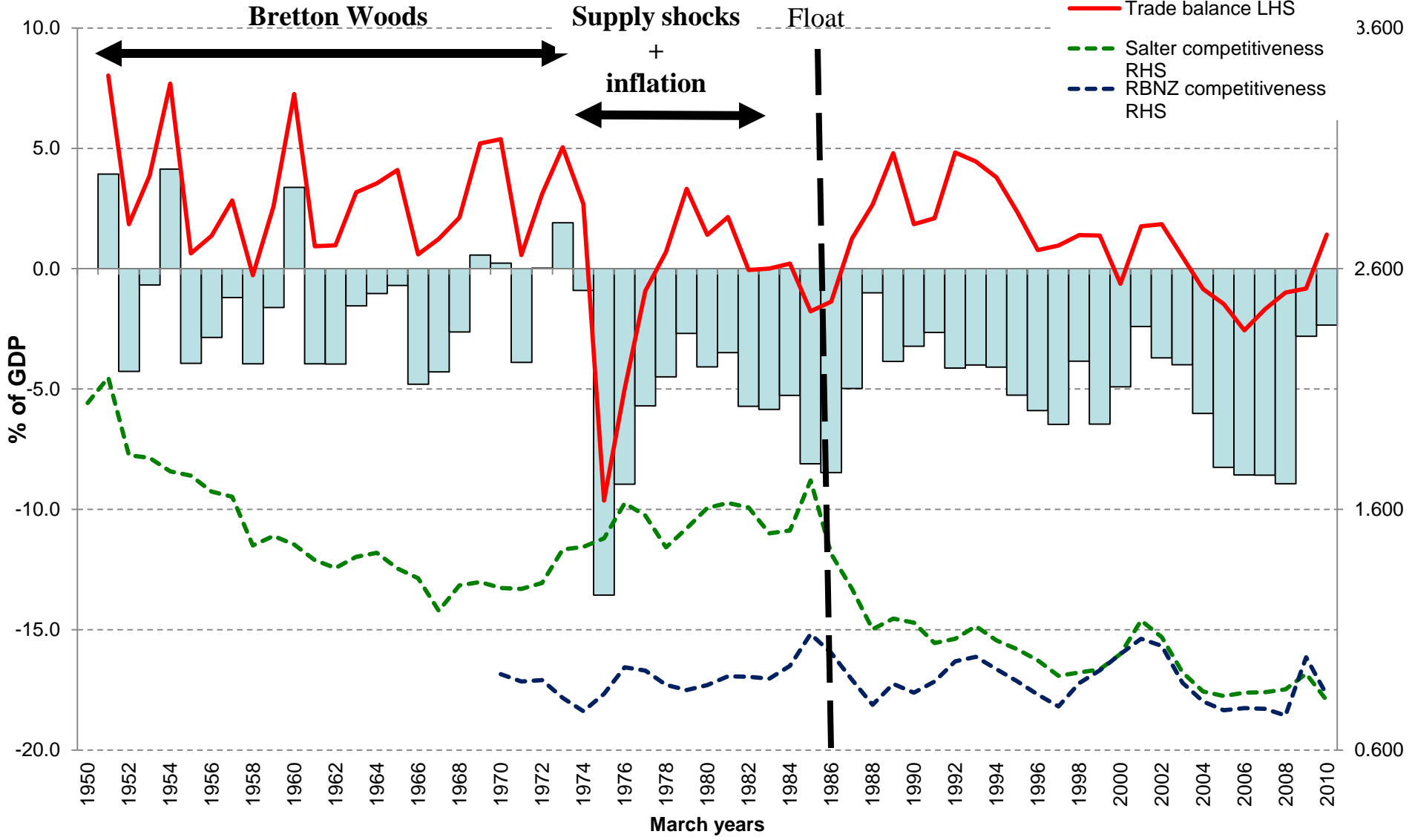
- Current account balance LHS
- Trade balance LHS
- Salter competitiveness RHS
- RBNZ comoetiveness RHS



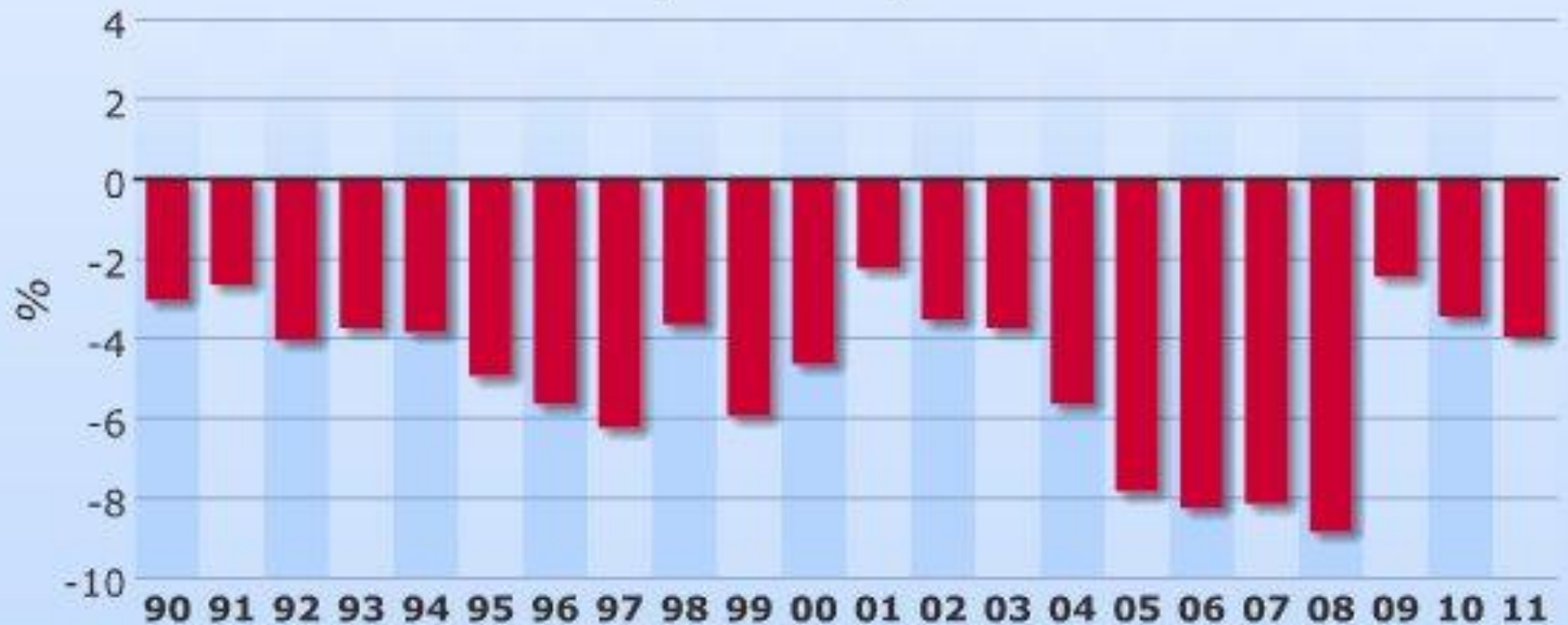
# New Zealand Current Account Balance and Merchandise Trade

## Balance, annual data 1951-2010

- █ Current account balance LHS
- Trade balance LHS
- - - Salter competitiveness RHS
- - - RBNZ competitiveness RHS



## Current account balance (as a % of GDP)



Source: Statistics New Zealand: 2011 uses latest available figure (Dec quarter).

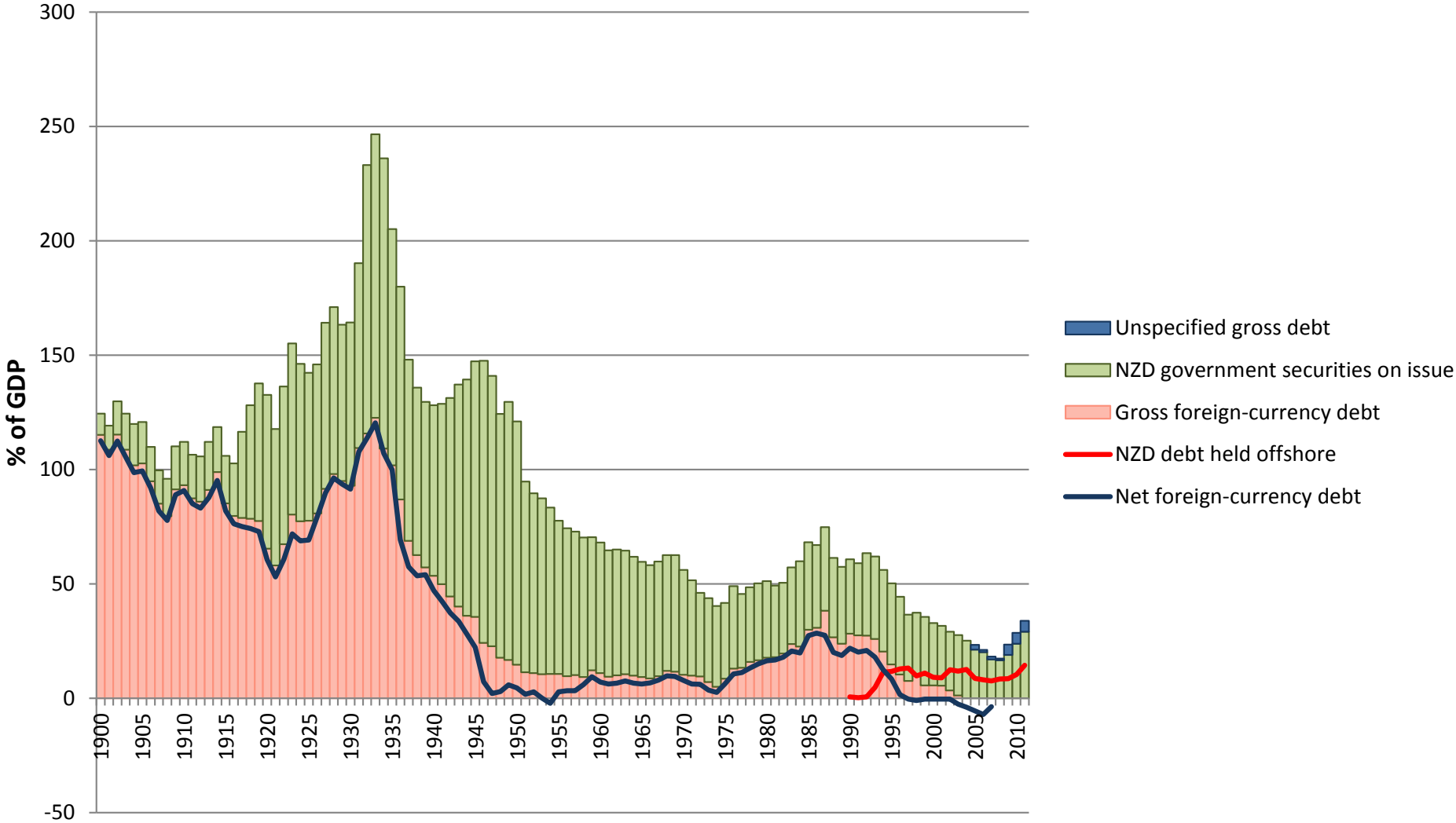
<http://www.rbnz.govt.nz/keygraphs/Fig6.html>

