

# Economic update

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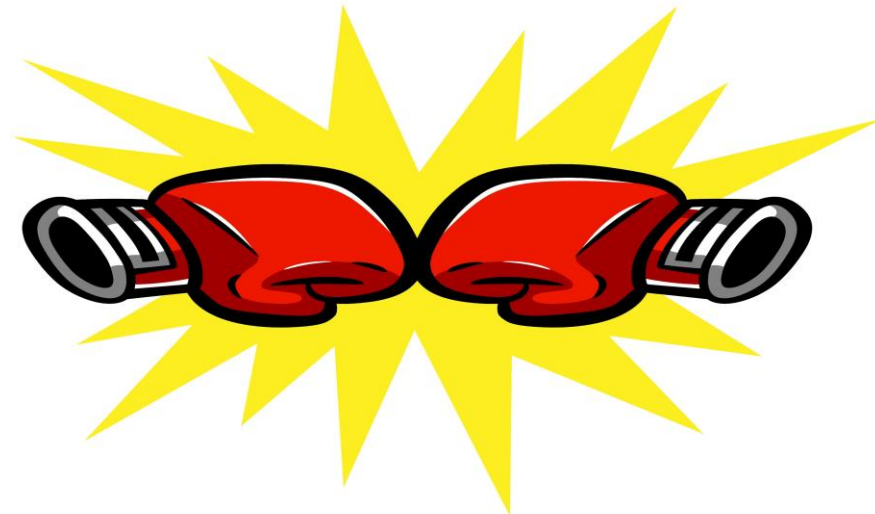
Data and information have been gathered from sources Bagrie Economics believes to be reliable.

Straight shooting weekly economic updates 8pm every Sunday. [www.bagrieconomics.co.nz](http://www.bagrieconomics.co.nz)



# The BIG picture is a massive collision

Cyclical  
challenge  
(inflation)



Adapting to  
structural  
change



Populism, division and  
regulators!

# The world has become a riskier place

## What we become used to

- Globalised and connected world
- Low inflation and low volatility
- Trend lower in interest rates
- Rules based system
- Trade for economic reasons
- Stability/abundance
- Fossil fuel
- Efficiency and just in time
- Rising inequality but stability
- Linear world/steady change
- Political leaders

## Now

- Fragmented world
- Inflation and volatility
- Rising interest rates
- Power challenging rules
- Trade in security
- Volatility/scarcity
- Renewables and decarbonisation
- Just in case model
- Division, crime and instability
- Non-linear – rapid change (AI)
- Populist leaders

# On Bloomberg today!



The Big Take

**There's a New  
Financial Crisis  
Brewing in  
Uninsurable US Homes**

# Some key questions

- Are we seeing capital uncertainty?
- Is new capital sufficient to fund capital losses?
- What pricing will be needed to compensate for modelling insurance uncertainties linked to extreme weather and climate change?
- Are extreme events becoming more correlated so the benefit of regional diversification no longer works?
- How will investor sentiment impact the reinsurance cycle?

