GLOBAL ECONOMIC TRENDS AFFECTING THE AUSTRALIAN WINE INDUSTRY

PRESENTATION TO THE 18TH AUSTRALIAN WINE INDUSTRY TECHNICAL CONFERENCE

ADELAIDE CONVENTION CENTRE
27TH JUNE 2022

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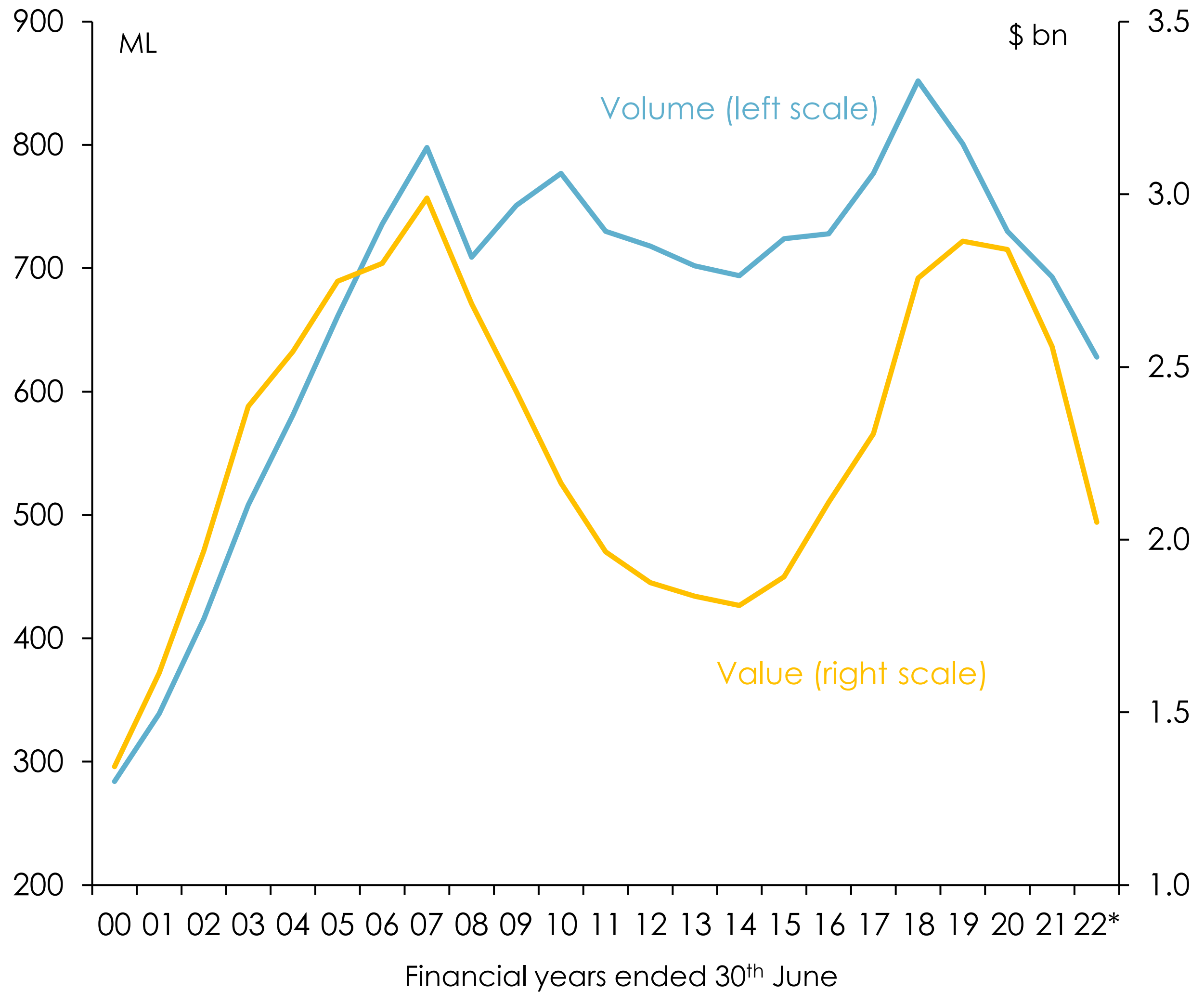
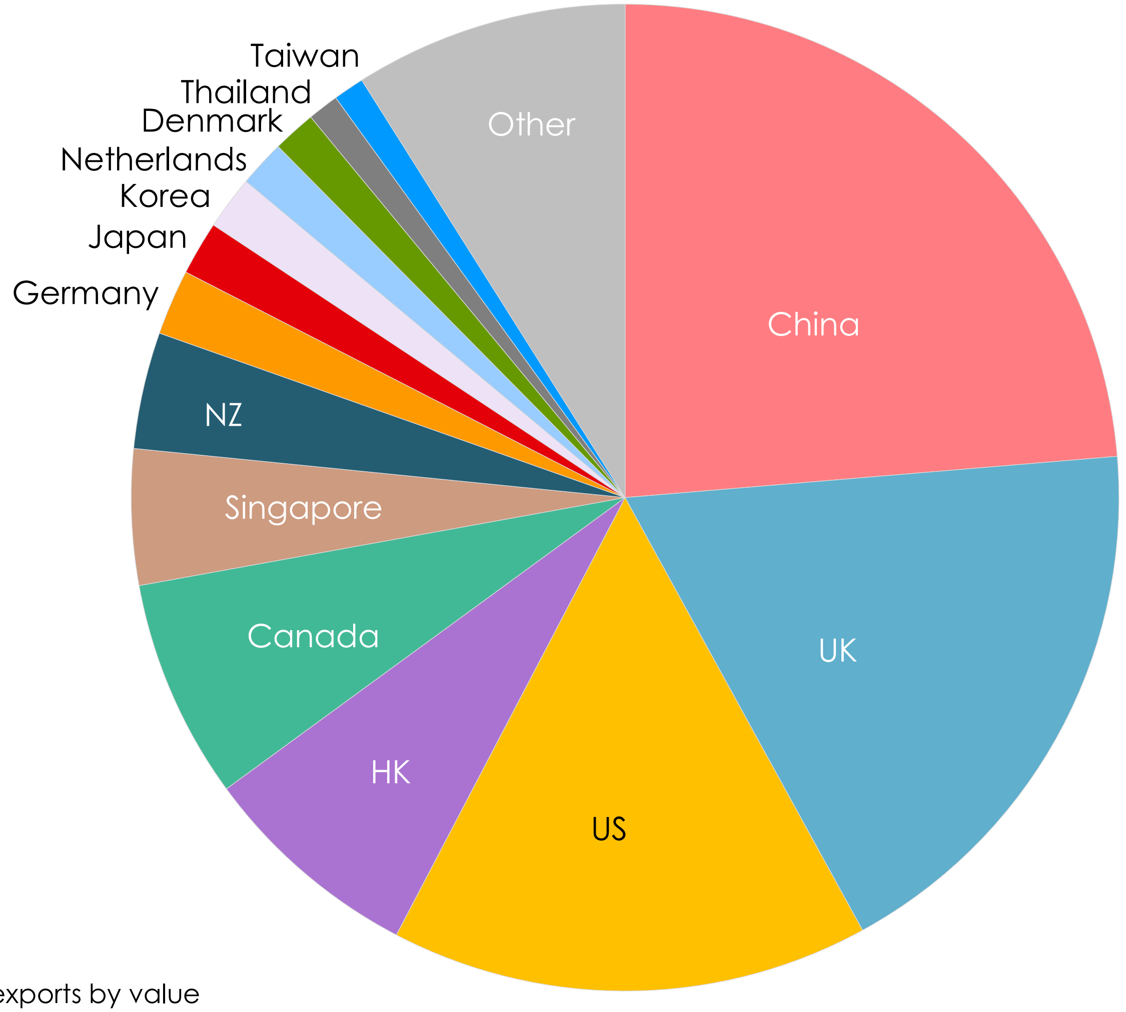
INDEPENDENT ECONOMICS

The past decade – and especially the past three years – have been tough going for Australia's wine exporters

Australian wine exports, by volume and value,



Wine exports by destination, 2020-21



Note: exports by value

Note: 2021-22 is the twelve months to March 2022. *Source:* Wine Australia.

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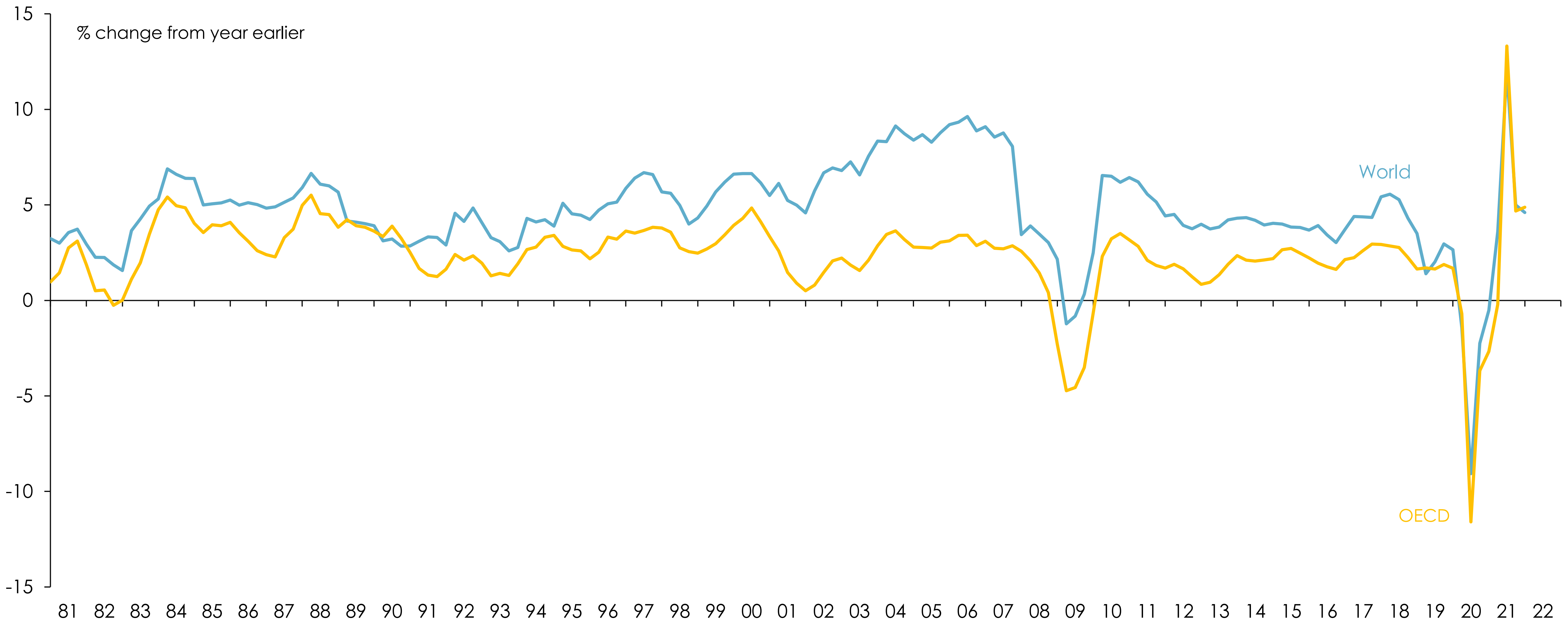
Covid-19 threw the world economy into its deepest recession since the 1930s, from which it has recovered quite quickly over the past 18 months

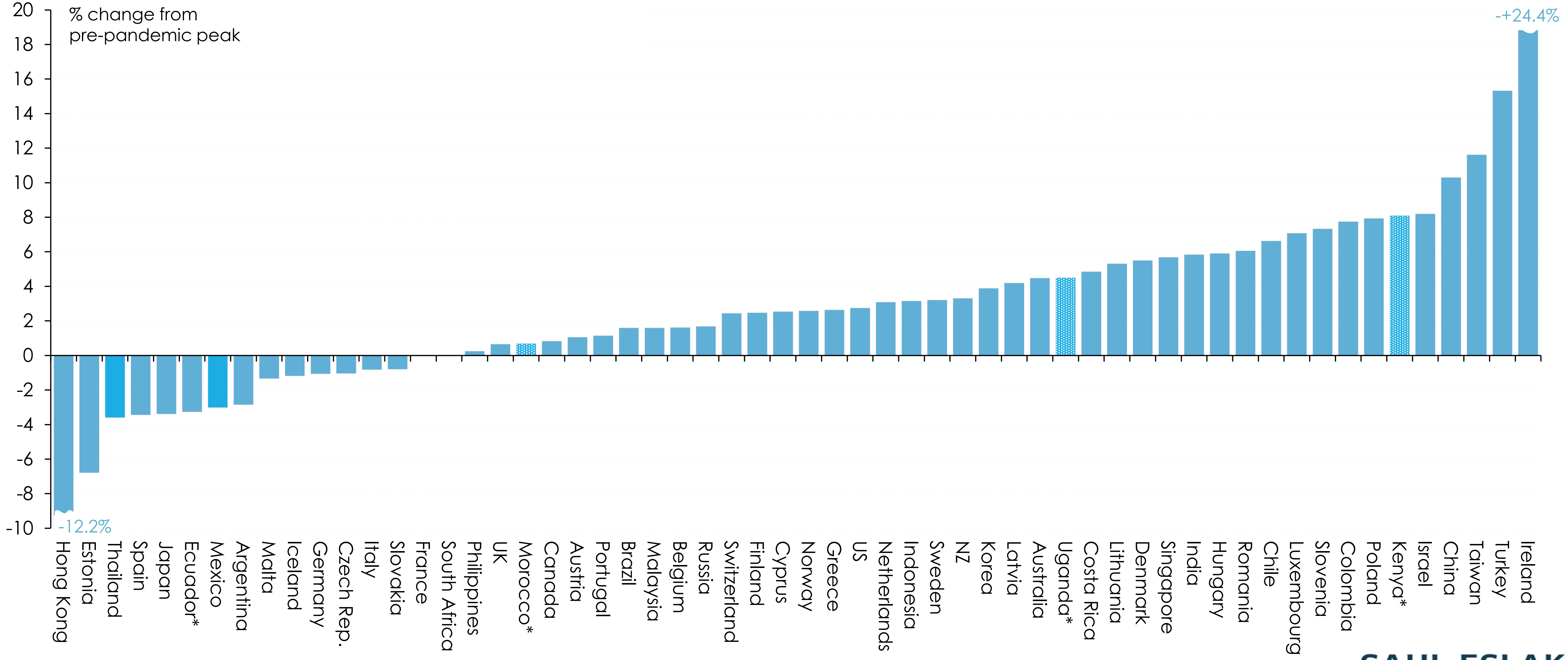
World and OECD area real GDP growth



Note: Estimates of global GDP growth compiled by Corinna using data for 100 countries accounting for 94% of 2019 world GDP as measured by the IMF, weighted in accordance with each country's share of global GDP at purchasing power parities in 2019; excludes constituents of the former USSR before 1993, the former Czechoslovakia before 1995, and the former Yugoslavia before 1998. *Sources:* national statistical agencies and central banks; Eurostat; OECD; IMF; Corinna.