Current account and investment income balance



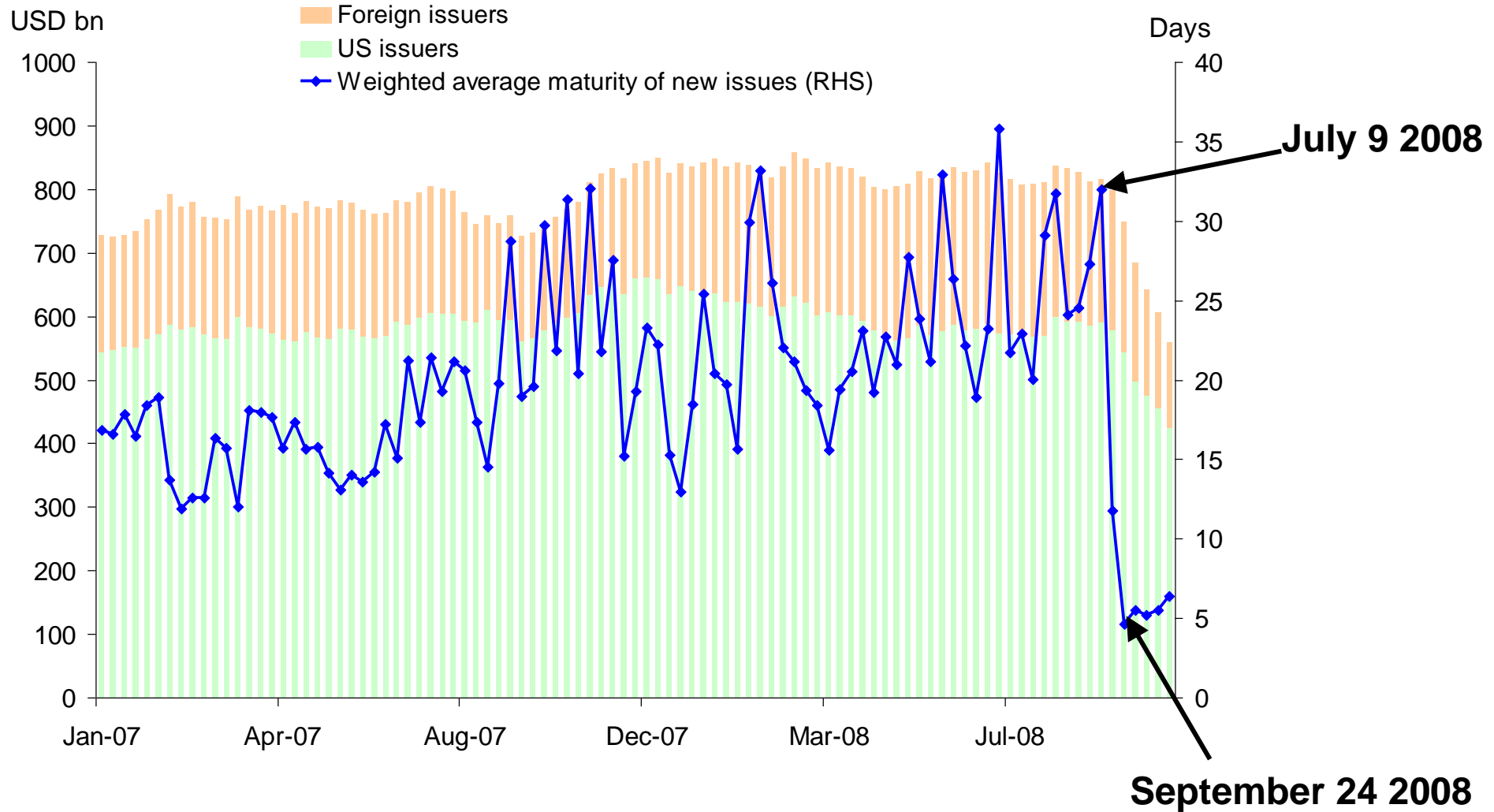
— Current account balance    ● Investment income debit

