

**ADDRESS TO GREENMEADOWS ROTARY CLUB, NAPIER
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**“WEATHERING THE STORM: NEW ZEALAND AND THE FINANCIAL
CRISIS”**

Thank you for the opportunity to spend some time talking with you this evening about the challenges facing New Zealand in a difficult global environment.

These are undoubtedly “the best of times and the worst of times” for the global economy.

They are the best of times because never before have international markets been so well integrated, never before has humankind’s technological capability been higher, never before have we known so much about business and what it takes to drive sustainable economic growth.

They are the worst of times because we face a global economic crisis of a magnitude not seen, many believe, since the Great Depression of the 30s.

I’d like to talk to you tonight about the causes of the crisis, about how it is impacting here in New Zealand and about some of things that might help us weather the storm.

During the holidays I read an excellent book by US President Barack Obama.

It has a title which is chillingly appropriate in the current environment: “The Audacity of Hope”.

The title actually comes from a sermon delivered by that fiery black preacher Rev Jeremiah Wright whose incendiary sermons caused such uproar during the Presidential election campaign.

Both audacity and hope are in short supply in this credit-constrained and confidence-shaken world.

Some say it is audacity that has got us into this mess.

Others say we should hold onto hope even when the going is toughest and that we should not allow our gloom and pessimism to make further economic decline a self-fulfilling prophecy.

There is truth in both of these observations.

At the end of last year a banking colleague of mine drew my attention to the purchase in late 2007 of the Dutch merchant bank ABN Amro by the Royal Bank of Scotland.

RBS paid an astronomical US \$100 billion for this acquisition.

At the end of last year that would have been enough to buy:

- Citibank \$22.5bn
- Morgan Stanley \$10.5bn
- Goldman Sachs \$21bn
- Merrill Lynch \$12.3bn
- Deutsche Bank \$13bn
- Barclays \$12.7bn

And you would still have \$8bn change - for which you would be able to pick up GM, Ford, Chrysler and the Honda Formula 1 Team.

Around US\$1 trillion has been sucked out of the global financial system but even though most of this has been replaced by governments injecting money into the system, lending remains difficult.

The truly astonishing thing is that markets continue to fall and confidence refuses to return.

In the United States the economy is expected to shrink by almost 4% this year.

In Japan, the world's second largest economy which languished in economic malaise all through the lost decade of the 90s, the economy is expected to lose 12% of its value.

Britain and Europe are faring scarcely better with the Bank of England saying last week the economy should shrink between 4 and 6%.

In China, where growth remains positive but much reduced from the double-digits of recent years, some 20 million migrant workers are now believed to be unemployed and factories are closing at a rate which resembles their earlier rate of opening.

How did it come to this ?

We now know that the origins of the crisis go back to June 2007 when there was a sharp increase in the number of mortgage failures in the United States.

These failures were the result of an usually large number of loans which had been made by US financial institutions to customers who in other times would not normally qualified for borrowing.

What was not clear at the time was that these loans were “highly leveraged” – that is to say they were funded by complicated financial instruments which discounted heavily the risk that they might not be re-paid.

The money for these loans came from Asia where large amounts of savings had been accumulated – leading several American commentators to suggest that these Asian savings were the cause of the crisis !

Mortgage failures increased and with them the failure of the lending institutions, those who had provided their funding and those who had provided insurance.

Some have described the crisis as a tsunami: in fact it has been a series of waves that have rolled over the global financial system in ever greater intensity.

The fact that so many financial institutions have been closely integrated through globalisation has meant the problem while starting in the United States has affected the global industry.

The result has been not only the loss of jobs, homes and savings, of long-established and well-respected companies along with many over-paid executives , but more critically a loss of confidence in financial institutions and in markets more generally.

The loss of confidence has gone further as companies and households cut spending across the board.

Some claim that the problem was a lack of government regulation and control over the dubious lending.

In fact several governments encouraged the lending as a means of stimulating the economy at a time when global growth had already started to slow.

There are plenty of rules and regulations to govern the operation of financial markets, however byzantine the lending: the problem was that these controls were not effectively applied.

Others say the problem was a failure corporate governance or even worse greed and corruption.

There is truth there too on which the business community needs to reflect deeply.

We in New Zealand have not been immune from this global financial contagion.

Our banks have not been exposed to the leveraged lending in the US and Europe so we have not seen the bank losses experienced in other countries.

Even so our Government moved early on to guarantee bank deposits and inter-bank lending creating a contingent fiscal liability for the Crown which could grow to as much as NZ\$180 billion.

Our small, globalised economy had grown consistently in recent years with healthy budget surpluses but is now in recession and the government books are in the red once again.

We have been hit not by a double whammy but by a quadruple whammy:

- tightening financial markets as our banks find it harder to borrow internationally;
- a slowing of the domestic economy as the housing market corrects and households and companies cut spending
- a declining fiscal position brought about by increased government spending and declining tax revenue
- and last, the biggest whammy of them all, declining demand in our key offshore markets along with declining commodity prices.

It's hard to think of a time when all our major markets have been in difficulty at once – not just Australia and the large consumer markets in the US, North Asia and Europe or but also the countries that supply them in China and South East Asia.