39 countries (of 54 for which seasonally-adjusted GDP estimates are available) have now surpassed their pre-pandemic peaks

Q1 2022 real GDP compared with pre-recession peak



Note: * Q4 2021. Estimate for China is derived from quarterly growth rates published by China NBS; estimates for India, Indonesia and Russia are seasonally adjusted by the OECD. *Sources:* National statistical agencies and central banks, and OECD.

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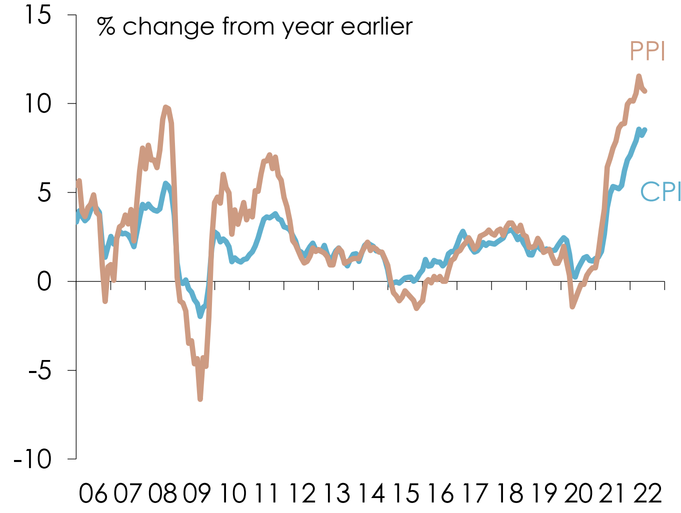
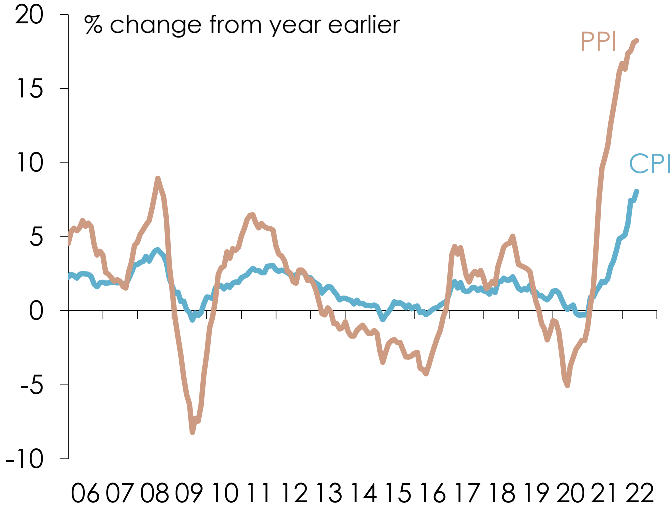
But now there's a new threat on the economic horizon – the highest inflation in at least 20, and in some countries, 40 years

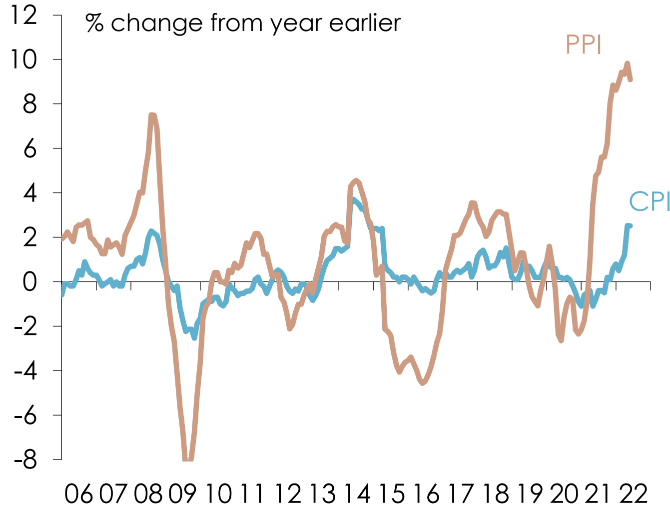
United States



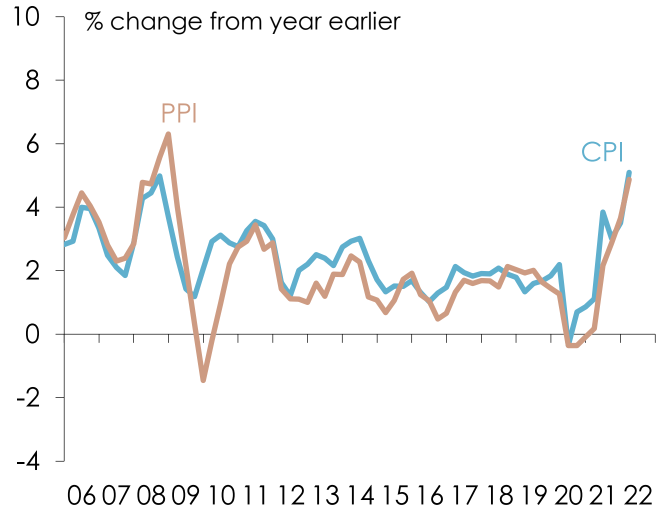
Euro area



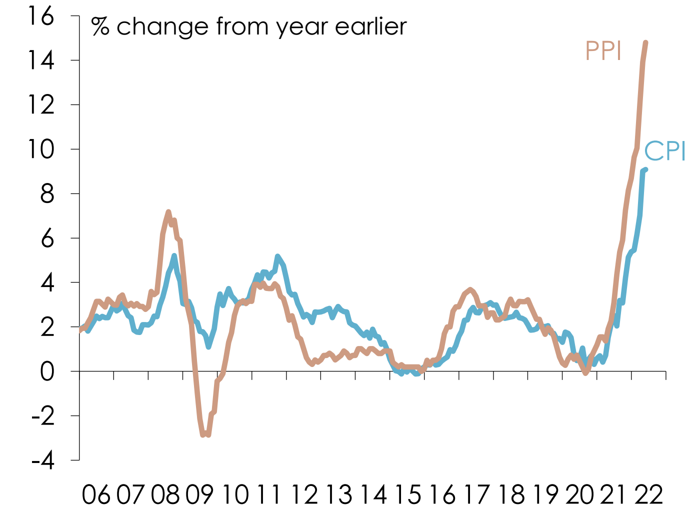
Japan



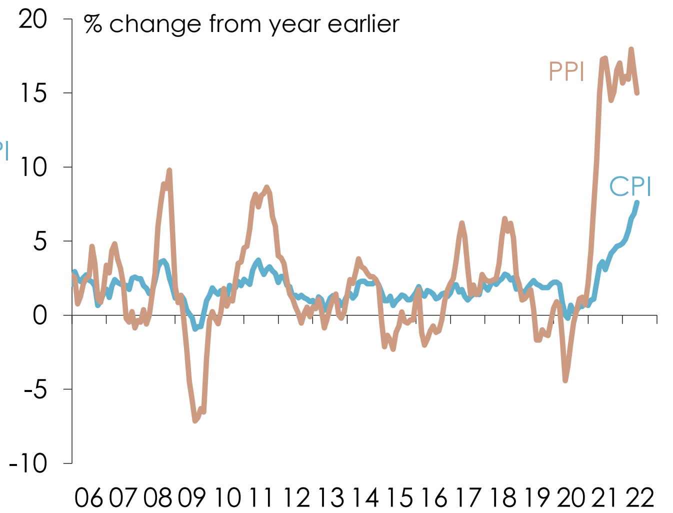
Australia



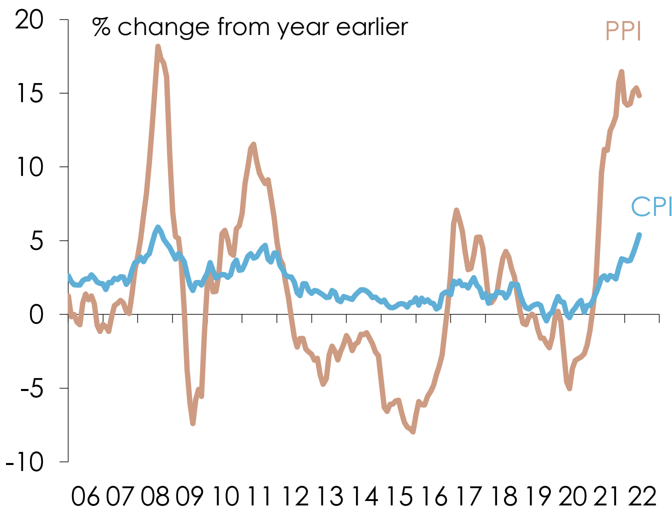
United Kingdom



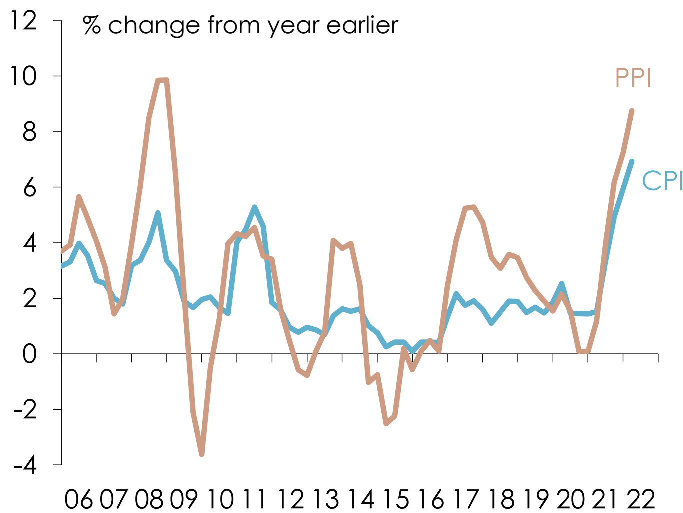
Canada



Korea



New Zealand



Note: 'PPIs' are producer price indexes, measuring prices of items produced by (in most cases) manufacturing firms. CPI is the consumer price index.
Sources: US Bureau of Labor Statistics; UK Office for National Statistics; Eurostat; Statistics Canada; Statistics Bureau of Japan; Statistics Korea; Australian Bureau of Statistics; Statistics New Zealand.

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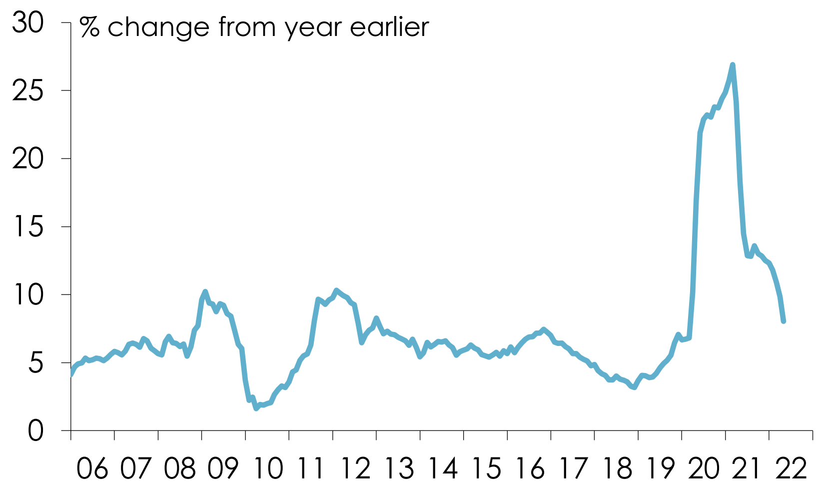
Where did this inflation, all of a sudden, come from?