# Breakdown of New Zealand Government Debt



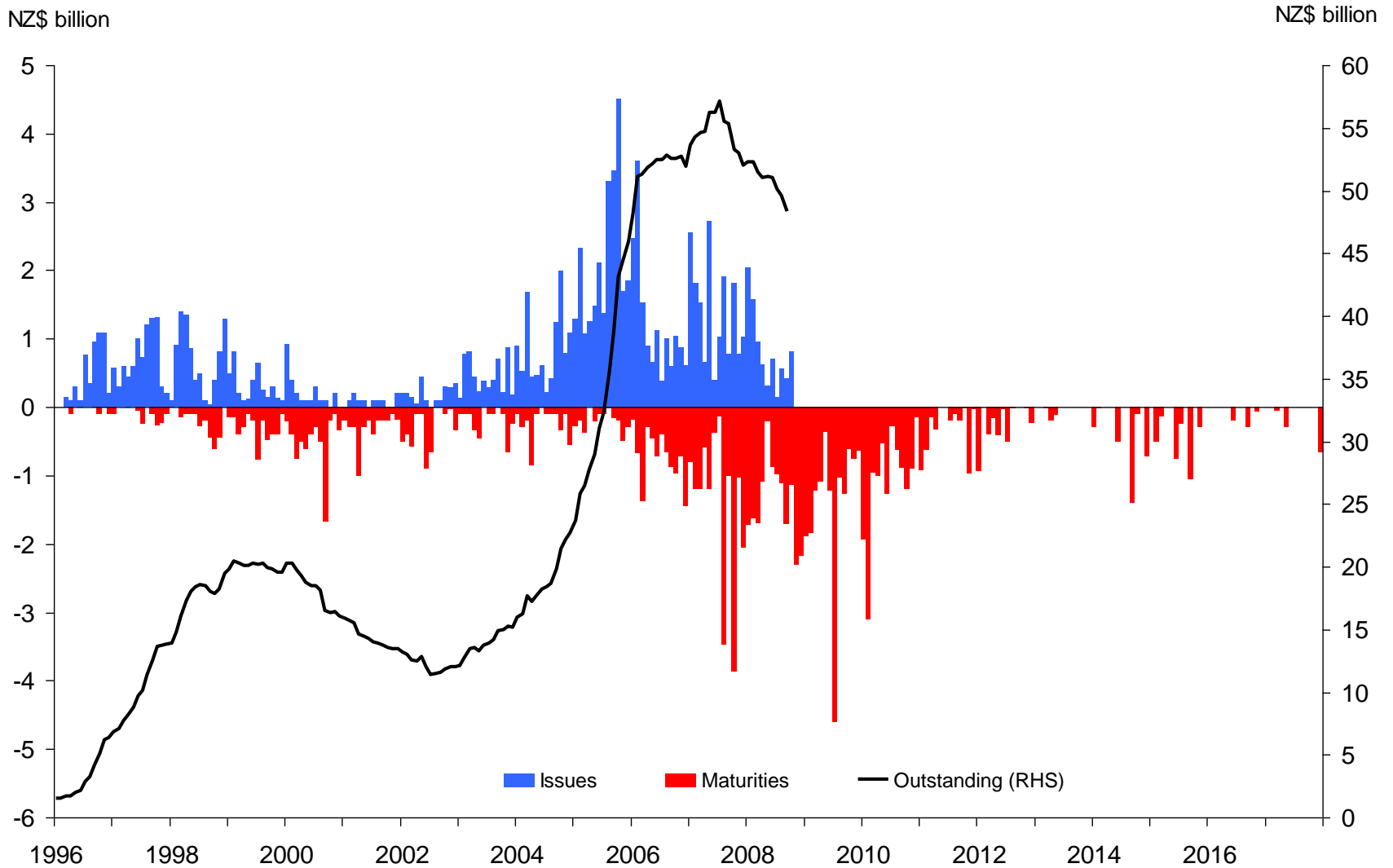
**Figure 2.2**

**Stock of US commercial paper outstanding and weighted average maturity of new issuance (*financial issuers only*)**



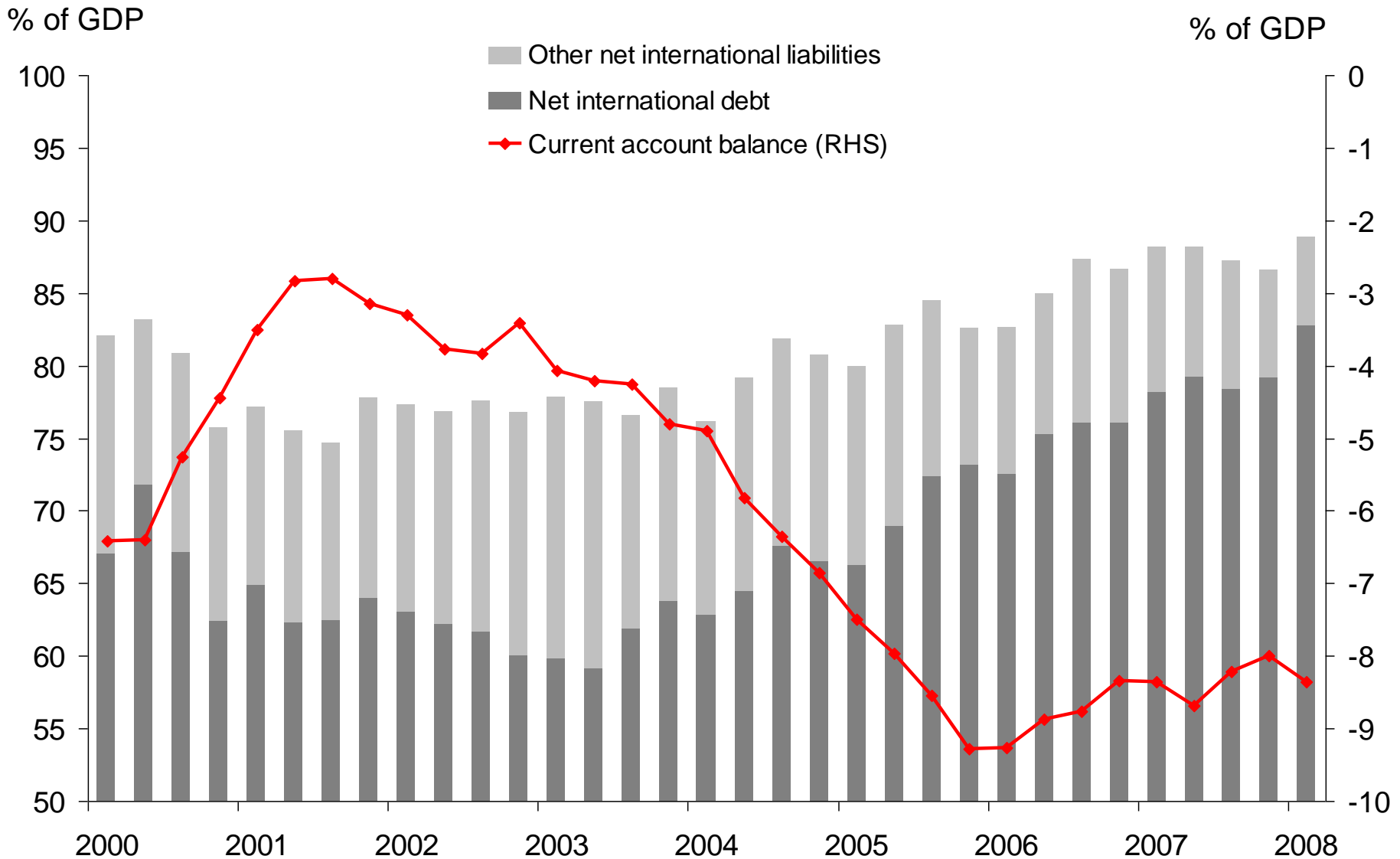


**Figure 3.3**  
**Offshore NZD denominated bond issuance (*Eurokiwi and Uridashi bonds*)**



Reserve Bank of New Zealand, *Financial Stability Report November 2008*,  
<http://www.rbnz.govt.nz/finstab/fsreport/>

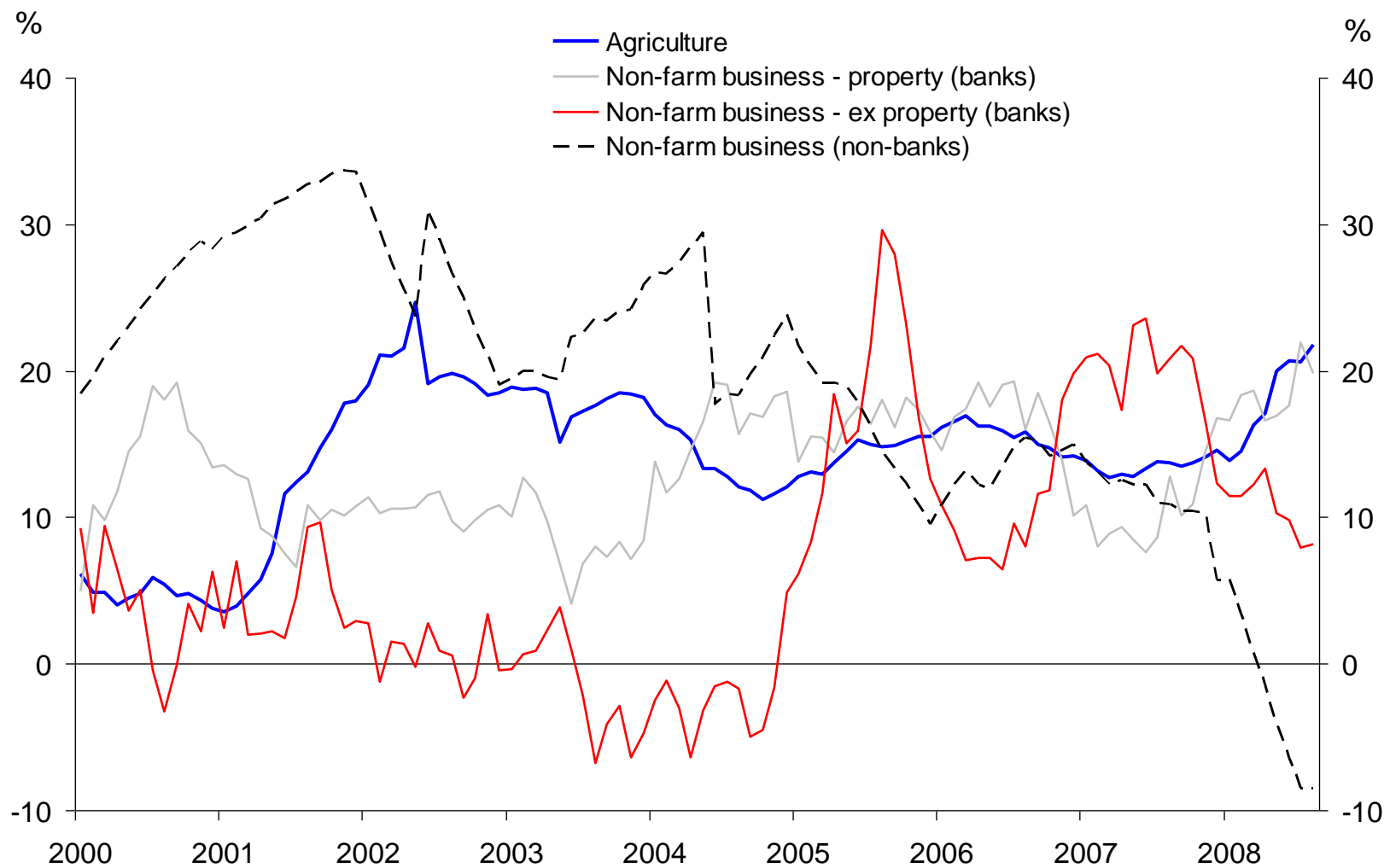
**Figure 3.8**  
**New Zealand's external position (percent of GDP)**



Reserve Bank of New Zealand, *Financial Stability Report November 2008*,  
<http://www.rbnz.govt.nz/finstab/fsreport/>

