

## Tracking the Economy

### Growing risks

New Zealand faces considerable imbalances. National savings is falling and we are borrowing more and more to invest. Construction costs are beginning to rise, likely reflecting early work in Canterbury. But this will not fuel widespread inflation. Firms are still unable to pass on cost increases, because of muted demand. A slow economy, global risks and contained inflation means the RBNZ will not raise interest rates until 2013.

### Global uncertainty

The global economy is slowing. Europe may fall into recession, as the sovereign debt crisis grinds on. Despite some hopeful signs of much needed economic reforms, it may be too little too late. Political infighting continues to threaten the USA. Worryingly, even Chinese exports have slowed and Asian manufacturing growth has stalled. Australia is slowing and the central bank there has cut interest rates to revive the economy. Even an orderly slowdown in global growth will slow our exports and tourism. A hard landing globally would put us back in recession.

### Dwindling national savings

Imbalances remain in the domestic economy. National savings is trending downwards, meaning we need to borrow from overseas to fund our investments. This reliance on foreign capital makes us vulnerable particularly with the current global financial market turmoil. New Zealand had a savings shortfall of \$4 billion in the year to March 2011. New Zealand needs to invest more in productive capital to drive a sustained economic recovery. Low national savings means our economic future is at the mercy of global financiers.

### Construction inflation rising

Construction inflation is beginning to rise. Prices in civil construction have risen to near peak cycle levels. This may be due to the recent earthquake clean-up and repair work in Canterbury. This suggests that inflation will accelerate for residential and non-residential buildings when the rebuild kicks in, probably late next year. This would increase the cost of the rebuild and also reduce construction demand outside Canterbury.

### But inflation won't spread

The likely acceleration in construction inflation will not spill over into wider inflation. We are currently producing less than we can with our current stocks of capital and labour. This spare capacity means inflationary pressures are subdued.

This is supported by firms' prices. Input costs are rising, but firms are unable to pass these through to prices, due to weak demand. Margins and profits are under pressure, and borrowing growth is low. This is inhibiting investment and hiring growth, two factors which typically lead an economic recovery.

**Written by Peter Nicholls**

Word count: 394