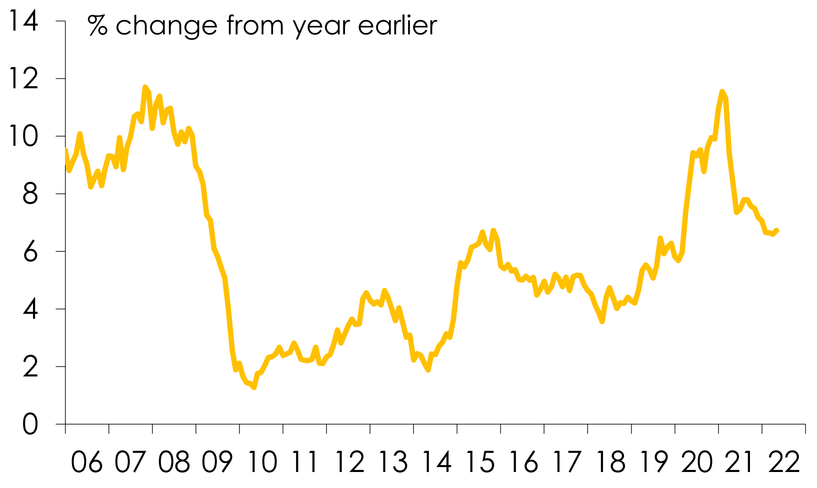
- **With the benefit of hindsight, governments and central banks provided 'too much' fiscal and monetary policy stimulus in response to the economic downturns wrought by the restrictions imposed to deal with Covid-19**
  - that was the 'right mistake' to have made, at least initially, in the circumstances
  - but governments and central banks were slow to recognize that it was 'too much', and to start winding it back
- **Covid-19 restrictions had a larger, and longer-lasting, impact on global supply chains than anticipated**
  - which combined with strong demand – especially for 'durable goods' – precipitated big increases in costs and prices that turned out not to be as 'transitory' as initially expected
- **Commodity prices rebounded dramatically after the contraction in the global economy turned out to be shorter than initially expected**
  - cuts in production of some commodities – in some cases (especially energy) not totally Covid-driven) – have had lasting consequences for commodity prices
- **Russia's invasion of Ukraine exacerbated the upward pressure on food and energy commodity prices**
  - some of these effects will likely persist for some time after the conflict is eventually resolved (if and when it is)
- **Large increases in housing prices (in part the result of 'excessive' monetary stimulus) have added to inflation**
  - this shows up in different ways in different countries because of differences in the way owner-occupier housing costs are included (or not included) in consumer price indices
- **Labour shortages – as a result of restrictions on immigration, and (in the US) permanent withdrawals from the labour force – combined with strong recoveries in employment have resulted in very tight labour markets**
  - in turn generating a significant pick-up in 'wage inflation' in the US, the UK and some other economies (though not thus far in the euro area, Japan or Australia)

Monetarists (like Milton Friedman) would say, "I told you so"

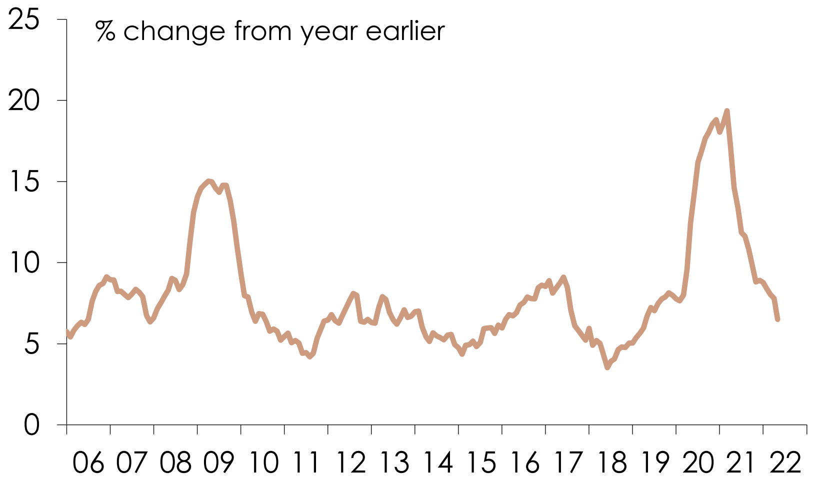
US M2



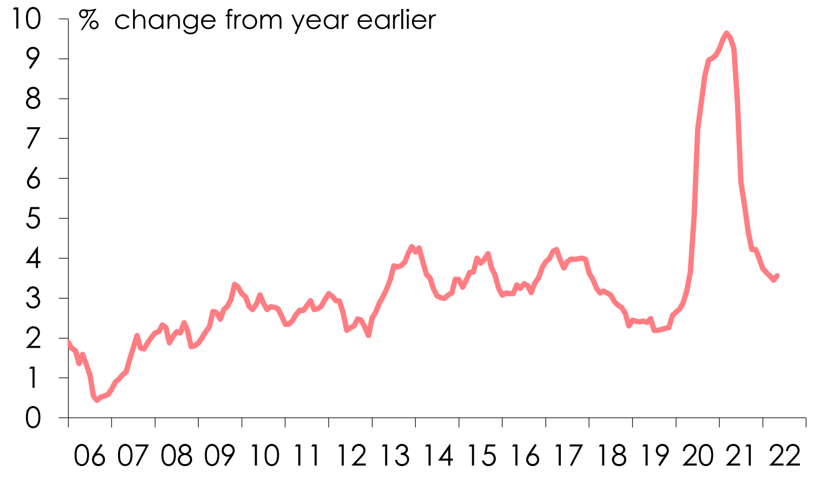
Euro area M2



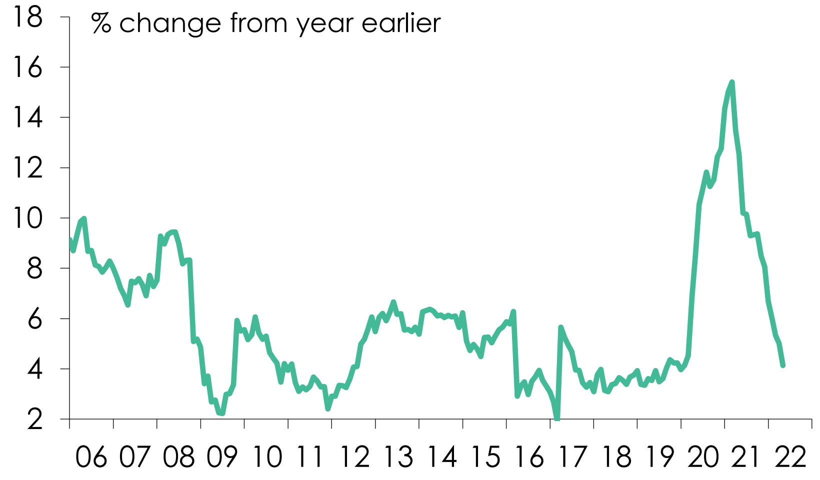
Canada M2



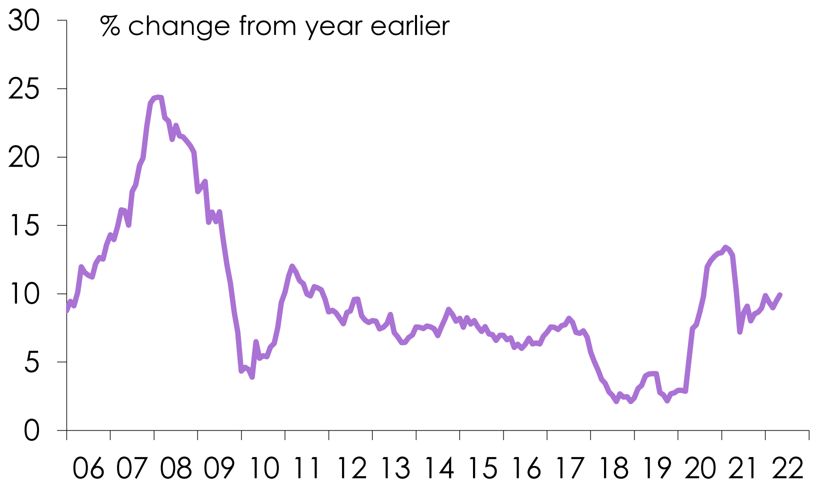
Japan M2 + CDs



UK M2



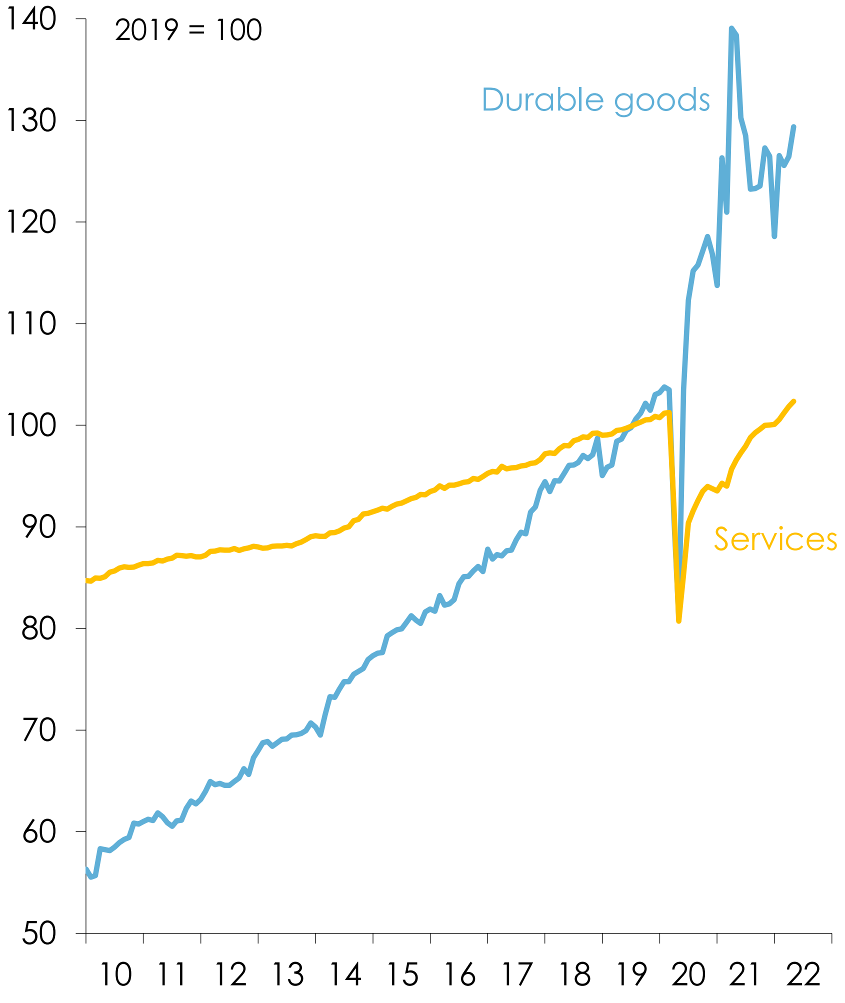
Australia M3



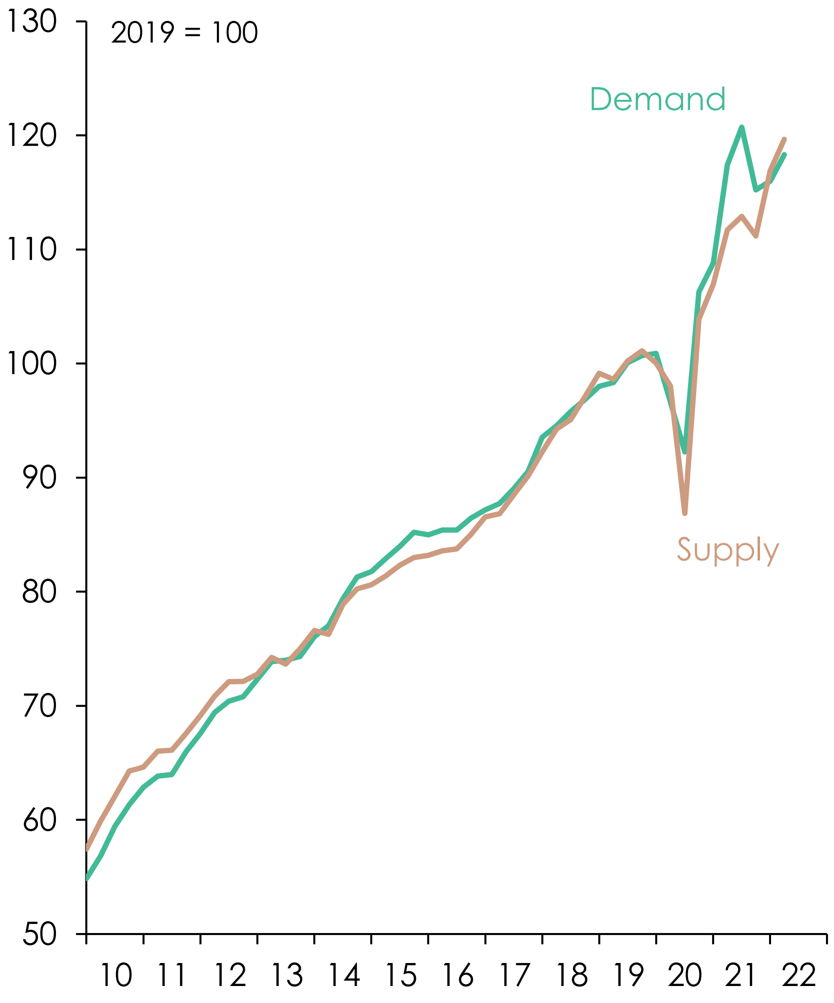
Sources: US Federal Reserve; Bank of Japan; European Central Bank; Bank of England; Bank of Canada; Reserve Bank of Australia.