**Figure 3.15**

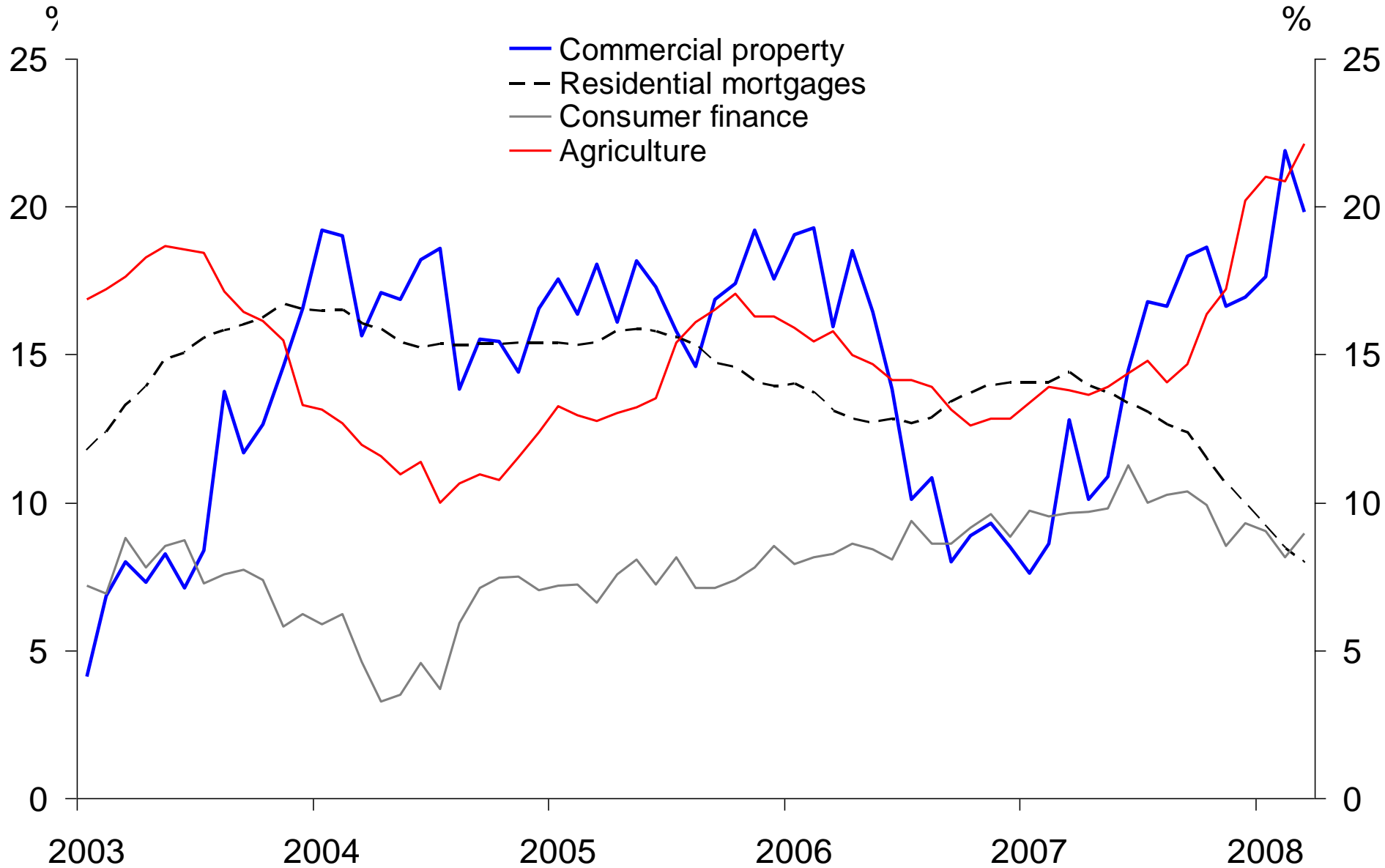
**Domestic financial institutions' lending to the business sector (*annual percent change*)**



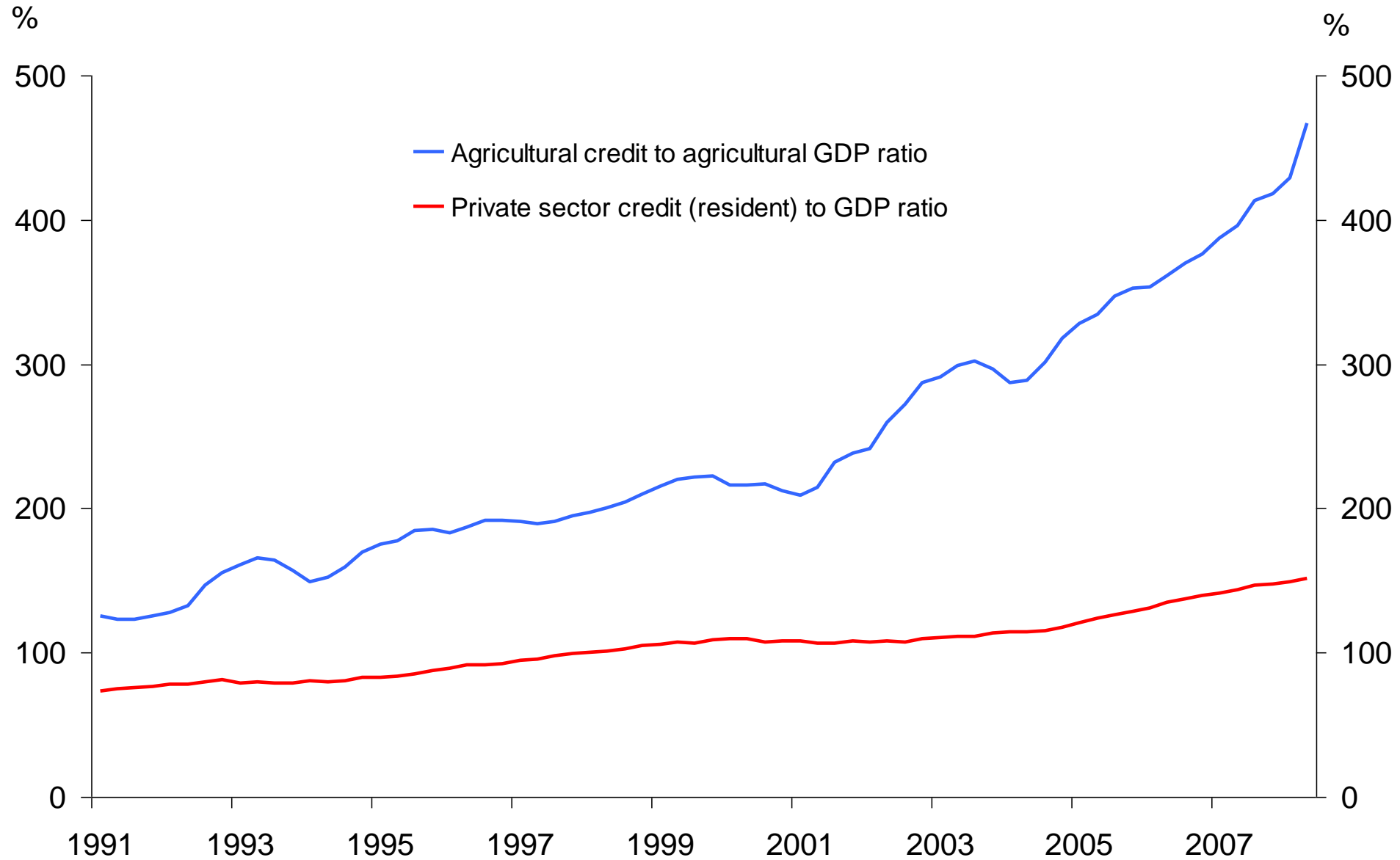
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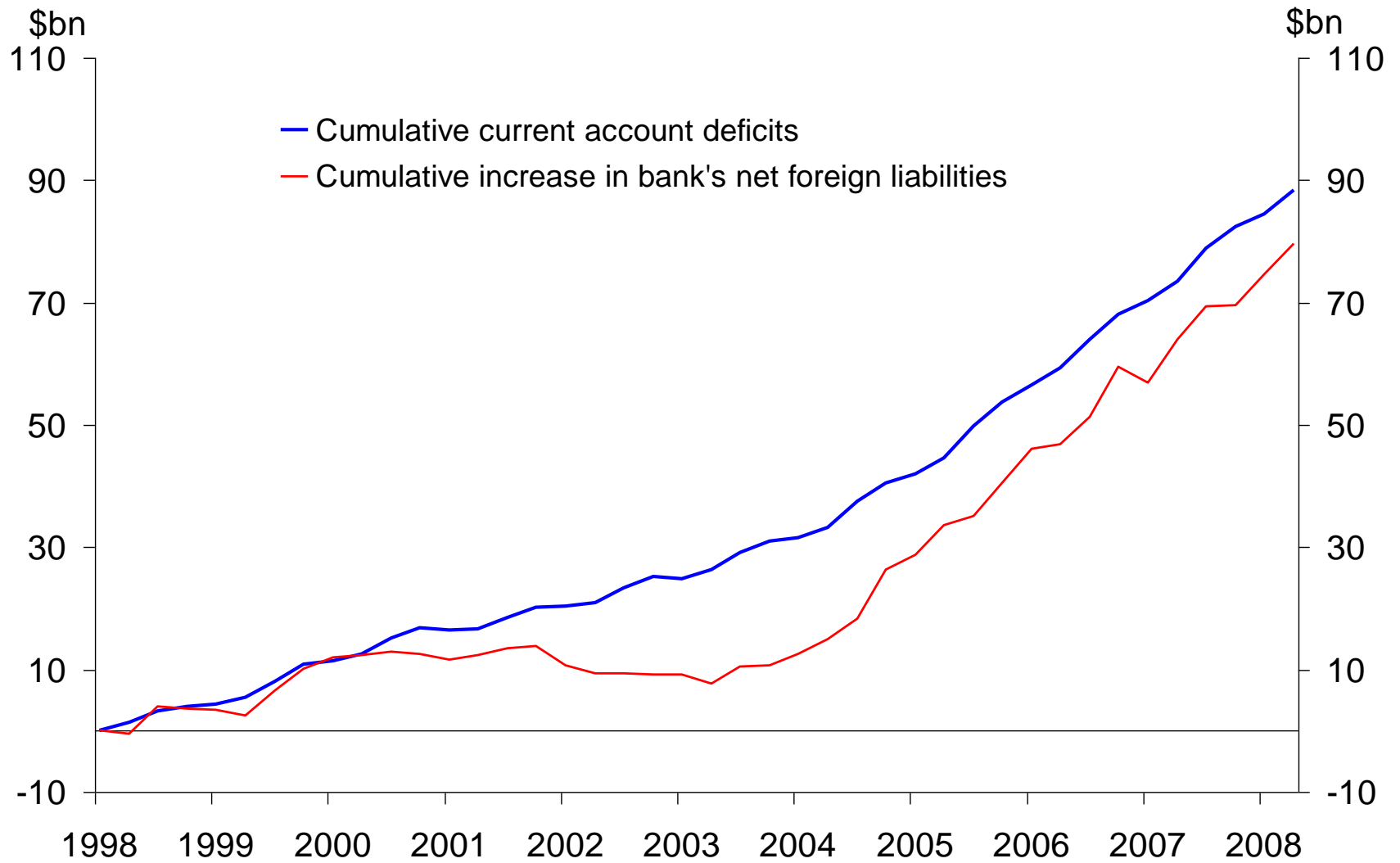
**Figure 4.8**  
**Banks' annual lending growth**