**Reinsurance demand to remain strong but prices to peak in 2024, says Moody's**

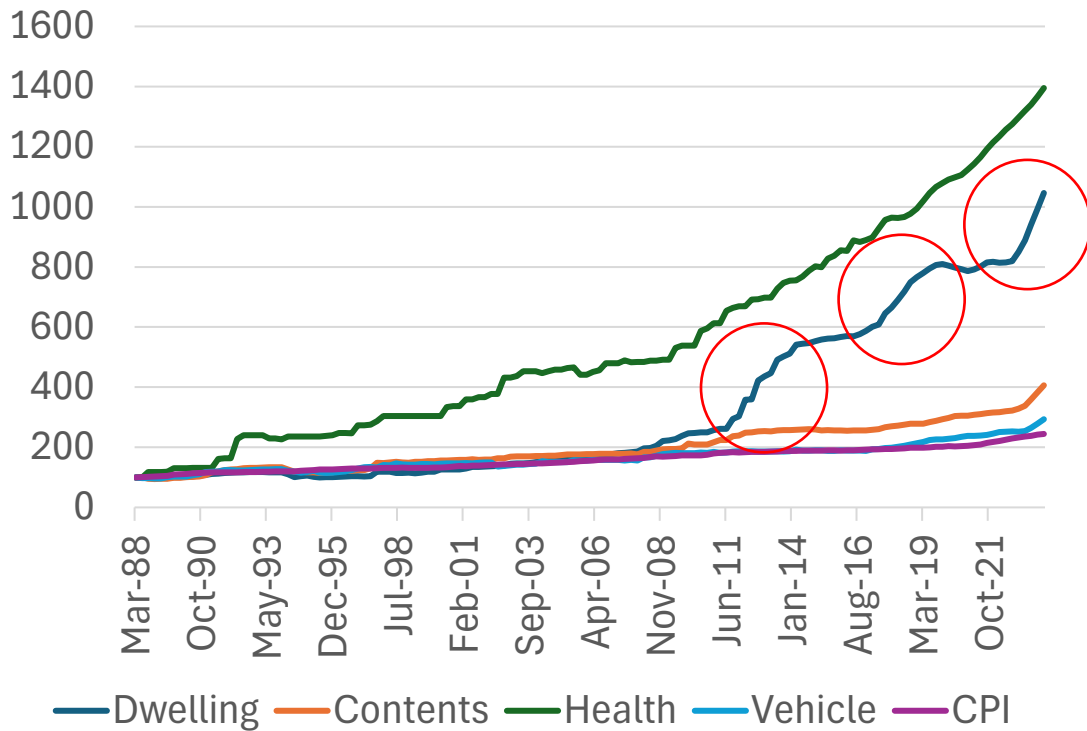
⚡ 5th March 2024 - Author: Luke Gallin

# RBNZ FSR on insurance...you all know what is going on

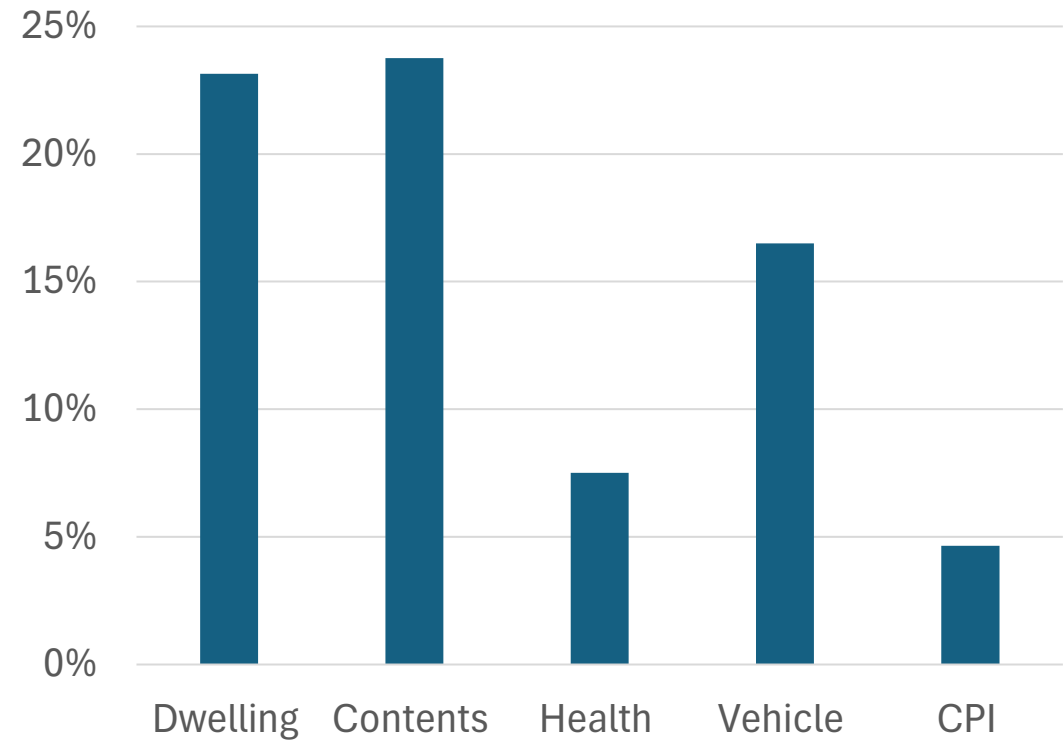
- Reinsurance costs have increased materially over 2023, driven by a global trend of reinsurers reducing risk appetites, and re-evaluations of risk following large weather-related losses in Australia and New Zealand. These changes to reinsurance have contributed to property insurers' premium rates increasingly sharply and means insurers will need to hold more capital due to an increased exposure net of reinsurance.
- With the range of impacts the severe weather events have had on insurers, there are likely to be lasting financial system effects, including changes to insurance availability and greater use of risk-based pricing.