The inflation surprise began with a huge imbalance between the demand for and supply of durable goods induced by Covid-19

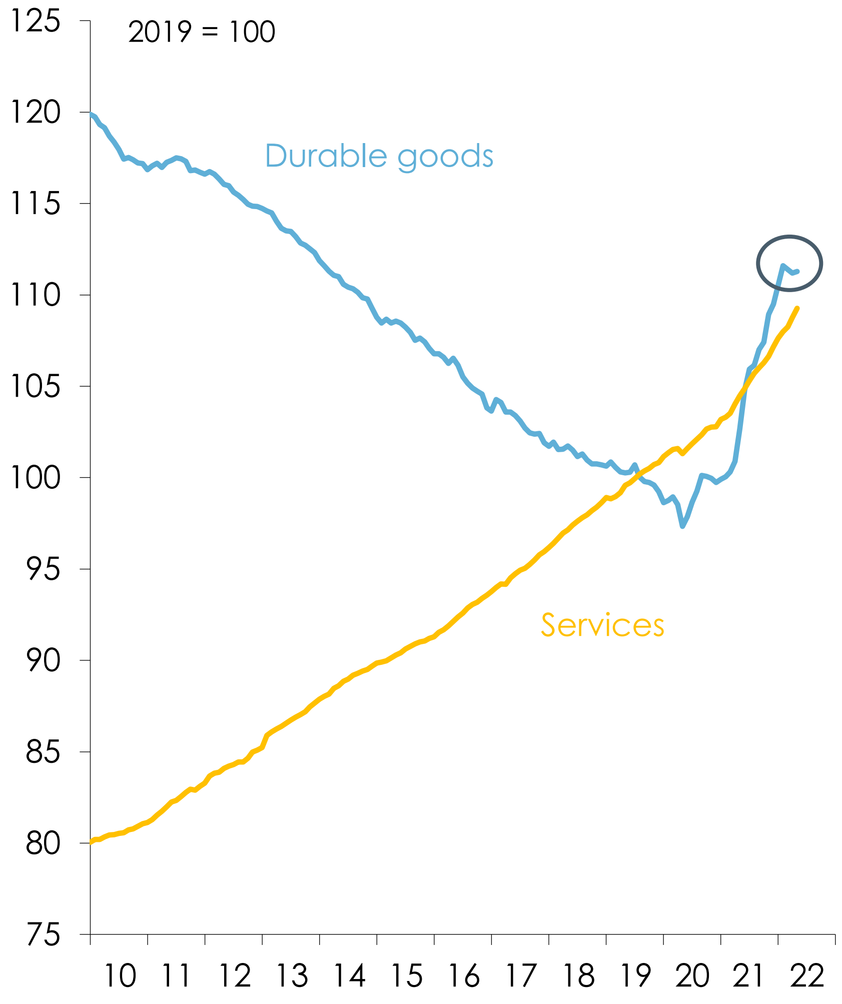
Composition of US personal consumption expenditures



Aggregate demand for and supply of durable goods in the US



Price 'deflators' (indexes) for components of US consumption



Note: 'Aggregate demand' for durable goods comprises personal consumption of durable goods plus business investment in equipment. 'Aggregate supply' of durable goods comprises gross domestic product (final sales plus change in inventories) plus net imports of durable goods. *Source:* US Bureau of Economic Analysis,

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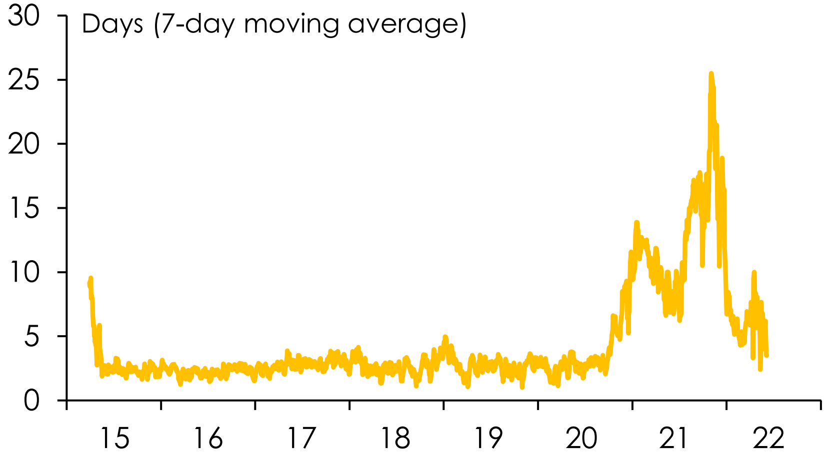
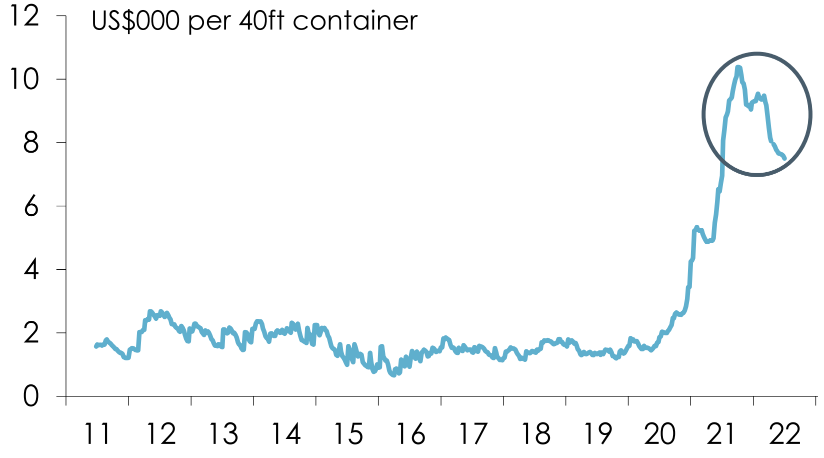
These ‘imbalances’ between demand & supply resulted in unprecedented disruptions to supply chains in the US and around the world

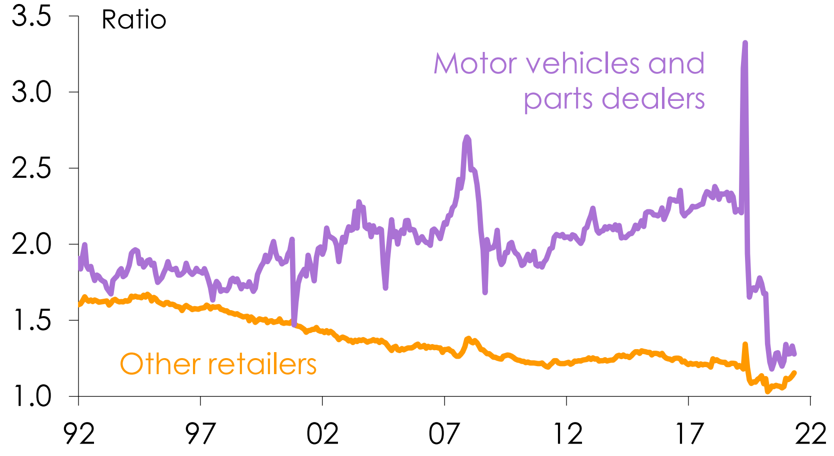
Average time at anchor and berth for ships at Port of Los Angeles



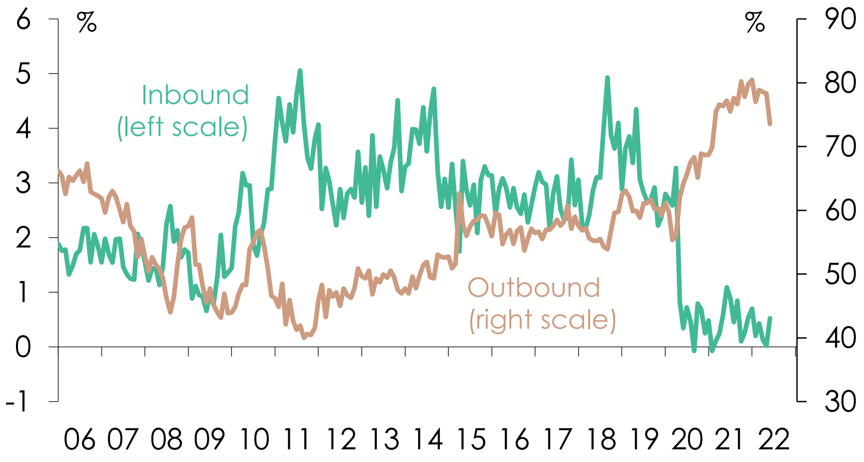
Container shipping freight costs



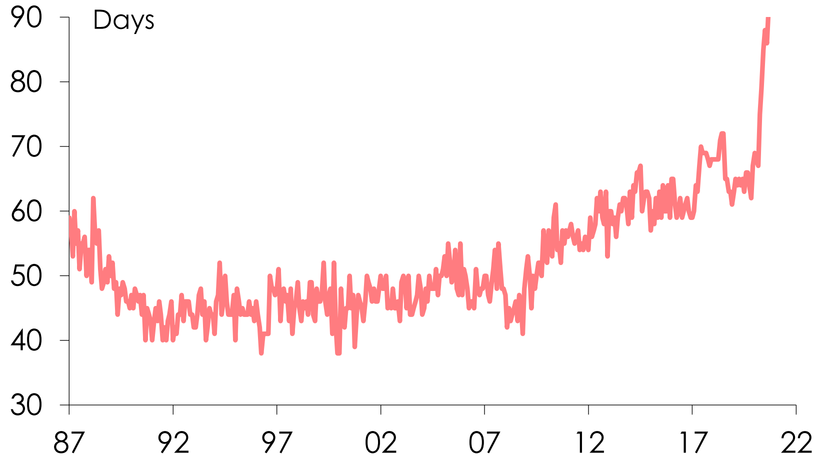
US retail inventories-sales ratios



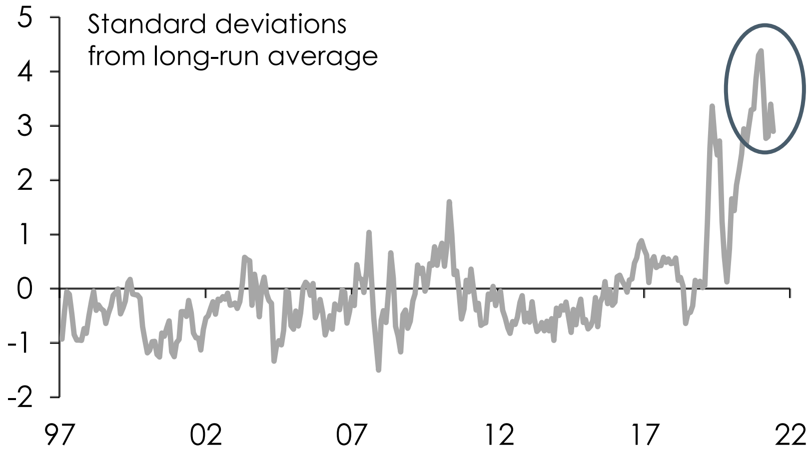
Empty containers as a pc of total passing through Port of Los Angeles



Average lead time for delivery of materials to US manufacturers



NY Fed index of global supply chain pressures



Sources: Port of Los Angeles; Drewry Supply Chain Advisors; Institute for Supply Management; US Census Bureau; Federal Reserve Bank of New York.

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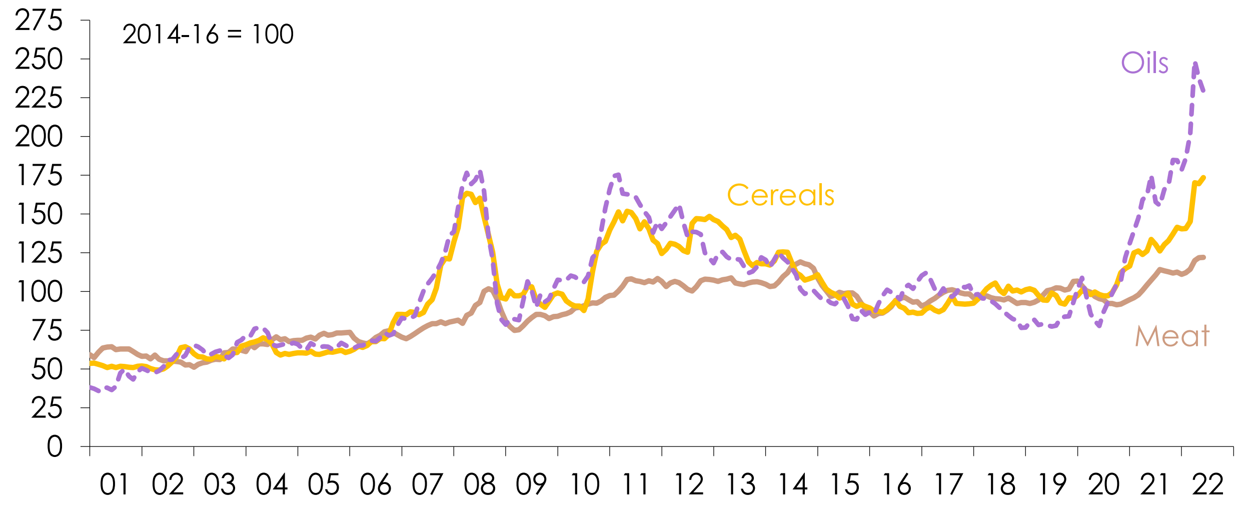
Commodity prices started rising towards the end of 2020, and (in the case of energy & some foods) rose further following Russia's invasion of Ukraine

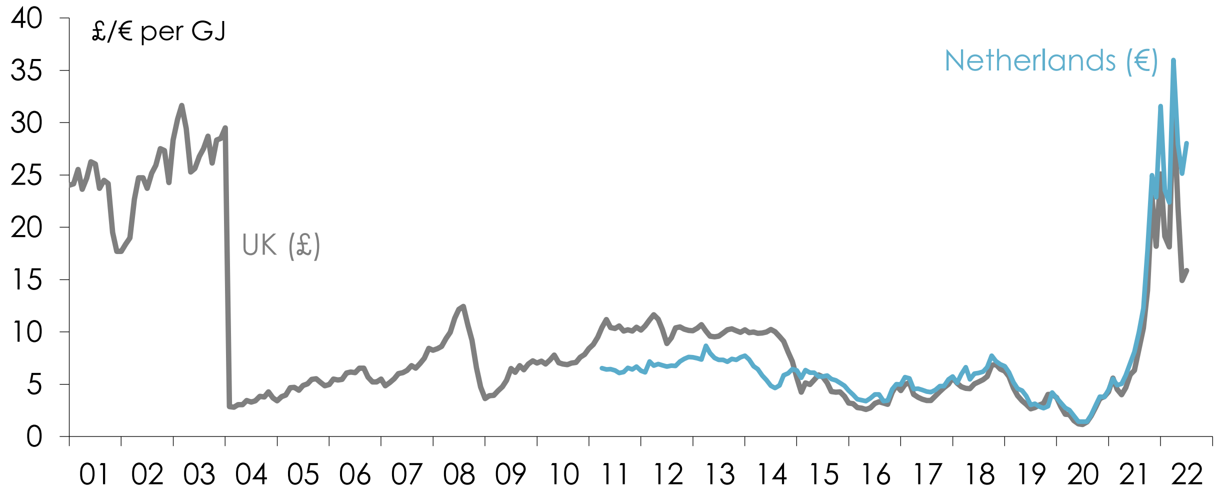
'Hard' commodity prices

Crude oil price

Food commodity prices



Natural gas prices



Sources: International Monetary Fund; UN Food and Agriculture Organization; Refinitiv Datastream.

