Great escape yes, but inflation not all bad

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An early October Wall St slump has reversed. Photo / AP

New Zealand has had a lucky break.

We have come through a phase of rapid economic growth without generating any serious spike in inflation. The Reserve Bank can leave rates lower for longer allowing the economy to keep growing even as it takes a hit from falling dairy prices.

That's not to say the dairy price fall is a good thing. It probably would have happened regardless but a number of other factors have shifted in international economics and most of those have been what a sailor might call fair winds.

I liked Westpac chief economist Dominick Stephens' "Houdini act" analogy - although you could argue that Houdini didn't leave as much to chance as New Zealand does.

China's economy has remained relatively buoyant. Of all the slowdown stories over the last year or so the track that China has taken is surely one of the more benign.

The US has continued its slow recovery - despite all the political weirdness that has seen Obama himself become so unpopular.

The Federal Reserve has stopped short of signalling an end to stimulus but it has ended quantitative easing - a six year, US$4.5 trillion programme of bond buying which has poured cash into the economy and weakened the greenback.

That's caused the US dollar to rise slightly and ours to fall - not yet to levels that will greatly cheer our exporters but a step in the right direction.

That swing of the currencies on the US recovery has been a slower process than anyone would have wanted but in a sense the delay has not been so bad for NZ. Any sooner and it would have poured fuel on an economy that was showing signs of overheating.

Rates would have had to move sooner and would have been at higher levels than those at which they have now paused.

Now the US recovery effect kicks in just as the rate of growth starts to slow here.

On Wall Street a late-September, early-October slump has reversed as US corporate earnings season proved a solid one.

The local NZX market has broadly followed clocking up a series of eight record closing highs last week.

And still inflation has not taken hold. There is downward price pressure on almost everything except property - which remains a socially and demographically driven phenomenon in our biggest cities.

That said, the Reserve Bank's Loan to Value Ratio (LVR) bank lending restrictions have been more successful than many had predicted. They have given the market a pull in the right direction and it does seem to have slowed at least relative to its recent peak.

Globally oil prices have slumped for a variety of reasons which is offsetting our lower dollar and keep pump price here stable and relatively low. All these things have conspired to buy us more time before there is a need for rate hikes.

Despite the deflationary talk it is hard to see rates staying this low forever. And it is worth remembering that if they did it would be an unfortunate outcome because that kind of stasis in the economy would make us poorer.

A deflationary environment is not one in which investors take risks and therefore it is not a great environment for new business and new technology to thrive. New Zealand does need that kind of growth to transform and diversify its economy. It needs it to create jobs and raise wages.

Just look at Japan, still a very wealthy and successful nation, but which at a global level has ceded the crown as Asia's innovation leader to South Korea, home of brands like Hyundai and Samsung.

Japan's export economy had the puff knocked out of it by deflation.

Some of that must be demographic. Japan was ahead of the curve with its aging population.

But America, Canada, Australia, New Zealand and much of Western Europe are following.

That ought to give us some foresight to tackle deflationary issues early and avoid some the mistakes made in Japan.

We know already that we can't afford to rely on our domestic economy, unsupported by export growth.

We simply have to borrow too much to maintain our way of life and we put ourselves at risk of blowing the whole economy by spooking international lenders.

It is sobering to remember that right now, despite the slowdown talk, we are still very much in the sweet spot in terms of dairy boom cash flowing through our economy.

We need to be prepared for the effects of the slowdown next year.

The same rule applies now as it did 12 months ago when growth was accelerating. We must make the most of the good times to strengthen and diversify our economy so we aren't acutely exposed to the fall of one commodity price.

And so that we are well placed to weather the global economic storms - which will never stop coming.

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