

Key: Interest rate spike biggest risk to NZ's economy

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Prime Minister John Key. Photo / Mark Mitchell

John Key has signalled a rapid and unexpected rise in interest rates and "something big that happens internationally" as the biggest threats to the New Zealand economy.

"Almost every recession we've had is driven by real interest rates going up," says Key.

"This is the big risk."

New Zealand has been enjoying economic growth at 3.6 per cent of GDP - the highest growth rate in the OECD - on the back of a 70-year low in interest rates.

In a recent address to Westpac customers, Key traversed some rosy economic statistics.

But the prime minister was also keen to highlight potential risks which could drive a recession in New Zealand.

The first is rising interest rates.

Said Key: "Almost every recession we've had is driven by real interest rates going up. And that is very unlikely at the moment. We really are bucking the international trend. We are still at two per cent base rates. Inflation is running incredibly low. There is fundamentally no pressure on the Reserve Bank to raise rates."

Traditionally drought has also contributed to recessionary risk in New Zealand, but Key discounts this as a current risk.

The third recessionary factor is "the risk that something big happens internationally."

It's this issue which is centre-stage with Key.

The prime minister, who recently returned from a trip to the United Nations where he presided over a Security Council debate on Syria, is particularly concerned what will happen when the US Federal Reserve begins increasing interest rates possibly as early as December.

He cited the huge burden the Japanese central bank is carrying with a balance sheet of 90 per cent of GDP, and increased exposure to corporate debt and equities.

"They have a massive carry trade and so does the Federal Reserve - about US\$1.7 trillion. As soon as interest rates go up they have a really significant issue," warns Key.

"The risk is a really unforeseen increase in inflation because in all the discussions I've had it is not at all clear these central banks have an idea of how they will get on top of this carry trade.

"Because all of a sudden money will be pouring the other way in really quite a significant way."

Key suggests New Zealand has options to deal with a sudden inflationary spike.

'We are just in so much better shape. We can spend money if we want to. We are back in surplus we can cut interest rates if the Reserve Bank wanted to. And we are not printing money and we have no intentions of doing that.'

The Prime Minister also cites political rhetoric from Donald Trump and Hillary Clinton during the presidential election campaign which is "negative to free trade".

"That is a big deal for New Zealand because we're at the bottom of the world. No one owes us a living. We make money when we sell things and deliver them to consumers."

Key underlined that he is a little bit less negative than others on this risk.

"Firstly if Trump wins, yes the barriers are going up and quite strongly. But he's got to get there and the electoral college doesn't favour him. He could do it but I am not so convinced," Key says.

"Secondly Clinton's rhetoric has been a lot more pro-trade - even though she was Secretary of State and part of the Administration her running mate has been massively in favour of free trade.

"Third thing is - and this is going to be the challenge if Clinton wins by a big margin - do they pass TPP in the lame duck period?'

Key suggests if Clinton is elected president it will be in the Republicans' interest to pass TPP saying it will "100 per cent" come down to Paul Ryan.

"If they lose the election, and they lose pretty big, Ryan in my view will be then next president of the United States of America.

"On the basis that it is Ryan, then Ryan needs to think about does he want to preserve his free trade credentials and get the Republicans to vote for it [TPP] in the lame duck period or does he want to throw it our the window and say to the hell with it I am not giving Obama a win?

"You cannot win elections on the fringes - only win elections when you talk to mainstream America. "

Key also painted a picture of an unstable Europe where Chancellor Angela Merkel's leadership in Germany is at risk; where far right forces were gaining traction in France and a intransigent Vladimir Putin was holding back a resolution in Syria.

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