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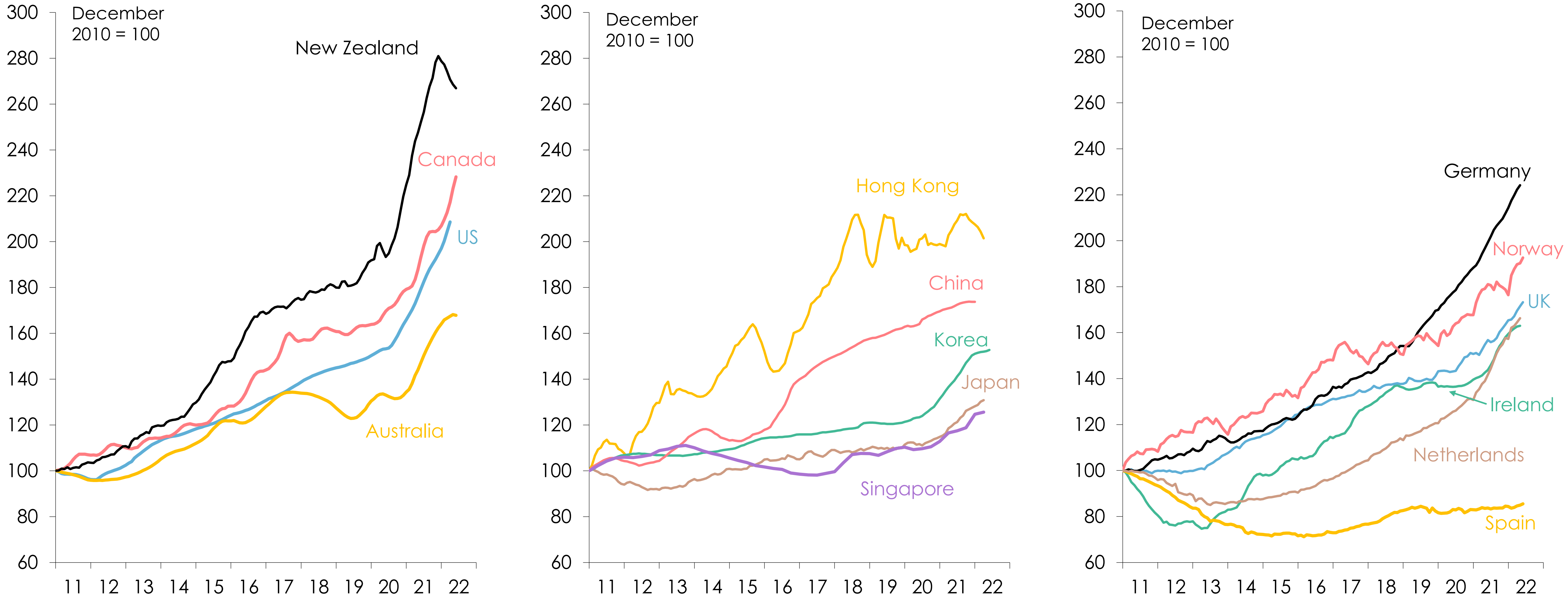
Record-low interest rates combined with readily available credit fuelled surges in housing prices across much of the world

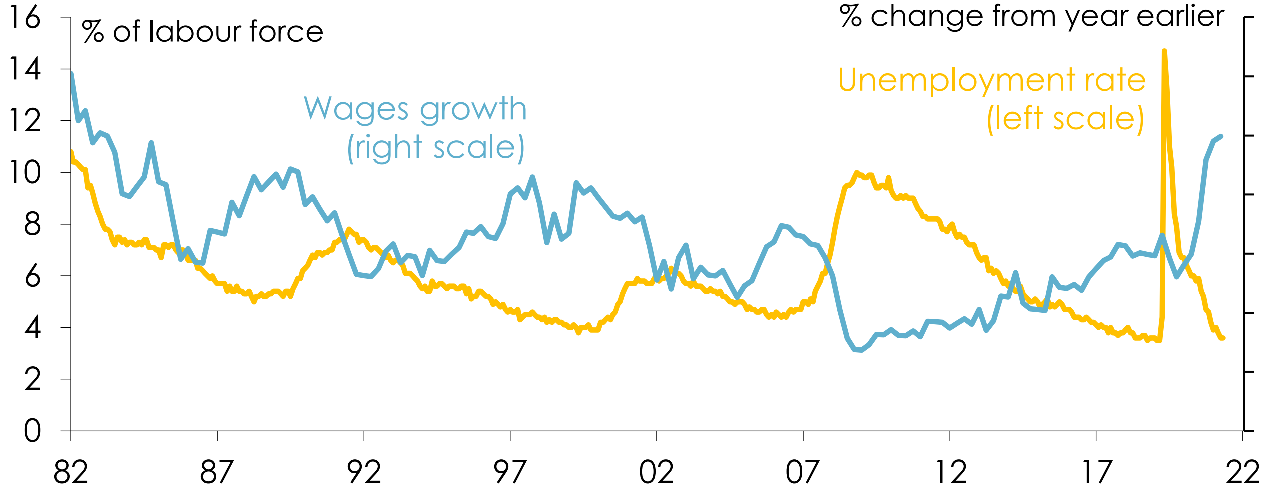
House price indices



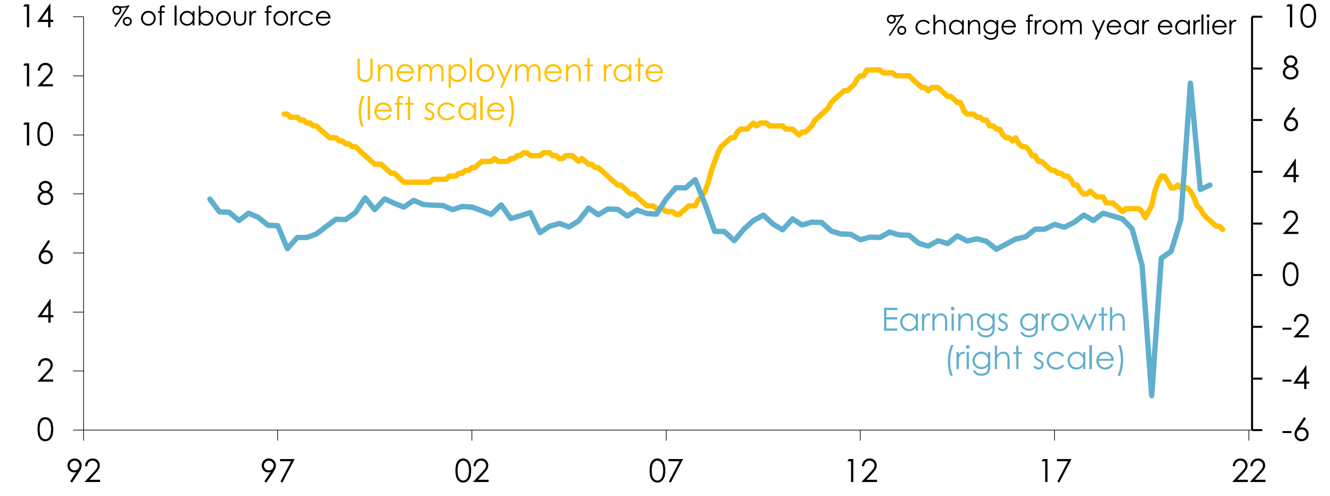
Sources: S&P-CoreLogic Case Shiller national (United States); Teranet-National Bank (Canada); CoreLogic (Australia); Real Estate Institute of New Zealand; China Index Academy; Japan Real Estate Institute (Tokyo condominiums); Kookmin Bank house price index (Korea); Centaline Centa-City Index (Hong Kong); Urban Redevelopment Authority (Singapore); Europace hauspreisindex (Germany); Halifax house price index (UK); Central Statistics Office RPPI (Ireland); Fotocasa real estate index (Spain); Statistics Netherlands; Eiendom Norge (Norway). These indices have been chosen for their timeliness and widespread recognition: they do not necessarily all measure the same thing in the same way. For more comprehensive residential property price data see the quarterly database maintained by the Bank for International Settlements.

And in the US and the UK – though less so in the euro area or Japan – low unemployment is fuelling the fastest wages growth since the 1980s

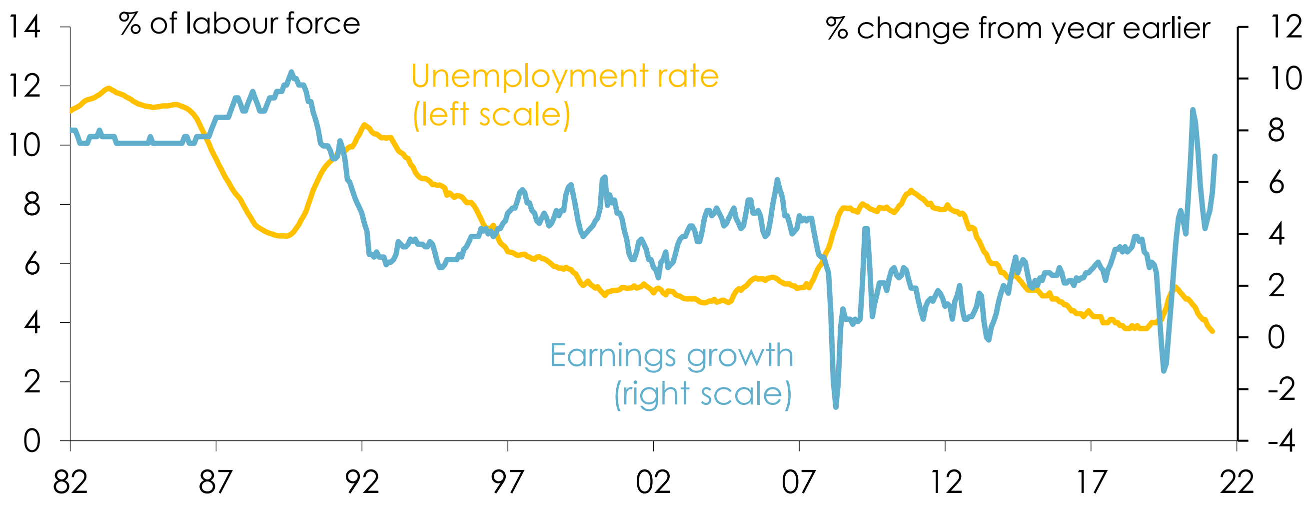
US unemployment and wages



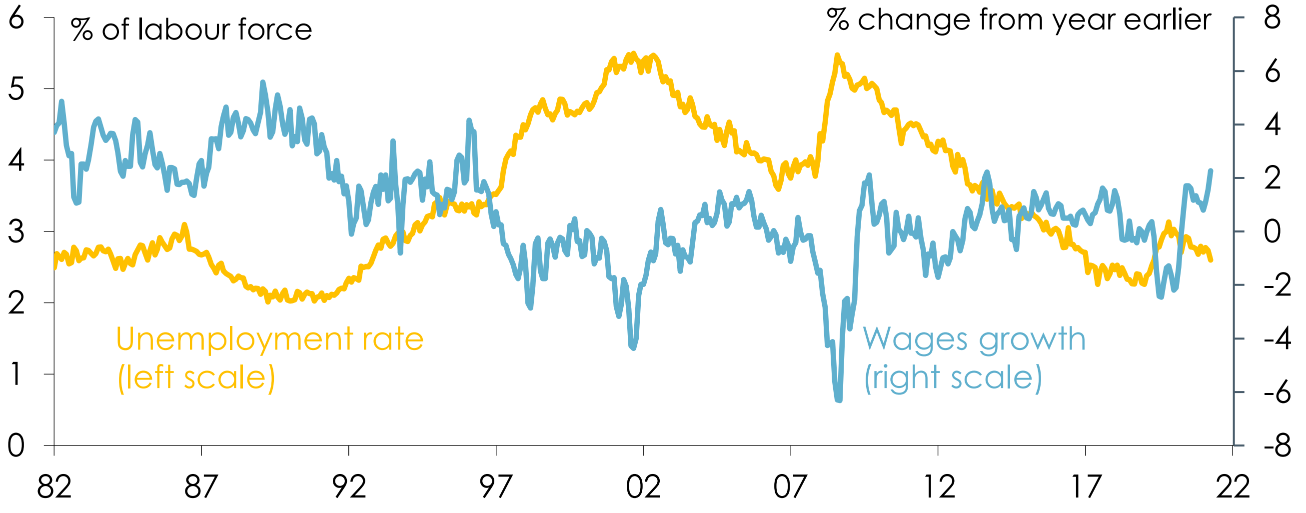
Euro area unemployment and wages



UK unemployment and wages



Japan unemployment and wages



Note: The US measure of earnings growth is the wages component of the employment cost index for private industry workers; for Japan, cash earnings for all employees; for the UK, 'underlying' average earnings growth; and for the euro area, average compensation per hour.
Sources: US Bureau of Labor Statistics; UK Office for National Statistics; Eurostat; Japan Ministry of Health, Labour & Welfare.