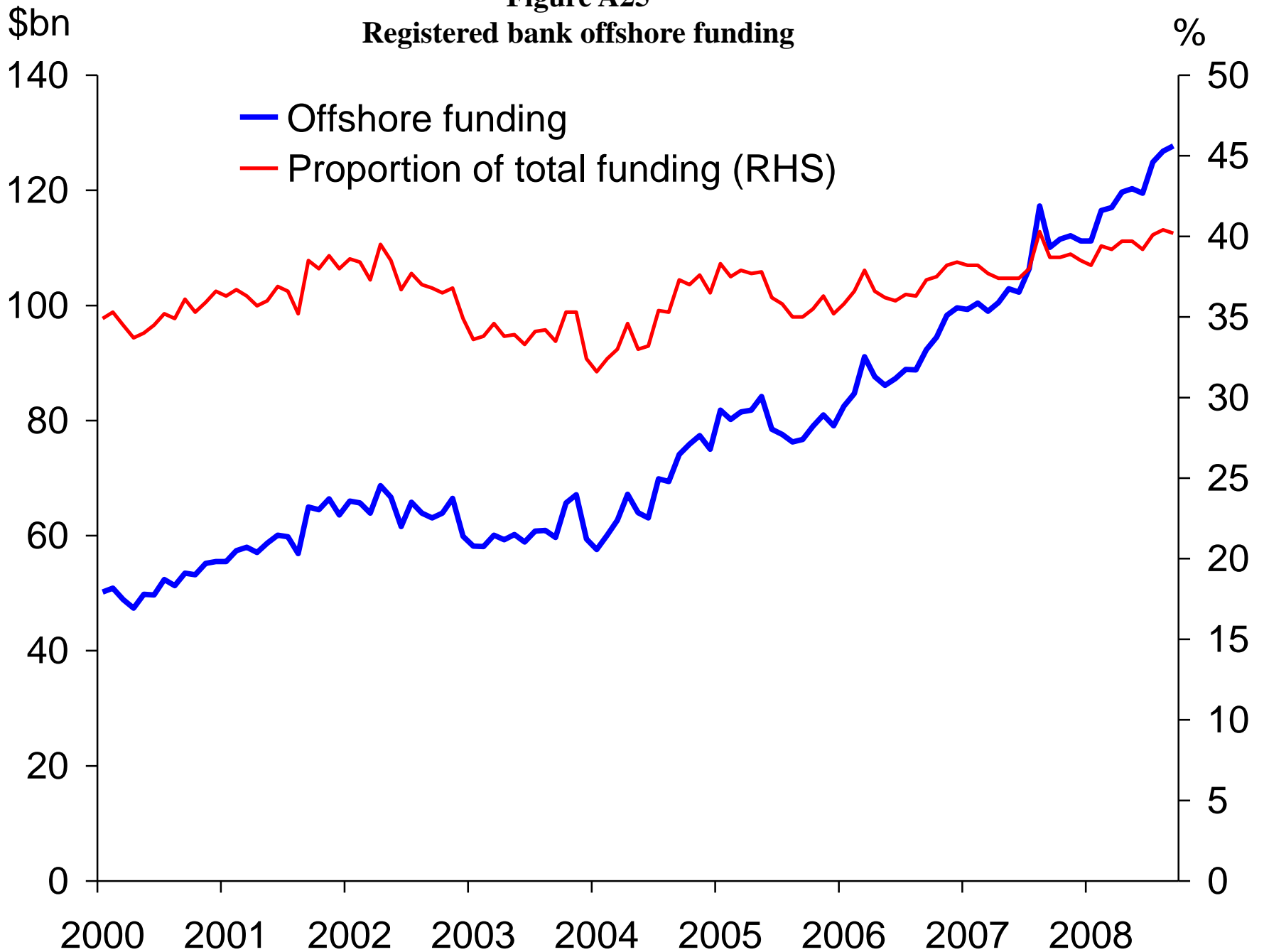
**Figure 3.18**  
**Agricultural debt-to-output**