# Insurance cost reality means consumers' face tough decisions

Insurance inflation. Index 1988=100



Insurance cost increase in last 12 months



# Disaster insurance is not alone in seeing large price rises. Models are broken in lots of areas

- Local authority rates – increase 50-100% in the next five year?
- Electricity prices to rise to pay for new investment
- AIA vs Air NZ standoff to pay for airport development
- Road user charges
- Car registration fees +50%
- Healthcare costs
- EV owners and road user charges (no more free lunch)

**Do we have the right inflation target?**



# The D's - there is a lot going on

Disinflation

Demographics

Deglobalisation

Decarbonisation

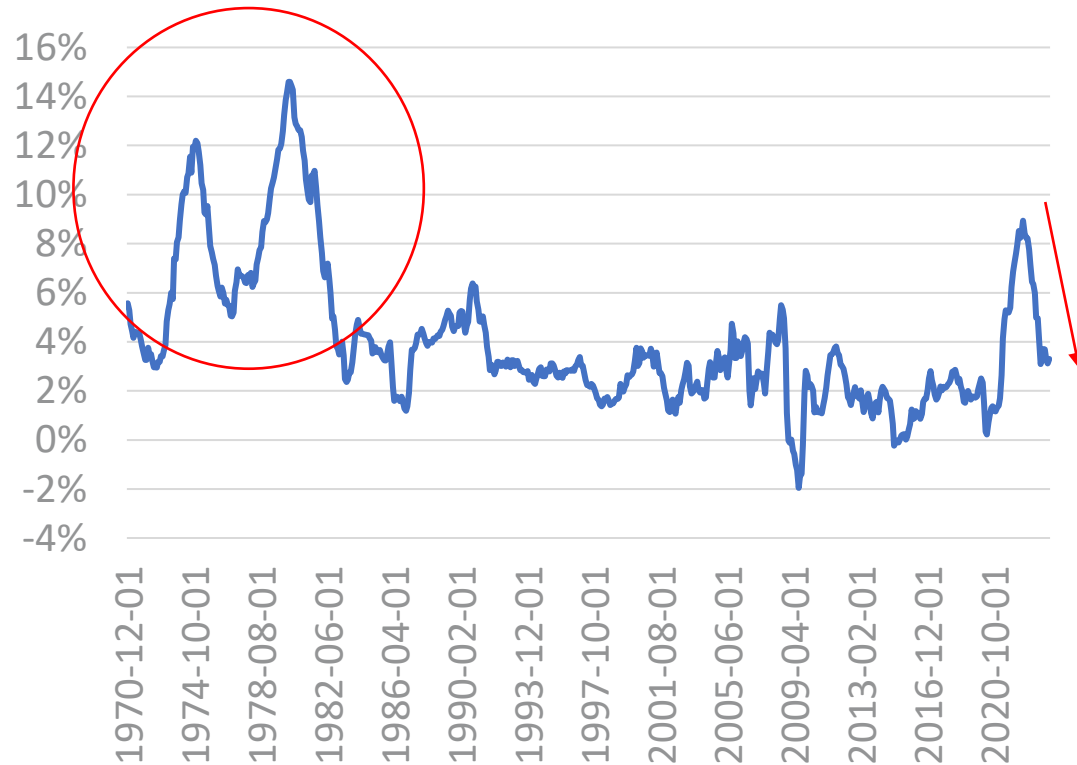
Debt

De-risking

Delivery

# Disinflation is here

## US inflation



## Reasons to be optimistic inflation will fall

- Supply chains connecting in a post COVID world
- AI productivity boom
- China exporting deflation
- Governments now facing borrowing constraints
- Monetary policy is working!!
- Global risk of an accident