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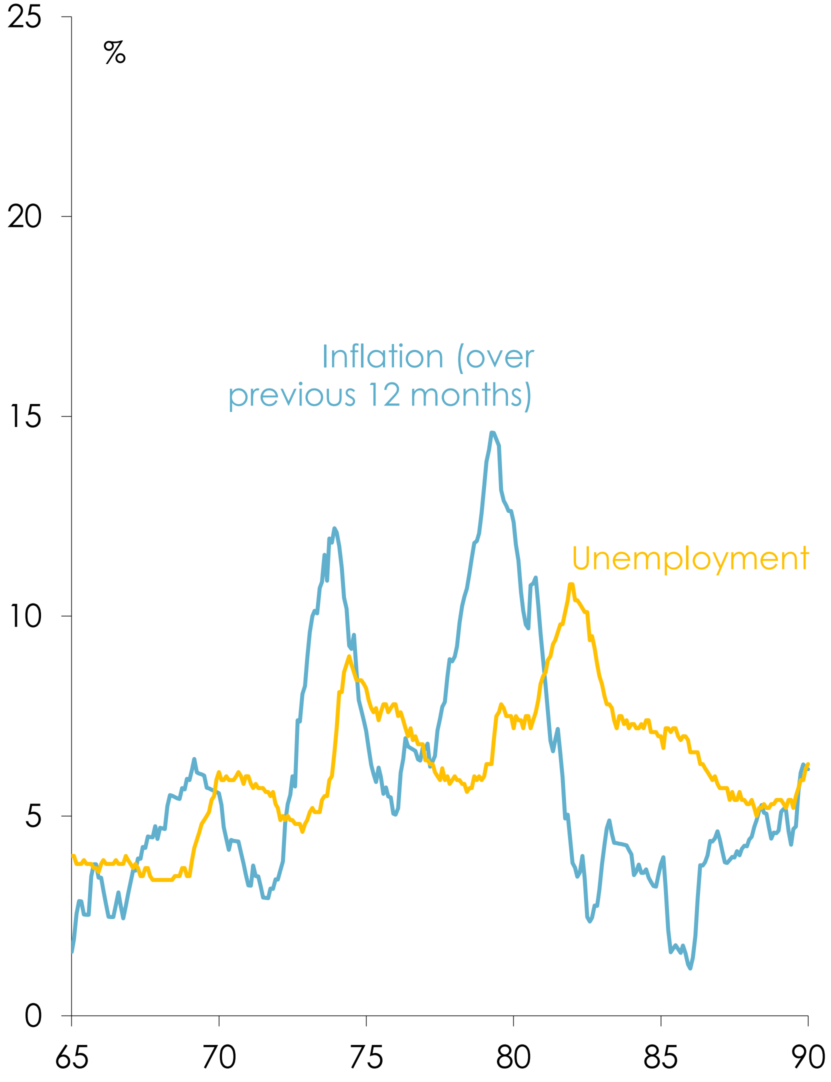
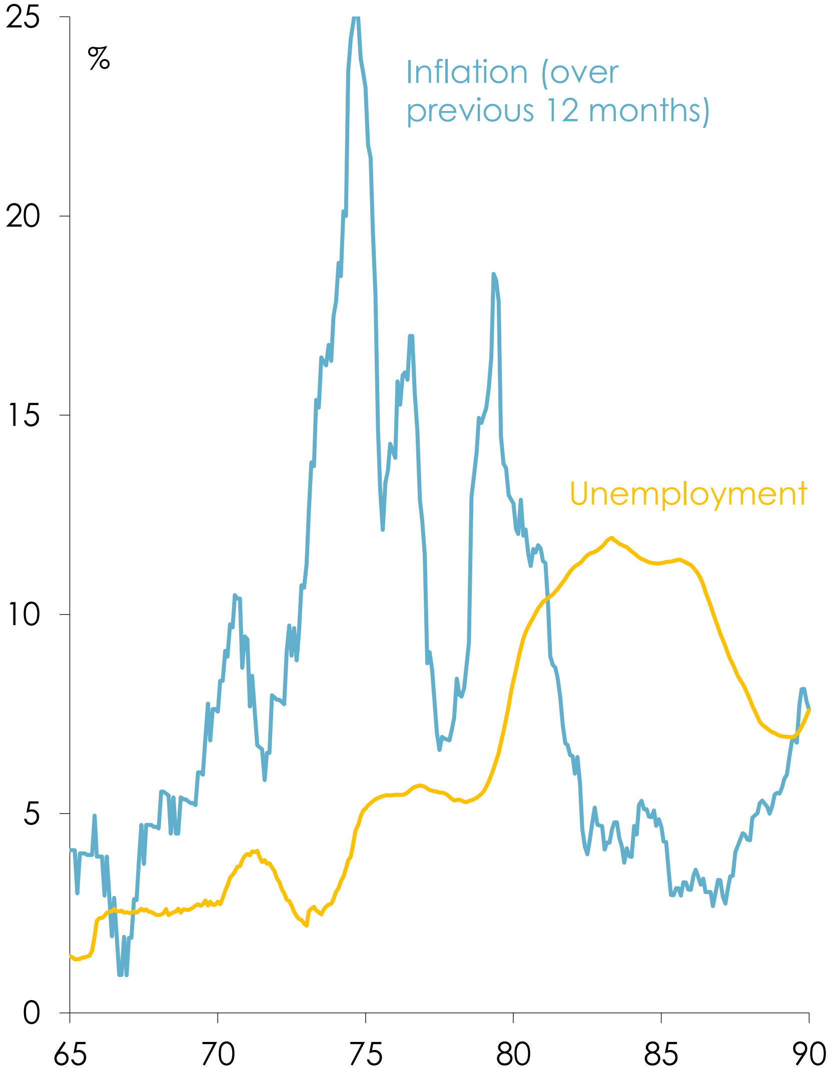
Could all this lead to a replay of the 'stagflation' of the 1970s and 1980s?

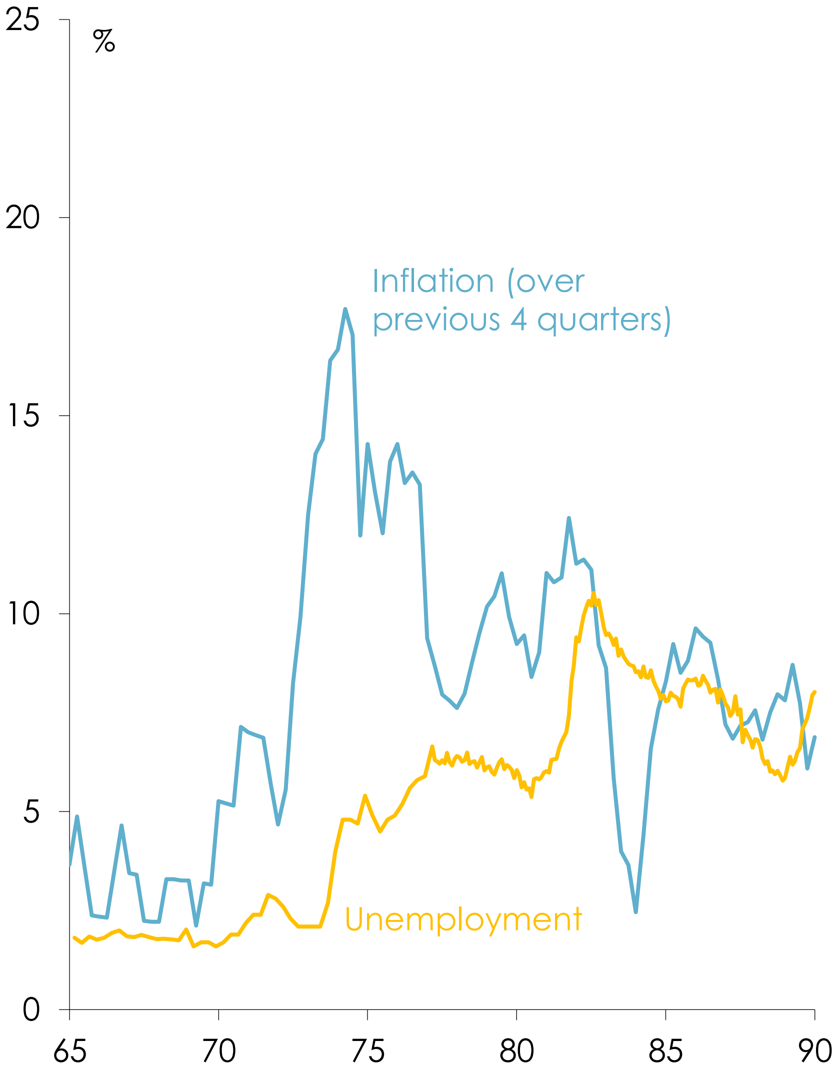
United States



United Kingdom



Australia



Sources: US Bureau of Labor Statistics; UK Office for National Statistics; and Australian Bureau of Statistics.

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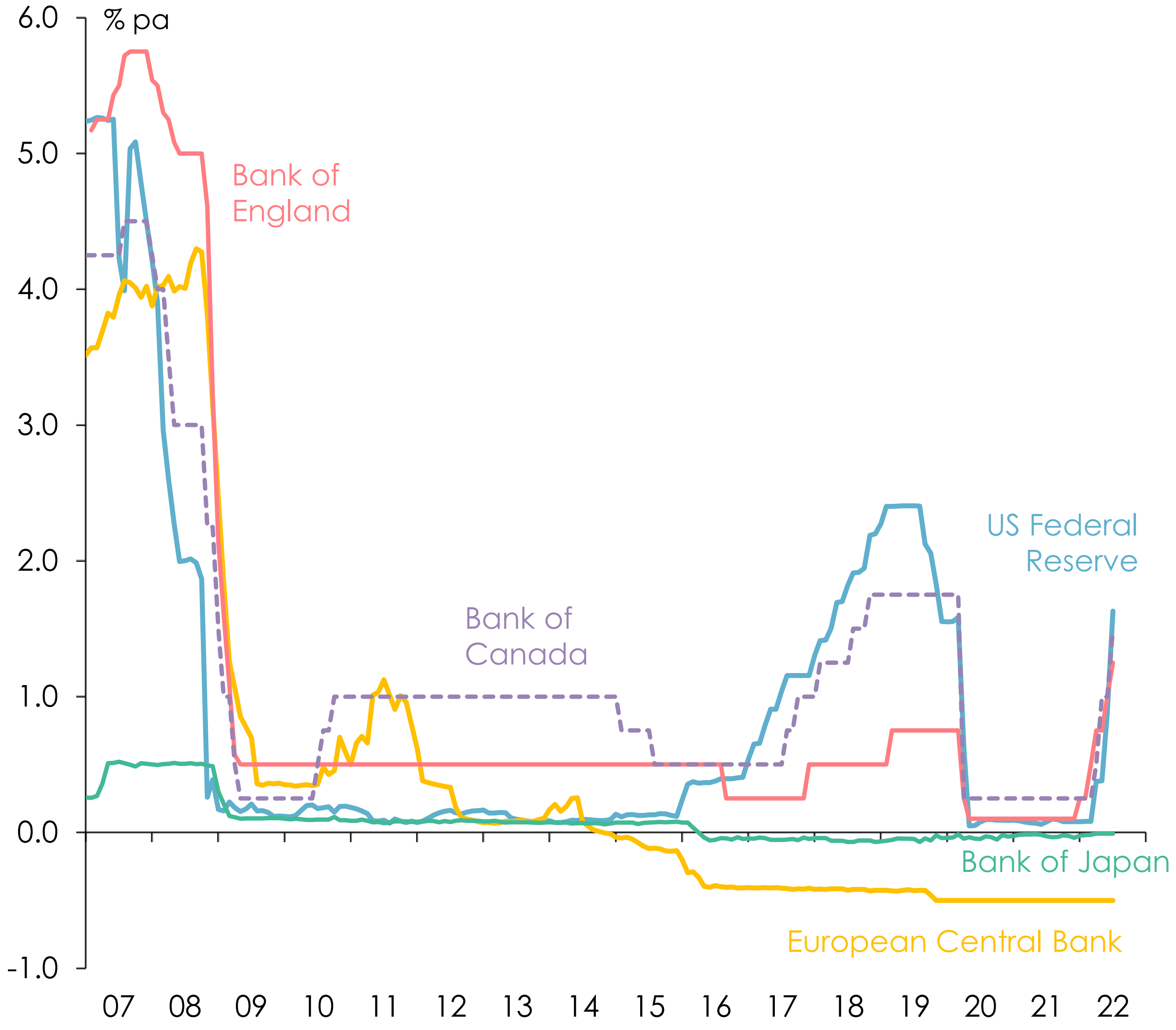
There are some parallels between now and the 1970s – but there are also some very important differences

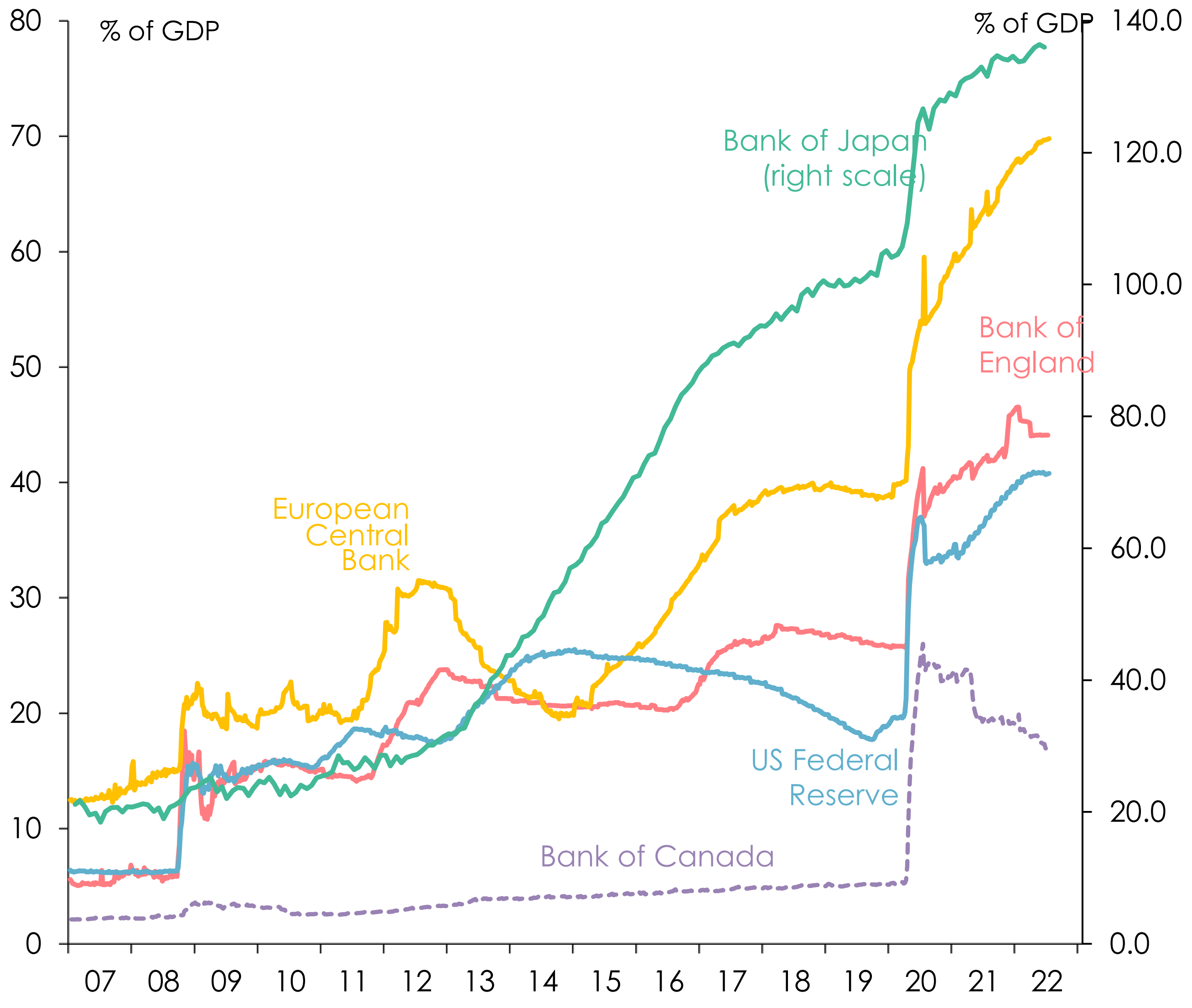
- The inflation of the 1970s and early 1980s was partly attributable to large increases in commodity prices (especially food and oil), excessively loose fiscal and monetary policies, and military conflicts
  - as is today's inflation
- But the demographic profile of 'advanced (and some 'developing' economies, especially in Asia) is very different from that of the 1970s and 1980s
  - the rise in unemployment after the mid-1970s was partly due to the entry of the second half of the 'baby boom' generation (including a much higher proportion of women than in the first half of that generation) into work forces
  - whereas by contrast today workforces are either growing much more slowly, or shrinking
- There are far fewer 'feedback loops' between prices and wages now than then
  - 'cost of living adjustment' clauses in employment contracts, or explicit wage indexation arrangements, were commonplace in the 1970s and 1980s – they're not now
  - more generally employees have much less 'bargaining power' vis-à-vis employers today than back then
- Central banks have the ability to do 'whatever it takes' to get inflation down
  - whereas until the 1990s, politicians (rather than central banks) had the 'final say' on monetary policy decisions
  - which meant that central bank assurances that they could and would keep inflation under control had very little credibility
- Inflation expectations are much better 'anchored' today than in the 1970s and 1980s
  - because central banks lacked credibility, people (as workers and consumers) and businesses expected inflation would remain high, and behaved in ways which tended to ensure that it did remain high
  - for example, demanding wage rises to compensate for anticipated increases in prices, or putting prices up in anticipation of future cost increases