**Figure 4.1**  
**The funding of the current account deficit**

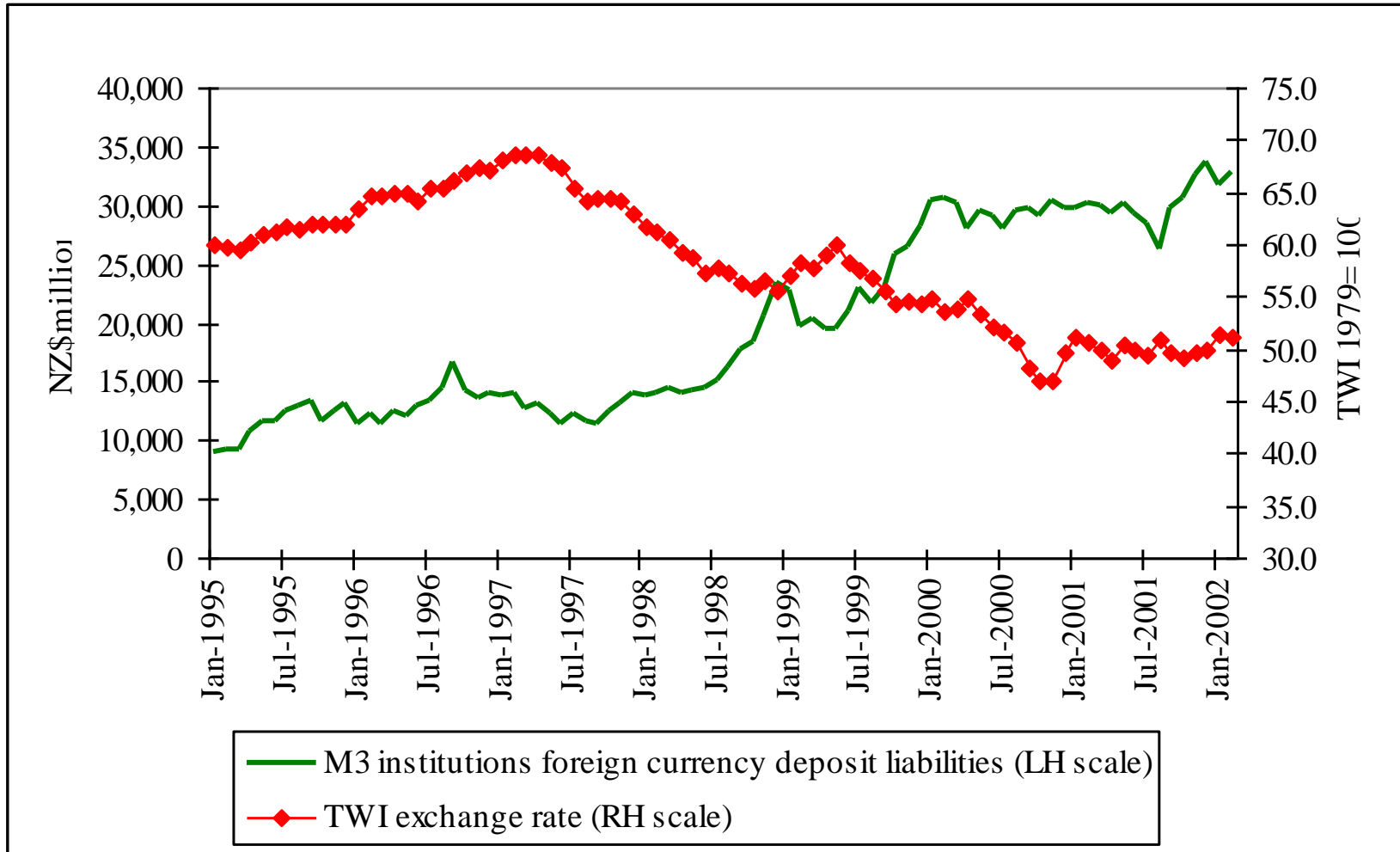


**Figure A25**  
**Registered bank offshore funding**



**Figure 5**

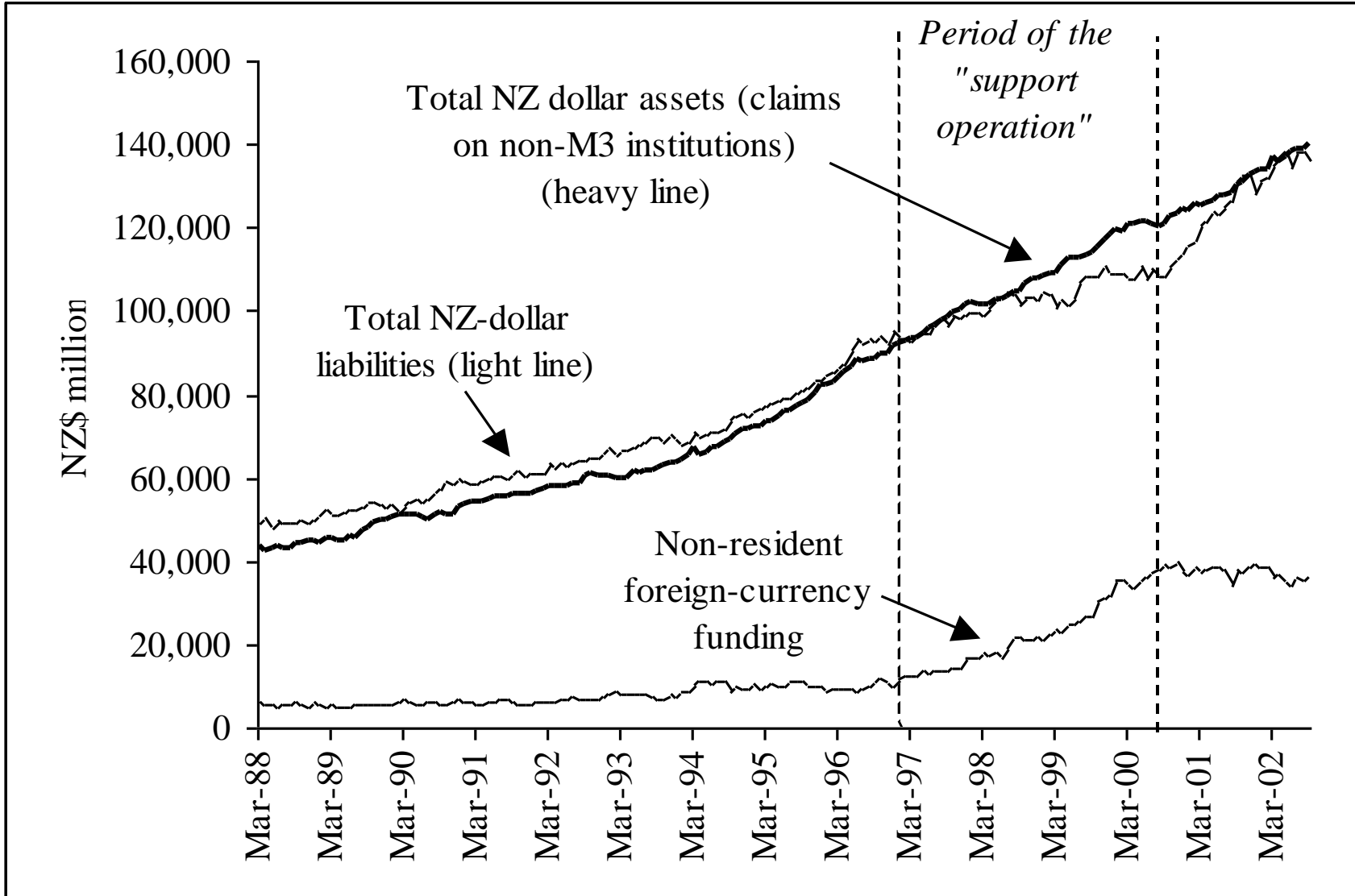
**Nominal Exchange Rate and M3 Institutions' Foreign-Currency Liabilities 1985-2002**



Source: RBNZ Historical Tables B1 and C5



**Figure 6**  
**Funding the Growth of M3 Institutions' NZ dollar Assets**



Source: RBNZ Table HC4.