# Maybe not

## **Fed's Preferred Inflation Metric Increases by Most in a Year**

- Core PCE gauge climbed 0.4% in January and 2.8% from year ago

Policymakers pay close attention to services inflation excluding housing and energy, which tends to be more sticky. That metric increased 0.6% from a month ago, the most since March 2022. Costs for portfolio management – which climbed by the most in three years – and accommodation led the advance.

## IMF warns central banks against fuelling market hopes of rapid rate cuts

Investor expectations of looser monetary policy could fuel another flare-up of inflation, says  
Gita Gopinath

- Core inflation sits at 4%
- Continued supply shocks (Red Sea)
- Globalisation is unwinding
- Demographics (baby-boomers are spending)
- Level of activity still high
- Equity market doesn't say financial conditions are too tight
- Climate change is inflationary
- Politicians will continue to borrow and spend like drunken sailors

# When interest rates rise you are taking real risk to make real money...welcome to the cleanout

3-year change in US 10-year bond yield  
– percentage points



Stickily inflation + growth uncertainty + risk  
= constricted capital

# We are finding out who the good and not so good operators are

Fletcher Building makes \$120m loss, CEO  
and chair resign

The Warehouse Group sells sports brand Torpedo7 for \$1

Kathmandu's shares plunge on  
sour sales shock

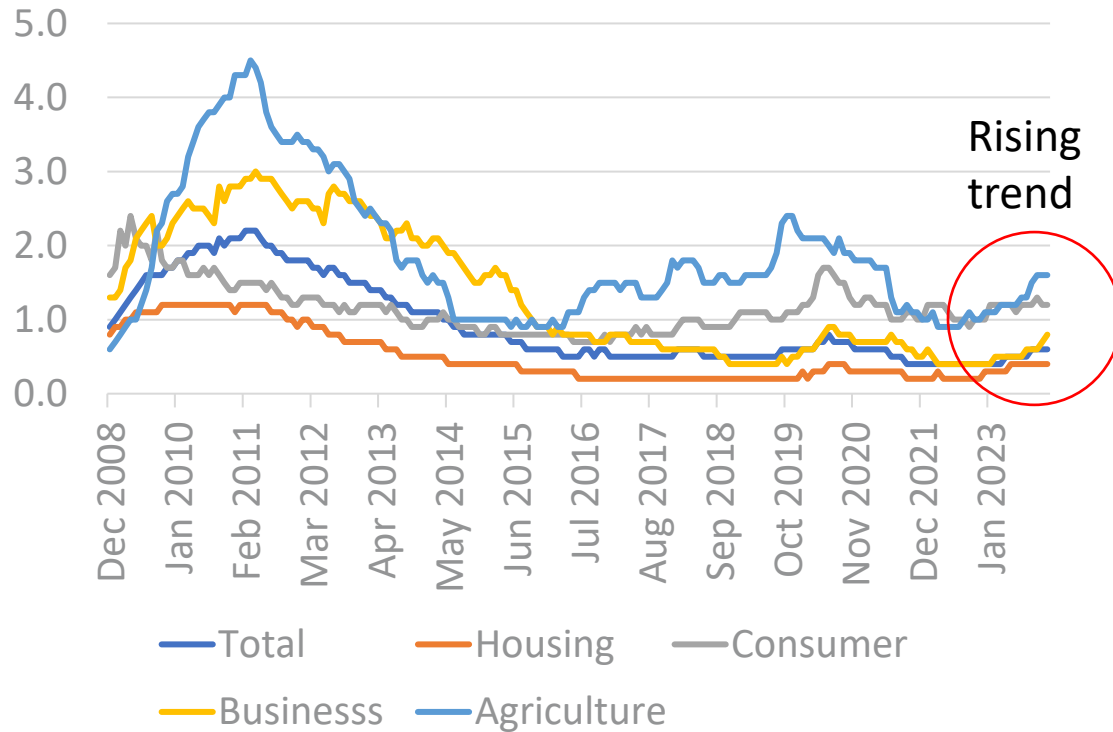
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Air New Zealand first-half profit drops 38% hurt by costs,  
engine troubles