Major economy central banks, apart from the BoJ, have begun tightening monetary policy and will keep doing so until inflation starts to come down

Major central bank policy interest rates



Major central bank balance sheets



Sources: US Federal Reserve; European Central Bank; Bank of Japan; Bank of England; Bank of Canada; national statistical agencies; Corinna.

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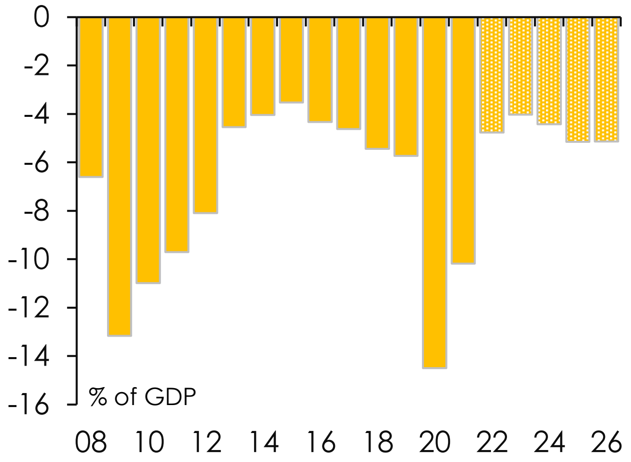
It may be difficult for central banks to engineer a 'soft landing' by doing enough to control inflation but not enough to induce recessions

- **Central banks don't know how high they need to raise interest rates in order to bring inflation back down to their targets**
  - apart from anything else it's been a long time since they have needed to bring inflation down
- **Central banks don't know what the impact of whatever level of interest rates turns out to be required to bring inflation down will be on economic activity**
  - particularly given much greater levels of private sector debt in many economies
- **Central banks don't really know how 'quantitative tightening' (the unwinding of their bond and other asset buying programs) will work**
  - other than via its impact on asset prices (shares and probably housing) and (probably) exchange rates
- **In these circumstances, there's a significant risk that central banks (and or governments) will 'get it wrong', resulting in recessions**
  - that risk is greatest for the UK, and for parts of the euro area
  - but it's not trivial in the US either

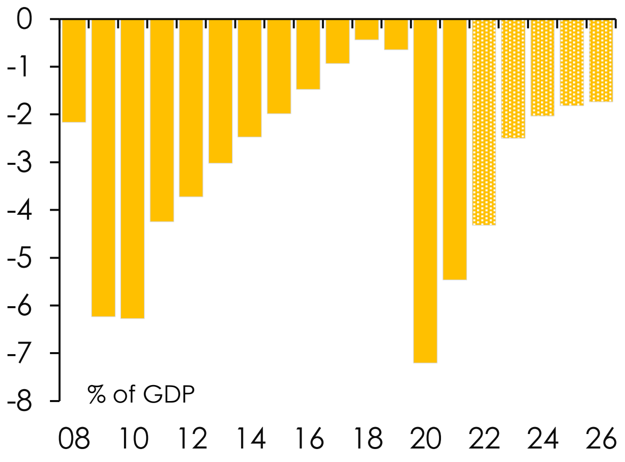
Fiscal policy is also being tightened significantly in most major economies as Covid-related measures expire and in some cases taxes go up

Government budget balances

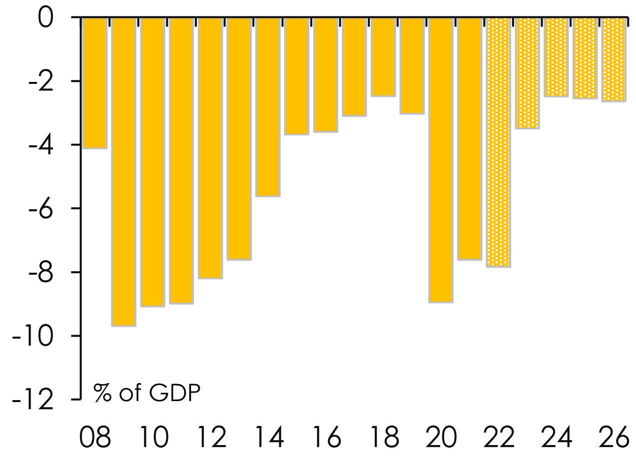
United States



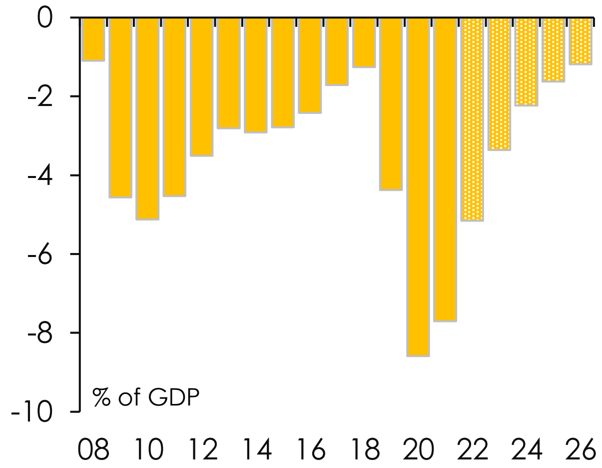
Euro area



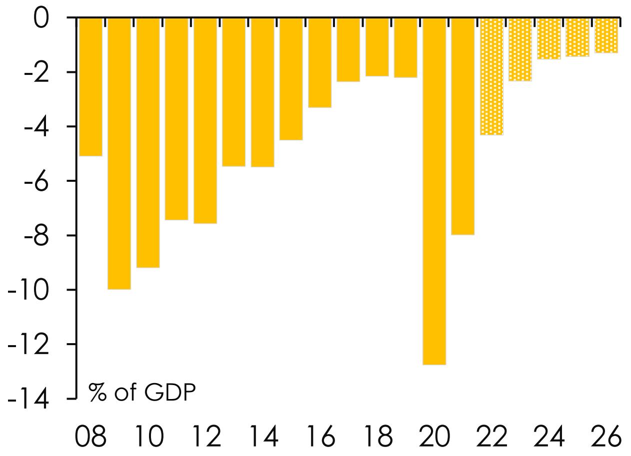
Japan



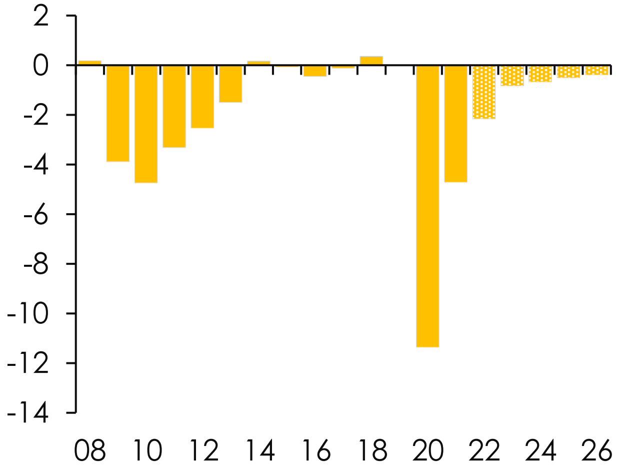
Australia



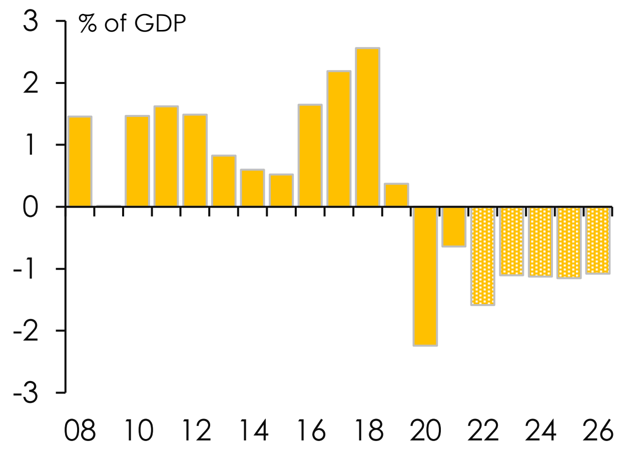
United Kingdom



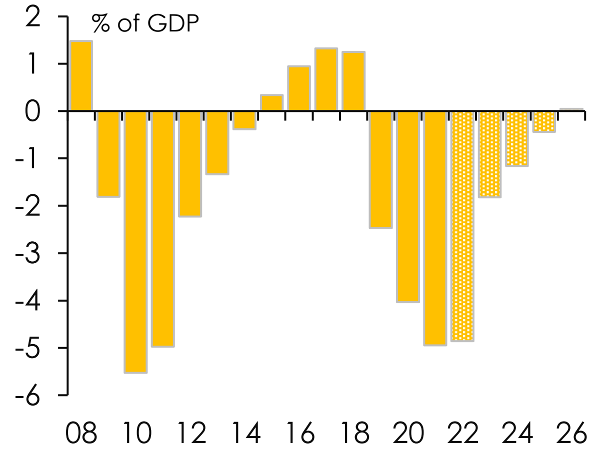
Canada



Korea



New Zealand



Sources: International Monetary Fund, *Fiscal Monitor*, and *World Economic Outlook*, April 2022.

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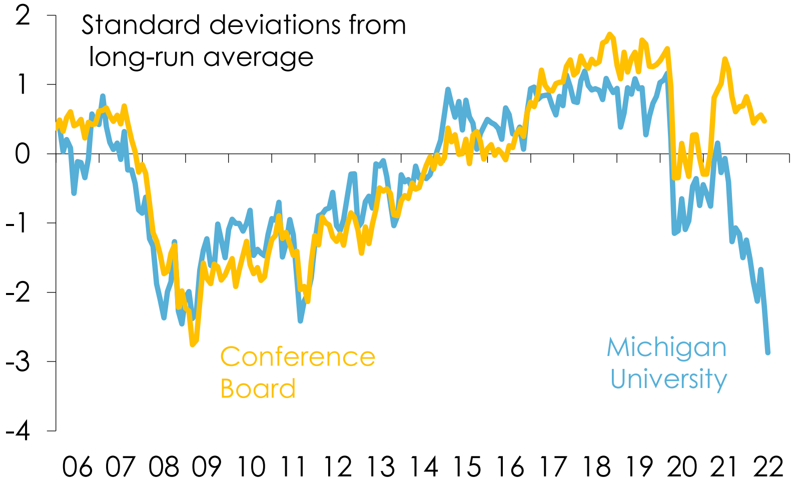
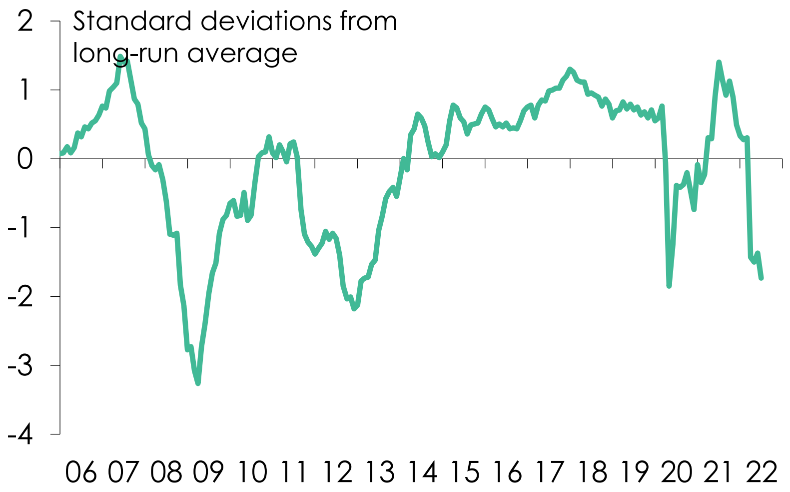
Consumer sentiment has deteriorated in almost every major economy, in most cases to lower levels than in 2020 or 2008