I think this is the single greatest challenge that our economy has yet to face.

Make no mistake – the real wealth of this country comes from exports, particularly from agriculture, forestry, fishing and horticulture.

It is this wealth that flows back through the rest of the economy.

The extent to which those key sectors can continue to trade profitably will be a key determinant of how soon, and how quickly, we can emerge from the crisis.

And emerge we surely will just as we have emerged from the other crises before – that's the hopeful part.

So what can we do here to weather the storm ?

If I had all the answers I'd be in the Beehive !

I think the first thing we can do is not do some things which others around the world are doing.

Some countries are already starting to put up those protectionist walls – like the Europeans who have re-instated dairy export subsidies.

We must resist this temptation at all costs because our internationally competitive industries cannot cope with the costs that this protection would place on our economy and because it runs counter to our reliance on open international markets.

At the global level we must do all we can to convince others around the world not to put in place measures which would inhibit the role of trade in increasing growth.

We do not have many weapons in our arsenal – Trade Minister Tim Groser says we can only rely on “advocacy and good friends at the table”.

But try we must because a closed world means fewer opportunities for New Zealand and, as we have seen in recent years, opening markets deliver benefits that flow to the rest of the economy.

Protectionism comes in various guises - export subsidies, import restrictions, higher tariffs, cheap loans to ailing industries, nationalisations, Buy America, loan guarantees that do not apply to foreign institutions.

I know there is a temptation, even here in New Zealand, to come to the aid of distressed companies on the grounds that in extraordinary times, extraordinary measures are called for.

But measures which restrict trade or which provide direct support to a balance sheet or favour local companies over their foreign competition are ultimately self-defeating.

They serve merely to prop up failing companies at the expense of others who can succeed in international markets.

No government can or should ignore a company at risk but the means by which they offer to resist must be carefully thought through.

Certainly in a New Zealand context where we are already staring at a large fiscal hole and where we already have large contingent liabilities I think we have to move very cautiously.

That’s undoubtedly why we have not seen a sizeable stimulus package from the Government.

“Don’t do it John” has been the advice from Treasury !

The Treasury’s argument is simply this:

- we have a series of tax cuts in place which will serve to stimulate the economy
- we can still cut interest rates further to provide further assistance – that is not the case by the way in Japan or Europe where interest rates are at almost zero already
- a stimulus package could stop some of the corrections that are needed to get the economy back on track
- the crisis here is not yet as pronounced as in other countries – it’s small comfort if you have lost your job but even a 6% unemployment rate would seem fairly low compared with other countries and even past experience in New Zealand.

This is not to say that government should do nothing.

On the contrary at this time we need the government to be the best it can be – we need government to work rather than expecting the government to bail out business.

That means reducing compliance costs, cutting back unnecessary or low quality spending and eliminating regulations which stifle business and further reducing company tax.

That means doing the business of government but doing it sensibly.

Advancing scheduled infrastructure projects such as have been announced recently makes sense but cannot be the sole answer.

If more spending were the solution to growing economies, why would we only do this in a crisis?

In every action there are unforeseen consequences.

Spending does not necessarily lead to increased demand.

And increased spending invariably means higher inflation which in turn leads to more spending.

We need to distinguish between spending that addresses problems that need to be fixed and spending that just makes us feel good.

One thing we must do is make sure that our social welfare system is responding quickly and effectively to those in need.

Transitional financial assistance, training and up-skilling for displaced workers must be a high priority.

At the international level as I said we need the government to continue to resist protectionism and accelerate the pace of opening new markets.

That means opening free trade negotiations with Korea, the United States and Japan as well as doing what we can to conclude the WTO's Doha round and moving forward in APEC.

It also means providing better assistance for exporters to enter new markets: increasing the financial support - ideally through the tax system - for market development, trade fairs and promotion.

Another good idea would be to re-instate the tax credit for research and development which was cancelled after the election.

Here in Hawke's Bay our local authorities need to be looking at what they can do to improve the climate for local business, not by providing direct financial assistance, but by ensuring that local regulation does not stifle business growth.

Hawke's Bay Inc – the joint creation of the local councils – has a key role to play here but needs to be made more business focused and given a stronger mandate to improve the business climate and attract new investment to the region.

Above all we need governments to govern and govern well and we need business to focus on business.

That's the key message I want to leave you with this evening.

That's the message I hope will get through at next week's Jobs Summit.

That's the audacity of hope for these worst of times.

Some of you may find my prescription too timid, too long term, too waffly.

Look at President Obama's stimulus package – NZ\$1.4 trillion – now that's audacious!

New Zealand is unique.

We are a small trading nation at the end of the earth.

We do not have the financial muscle of the world's largest economies.

We live not by fulfilling needs in our domestic market but by producing for export and selling to the world.

Our markets are sick but our hope is strong.

There is no doubt that significant attention needs to be paid to ensure the vulnerable are protected and those individual workers and families affected by the crisis are assisted.

But, above all, and more than ever before, we need to create an environment here in New Zealand where our key international businesses can continue to trade competitively and help us grow our way out of the crisis.