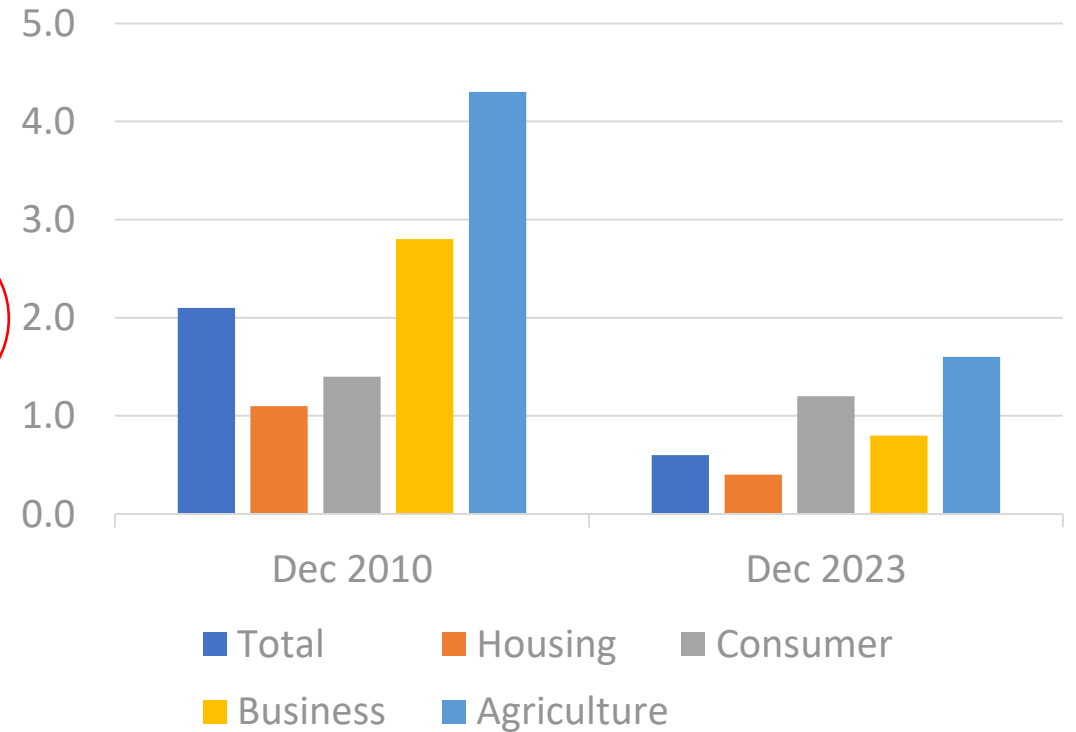
Councils placed on negative credit watch  
due to three waters repeal