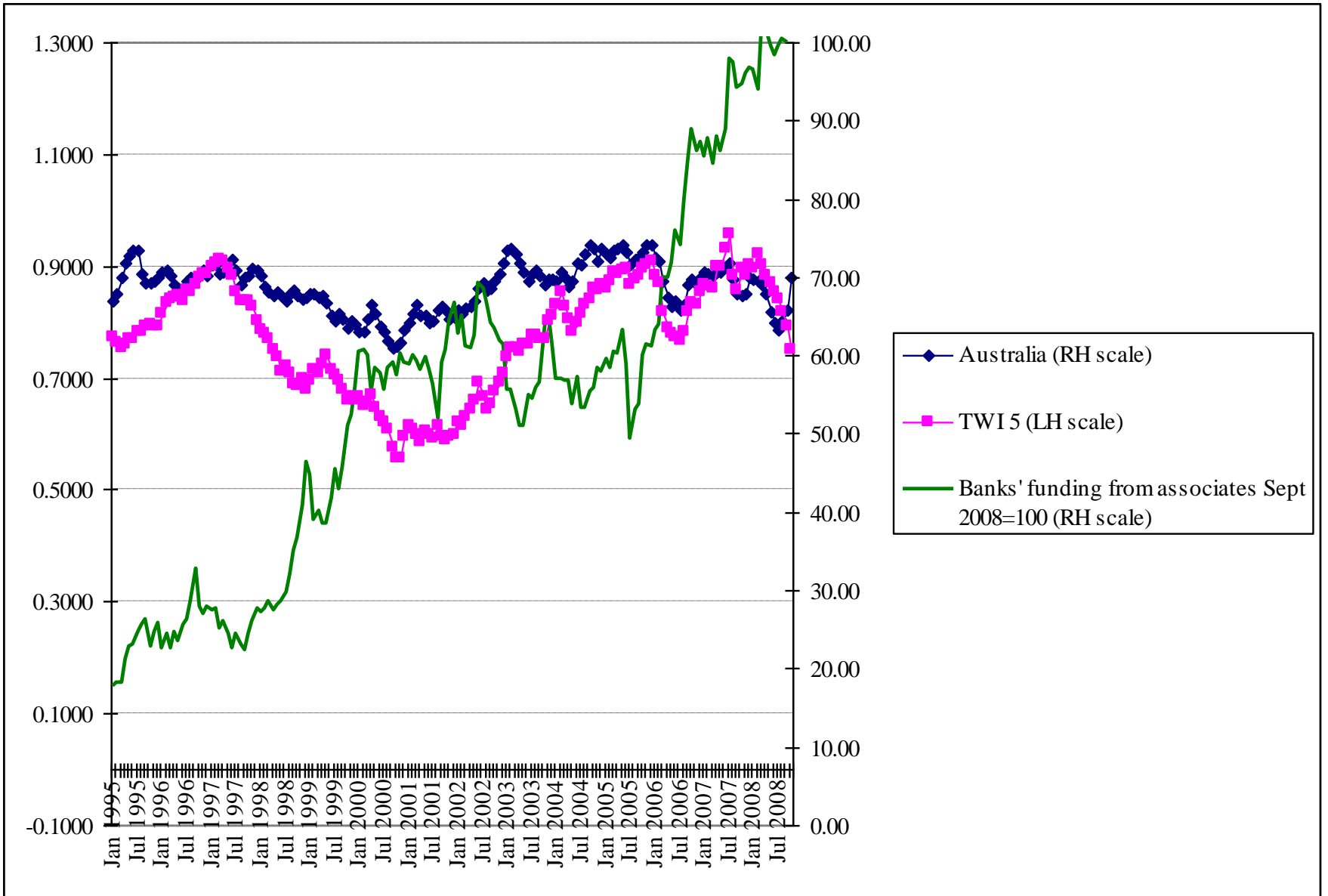


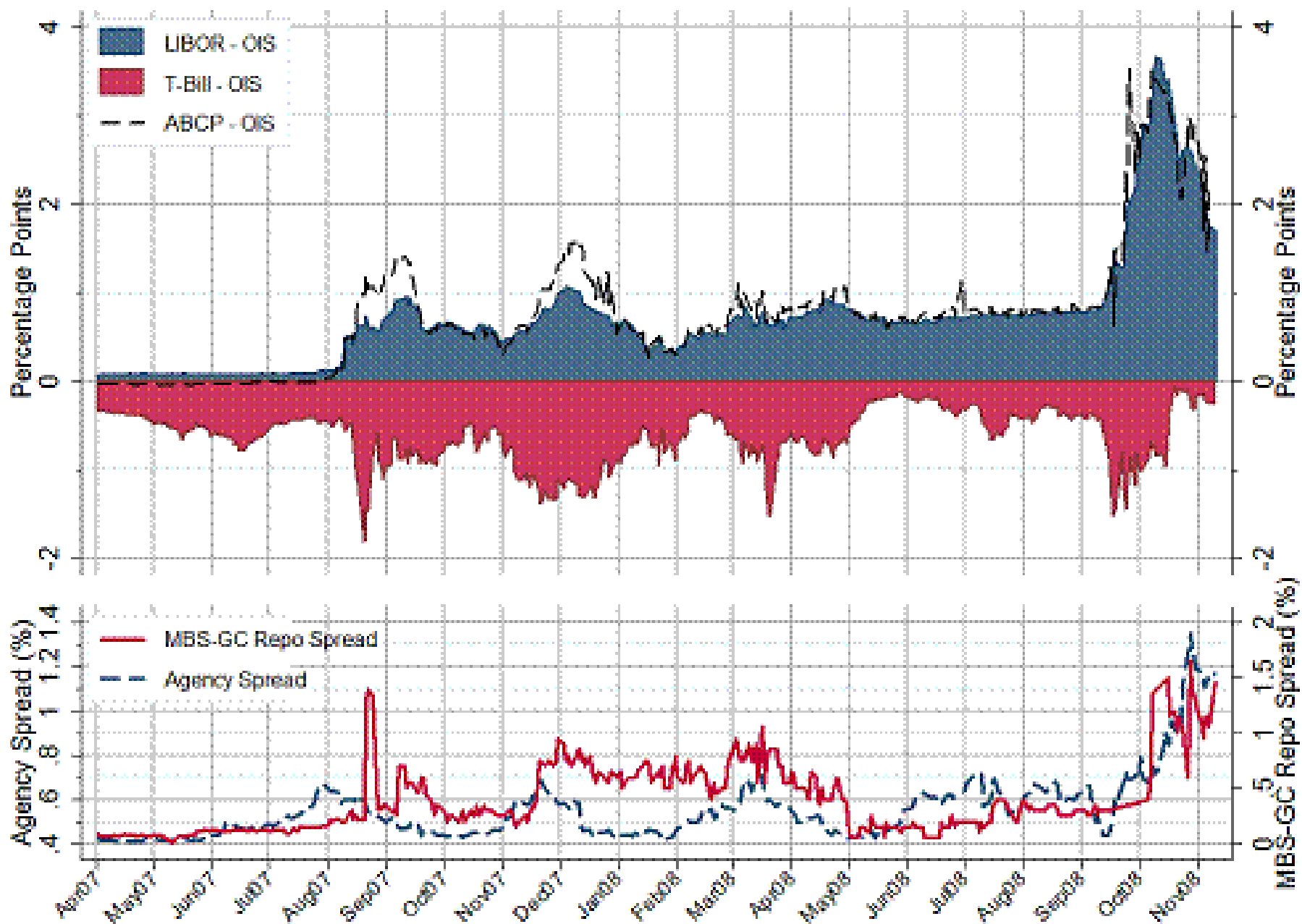
Table C1

## Indebted households' financial situation in 2007 and changes since 2001

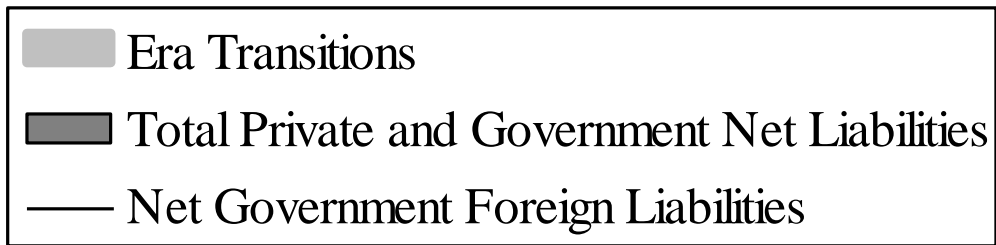
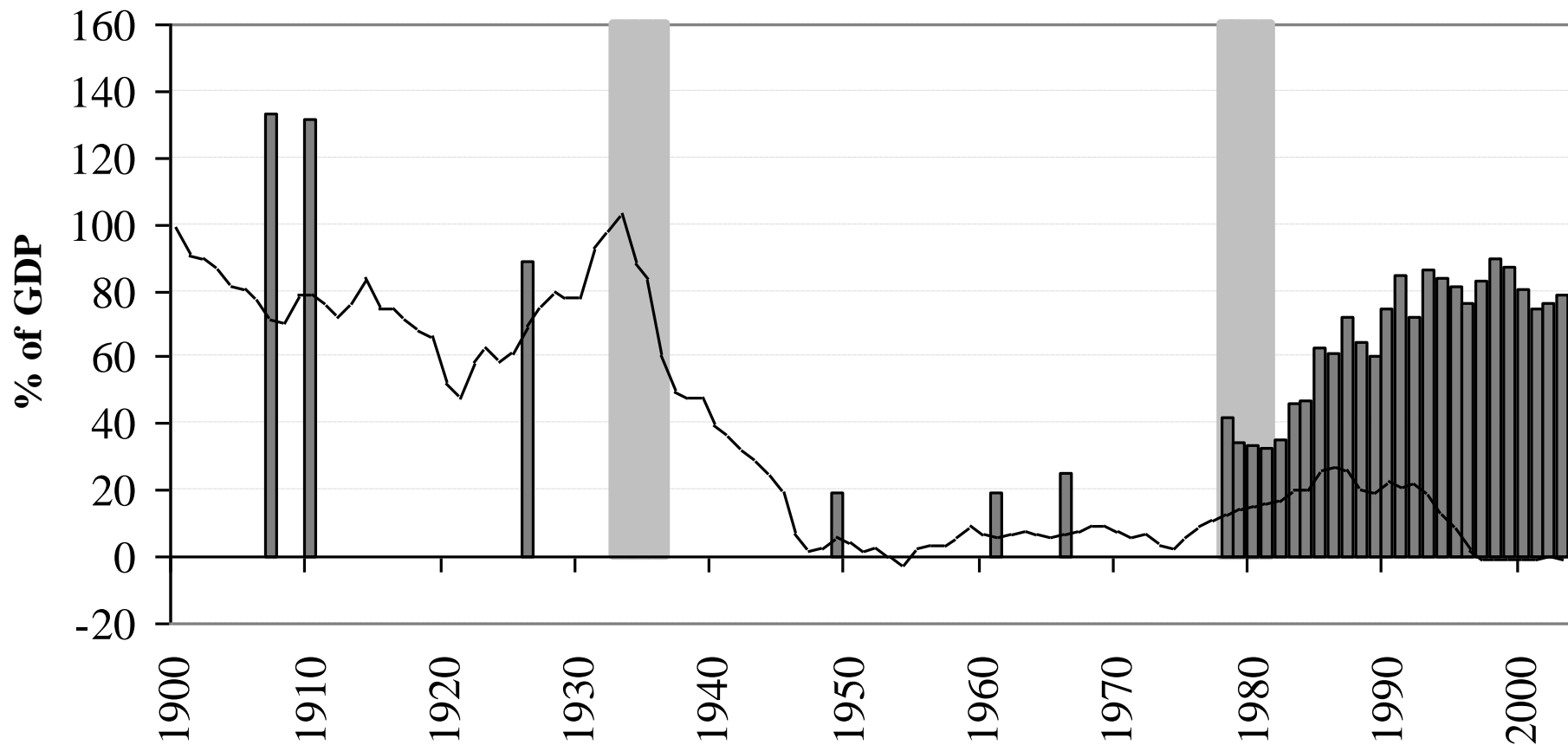
*(medians by income quintile, percentage change since 2001 in parentheses)*

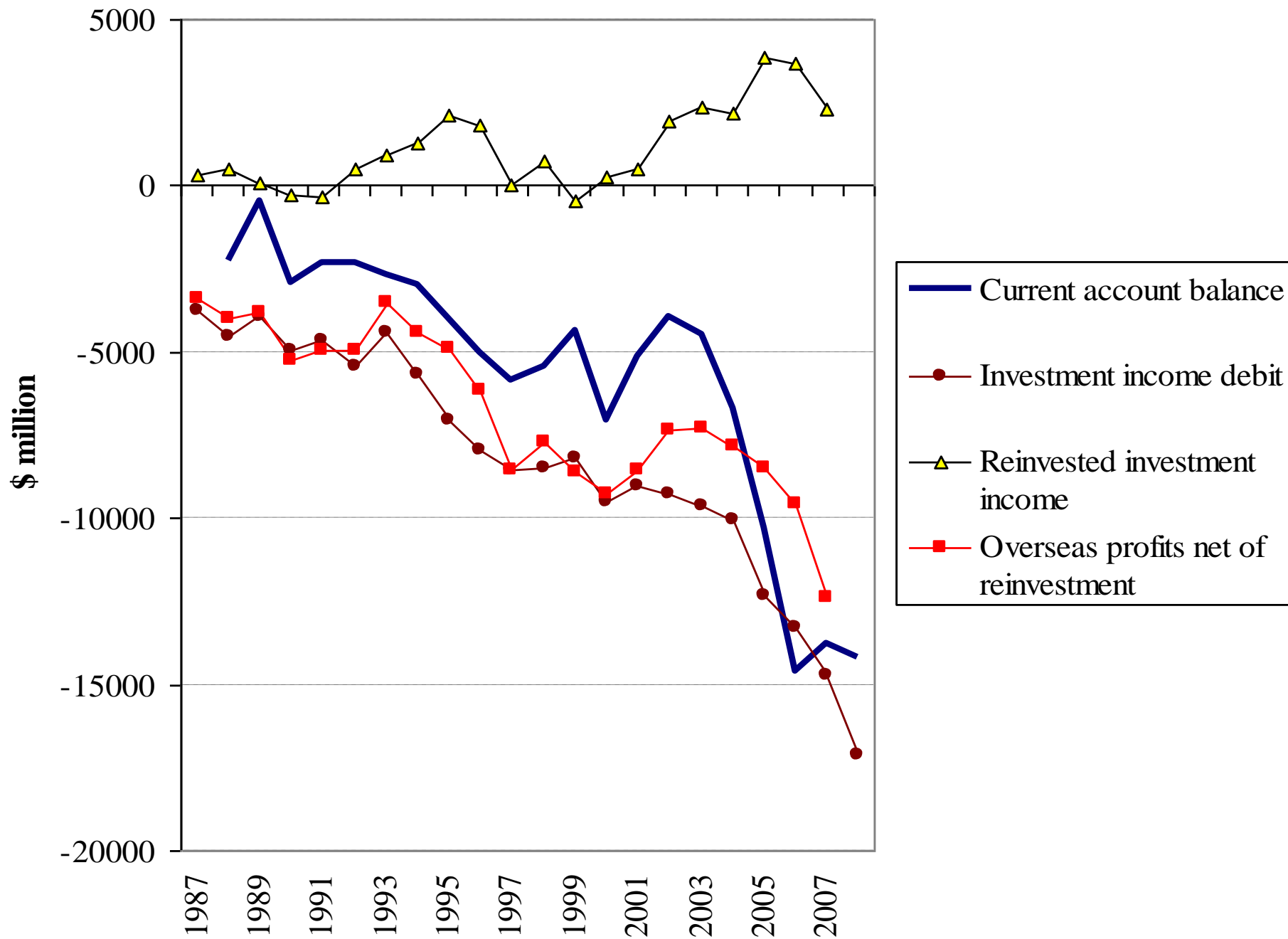
2007	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Housing debt (\$,000)	27 (-6.9)	68 (44.7)	87 (47.5)	111 (29.1)	137 (26.9)
Housing asset (\$,000)	201 (85.8)	244 (85.8)	305 (119.2)	316 (91.5)	451 (108.8)
Debt-to-asset ratio (LVR) (%)	14.7 (-53.3)	28.7 (-41.2)	33.1 (-25.8)	41.3 (-24.1)	36.0 (-33.0)
Debt service ratio (%)	26.7 (-5.3)	21.7 (-9.6)	20.4 (-6.0)	18.4 (-1.1)	16.3 (4.5)
Share of total housing debt (%)	1.0 (-63.0)	6.1 (-23.8)	19.9 (18.5)	30.6 (1.3)	42.4 (0.0)
Share of total indebted households (%)	3.4 (-55.3)	10.4 (-16.8)	22.9 (5.5)	32.0 (12.3)	31.3 (5.0)