# Things are not that bad...yet!

## Non-performing loans (% of total loans)

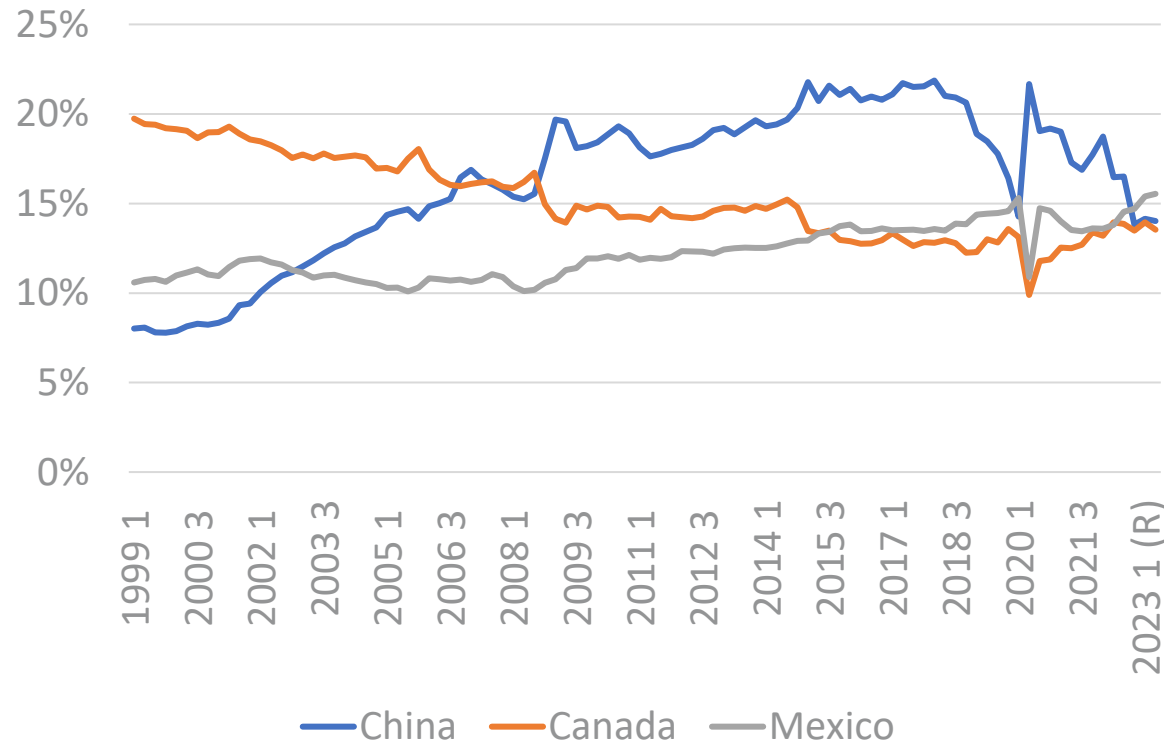


## Non-performing loans (% of total)

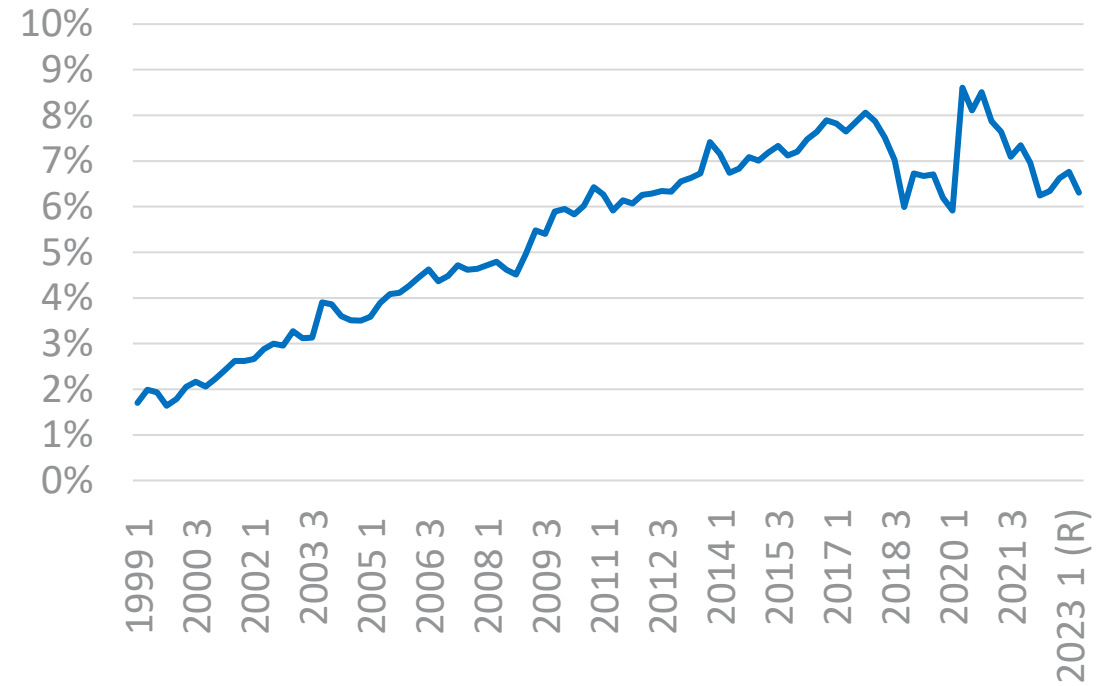


# Decoupling is real – the world is dividing. Expanded BRICS?

## Share of US imports



## China share of US exports




Europe next to decouple? Poland the beneficiary



# A trifecta on China and a different world

- MFAT's Navigating a Shifting World

- Power trumping rules
- Security driving trade
- Efficiency replaced by resilience as just in time becomes just in case



NZ needs to  
rethink

- Defence review

- "An increasingly powerful China is using all its instruments of national power in ways that can pose challenges to existing international rules and norms"

- NZSIS

- "ongoing activity in and against New Zealand and our home region that is linked to the [People's Republic of China's] intelligence services.."

# It's election year! Growth in political periphery a worry. How do we integrate that risk?

## Are we at an inflection point for democracy?

More than 60 countries representing half the world's population will go to the polls in 2024

- Taiwan
- India/Indonesia/Pakistan/Bangladesh
- UK/EU/Belgium/Austria/Portugal
- USA (and Mexico)

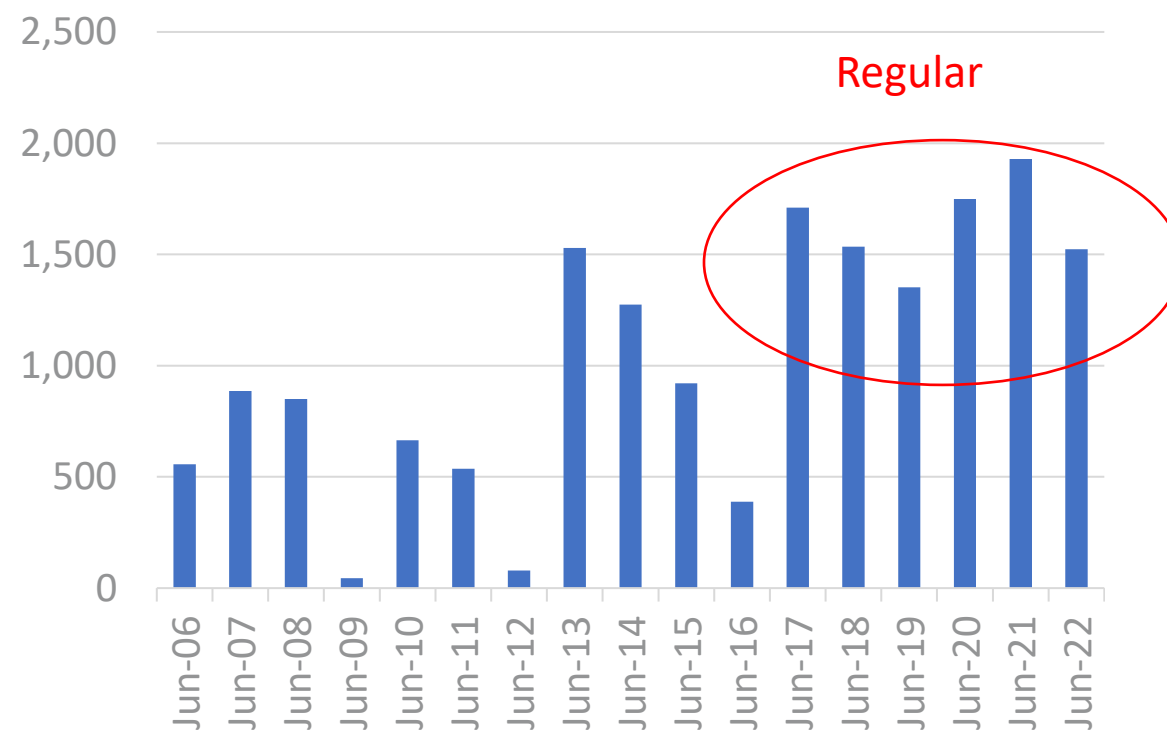


# The news on climate change risk is nothing new

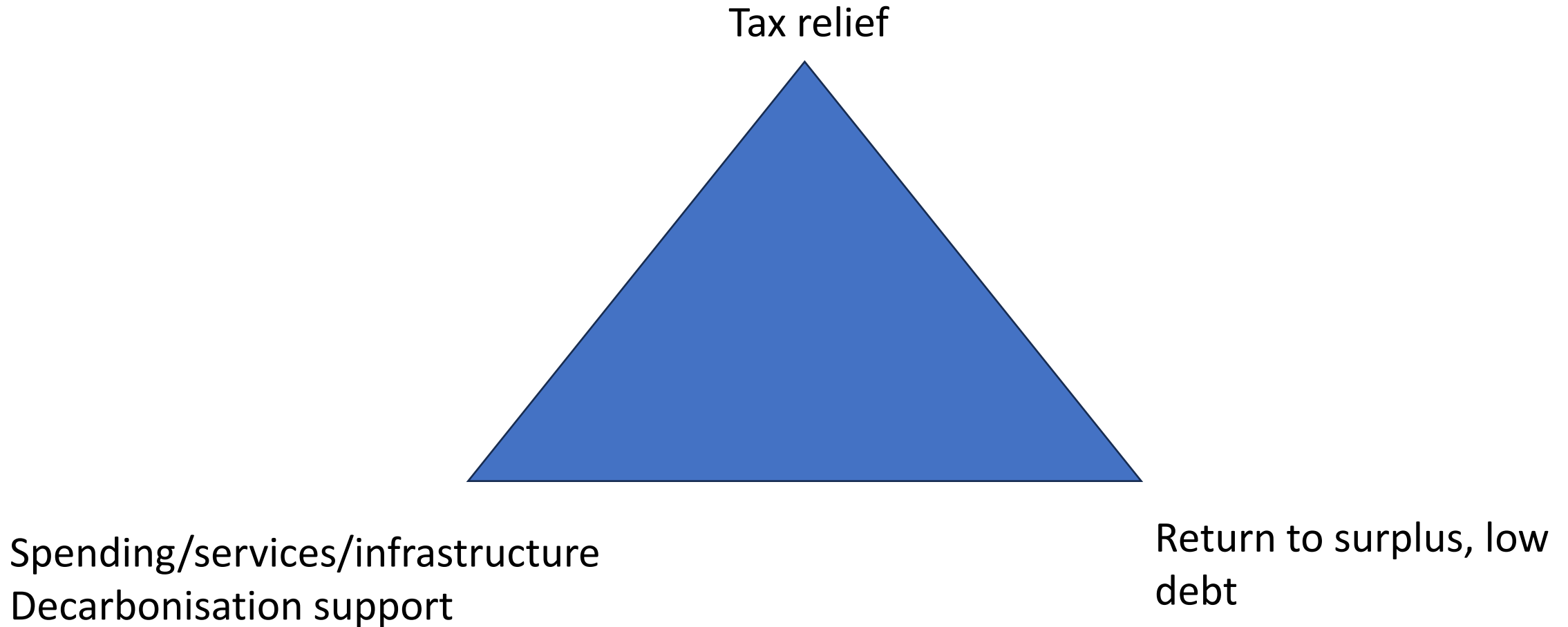
## What is at risk from flooding?

- A population of 675,491
- Buildings numbering 411,516
- 19,098 kilometres (km) of roads
- Transmission lines totalling 3,397 km, and 8,848 electricity structures.
- Three-water pipelines totalling 21,173 km
- Production land cover of 15,190 km<sup>2</sup>

## Insurance claim cost from weather event (CPI-adjusted) - index



# It's a populist environment. Welcome to the impossible trinity for any Finance Minister



# The upshot...bit of a cleanout taking place

- There is no shortage of capital and financial conditions are not overly restrictive
- Appetites are selective though and it getting a lot tougher
- Risk is back!
- We have not been used to taking it or managing it
- Basic economics = prices rise and risk-based pricing (user pays)
- Huge opportunities in some areas
- Hope everything is going to be fine, but hope is not a strategy