# Interest rate spreads in the USA, April 2007 – November 2008



# Net International Investment Position (Government and Private)





**Table 2**  
**International Assets and Liabilities**

	<i>IIPQ</i>	Jun
<b>New Zealand's international assets<sup>(3)</sup></b>		
Equity assets <sup>(4)</sup>	S5AA1A	R 52,098
Lending	S5AA3	R 77,683
Banks	S5AA8C	21,723
General government	S5AA8B	8,976
Monetary authorities	S5AA8A	20,210
Other sectors	S5AA8D	R 26,774
<b>Total international assets</b>	S5AA1	R 129,780
<b>New Zealand's international liabilities</b>		
Equity liabilities	S5AL1A	R 63,115
Borrowing	S5AL3	R 225,858
Banks	S5AL8C	R 138,881
General government	S5AL8B	R 17,574
Monetary authorities	S5AL8A	273
Other sectors	S5AL8D	R 69,131
<b>Total international liabilities</b>	S5AL1	R 288,974
<b>New Zealand's net international asset position</b>		
<b>Net international equity</b>	S5AA2A	R -11,018
<b>Net international debt</b>	S5AA2B	R -148,176
<b>Net international asset position</b>	S5AA2	R -159,194

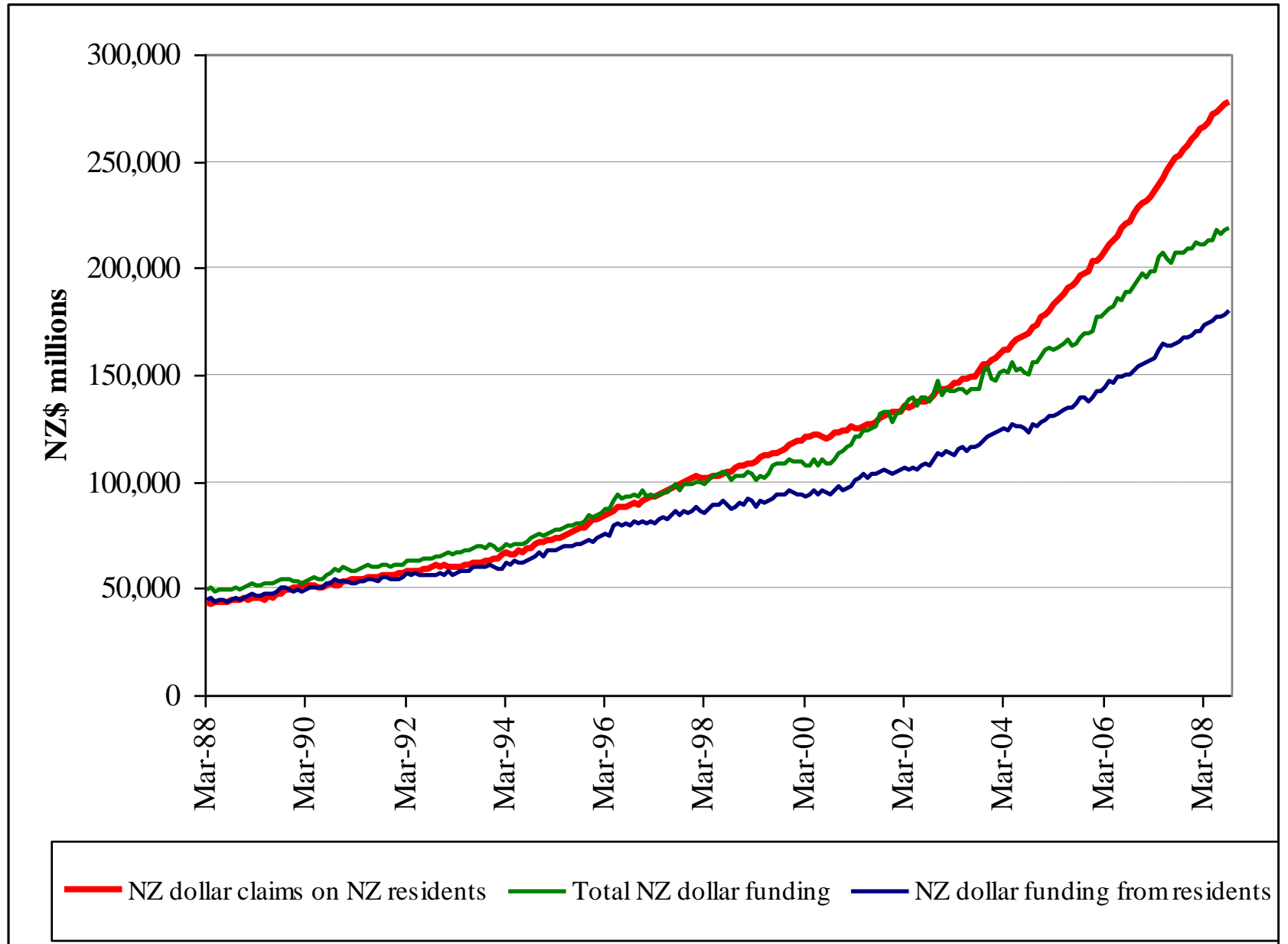


# Consolidated Balance Sheets of the Banks

Liabilities, capital and reserves		Aug-08	Sep-08	Assets		Aug-08	Sep-08
<b>NZ dollar funding</b>				<b>NZ dollar claims</b>			
1	NZ resident	177.6	179.6	NZ resident (Non M3)		277.2	277.9
2	Non-resident	40.0	39.0	Non-resident		7.6	9.0
3	Total 1+2	<b>217.6</b>	<b>218.6</b>	Sub-total to here		<b>284.9</b>	<b>286.8</b>
				NZ resident (M3 institutions)		15.0	15.1
				Total		<b>299.9</b>	<b>302.0</b>
<b>Foreign currency funding</b>				<b>Foreign currency claims</b>			
4	NZ resident	10.2	9.9	NZ resident		4.0	4.2
5	Non-resident (?all wholesale?)	80.1	80.7	Non-resident		11.6	6.6
6	Total 4+5	90.3	90.7	Total		<b>15.6</b>	<b>10.8</b>
7	Capital and reserves	22.6	22.5	Foreign currency fixed assets and		0.1	0.1
8	Other Liabilities	19.6	27.9	Shares in NZ companies		0.4	0.4
				Other Assets		<b>25.4</b>	<b>35.0</b>
				Treasury bills		1.5	1.4
				NZ notes and coin		0.5	0.5
				Claims on the Reserve Bank		6.7	9.3
<b>Total liabilities</b>		<b>350.1</b>	<b>359.6</b>	<b>Total assets</b>		<b>350.1</b>	<b>359.6</b>
Memo items:				Memo items:			
9	funding from associates	50.7	50.4	financial claims on associates		7.1	6.6
10	total non-resident funding	120.1	119.7	total non-resident claims		19.2	15.6



# Funding of the NZ Banks 1988-September 2008



- For the longer term, it should forswear spending-is-bad/taxes-are-bad dogma, and, besides dealing with healthcare, face head on the question of how much of the growing GDP we should divert from valuable private use to valuable public services and investment, and from other valuable private use to the use of the truly needy. For the former, the test should be the value of better infrastructure, schools, research, etc. (net of costs due to incentive-distortions caused by higher taxes) versus the value of the personal consumption that higher taxes would cause each of us to forgo (the least valuable dollars of personal consumption). The plan should eschew what Paul Samuelson once called shibboleth, such as a specific debt/GDP objective.
- Francis Bator, **There is no US federal debt crisis**,  
<http://blogs.ft.com/economistsforum/2011/03/there-is-no-us-federal-debt-crisis-2/>