Consumer confidence indexes

United States



Euro area



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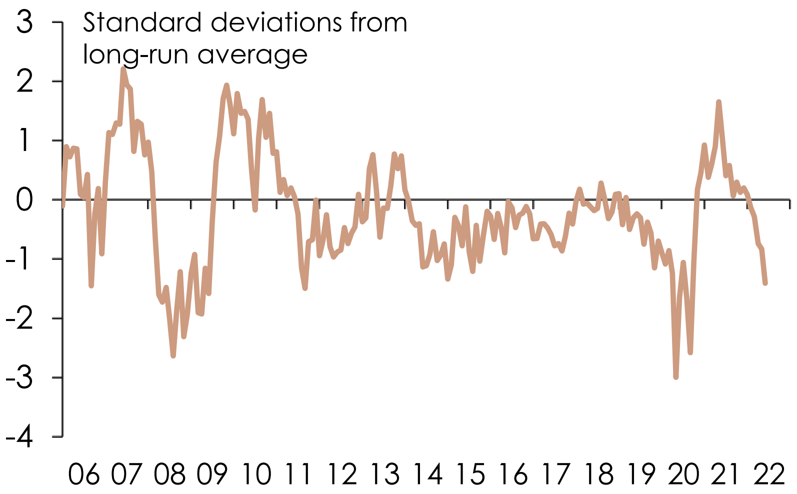
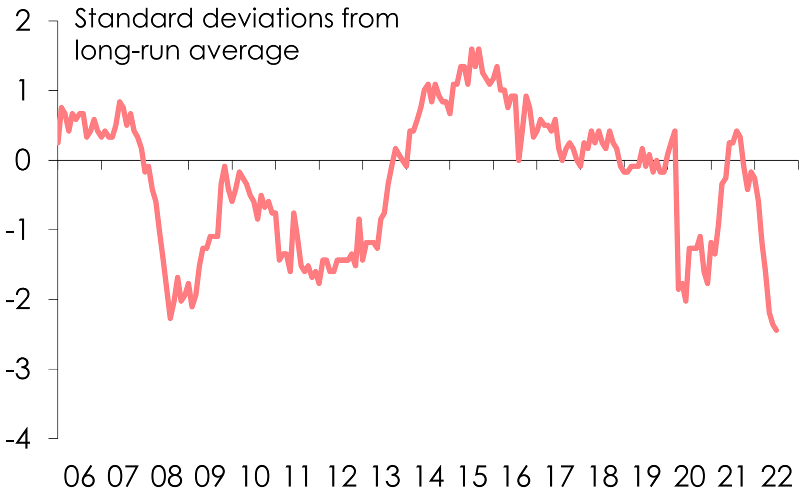
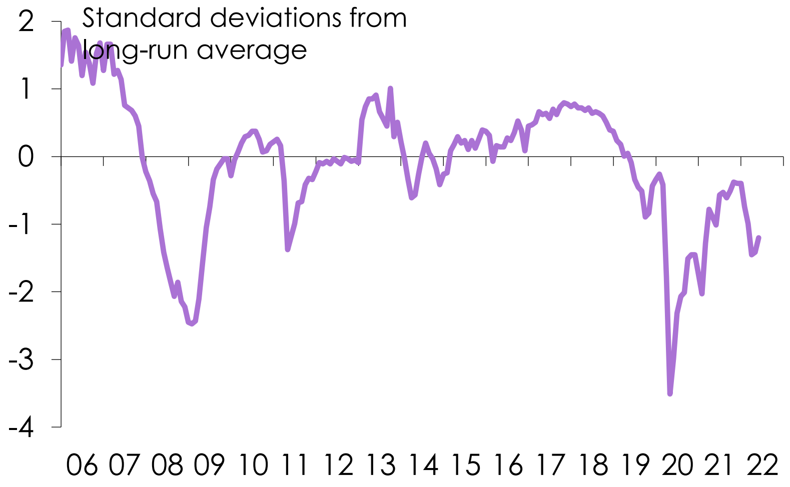


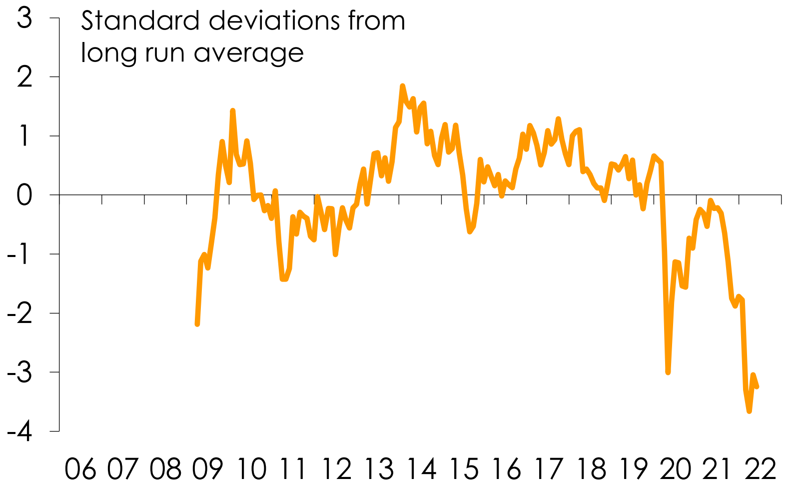
United Kingdom



Japan



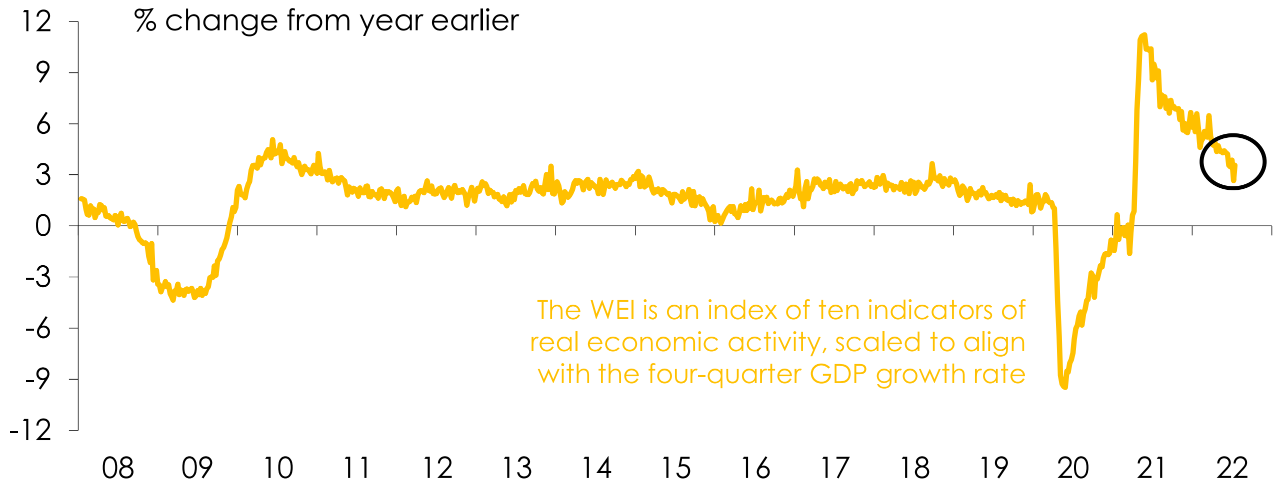
New Zealand



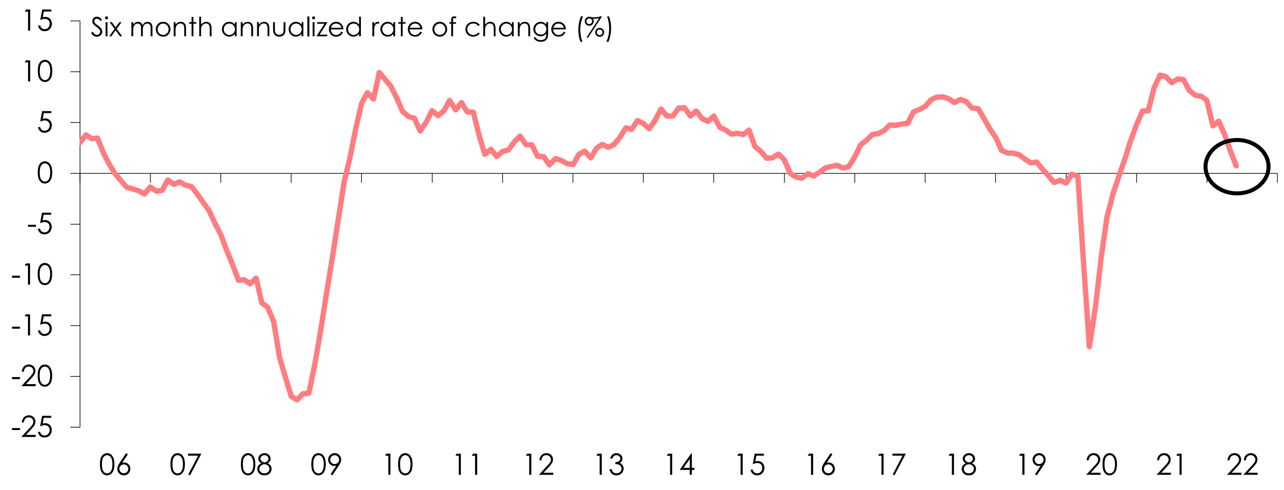
Sources: Michigan University Survey Research Center; The Conference Board; GfK; European Commission; Japan Cabinet Office; Westpac-Melbourne Institute; ANZ-Roy Morgan.

A number of timely indicators are beginning to signal a slowing in the US economy

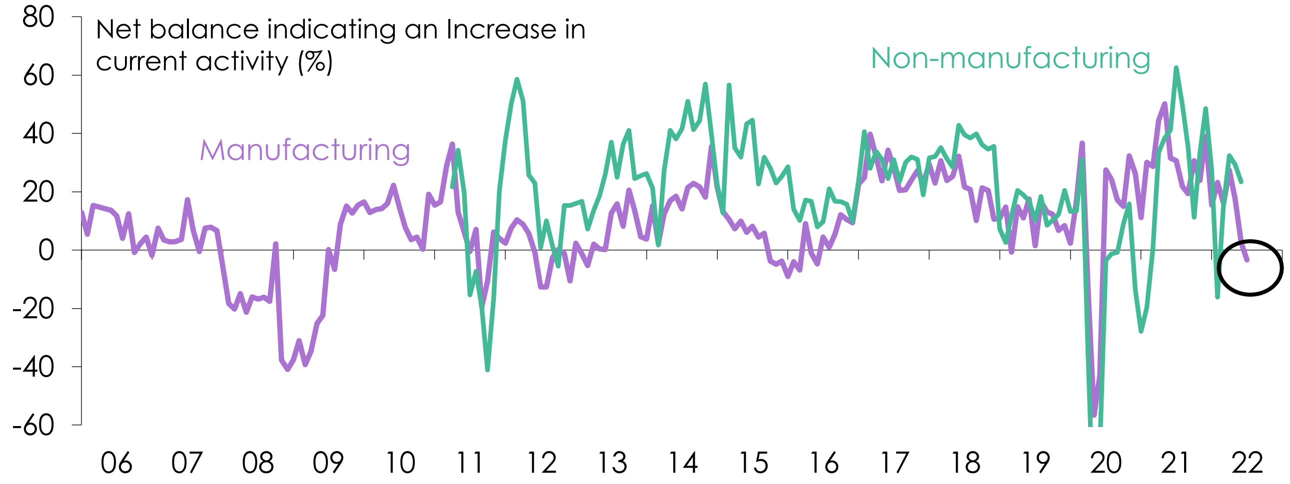
NY Fed weekly economic index



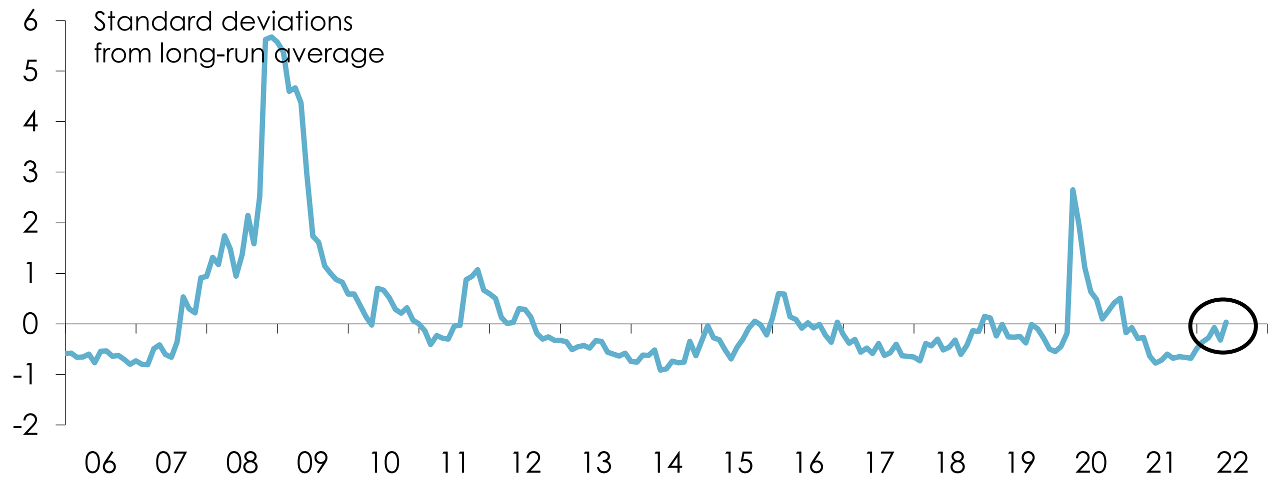
Conference Board index of leading indicators



Philadelphia Fed business outlook survey



Kansas City Fed financial stress index



Sources: Federal Reserve Bank of New York, Weekly Economic Index; Federal Reserve Bank of Philadelphia, Regional Economic Analysis, Manufacturing and Non-Manufacturing Business Outlook Surveys; The Conference Board, Global Business Cycle Indicators; Federal Reserve Bank of Kansas City, Kansas City Financial Stress Index

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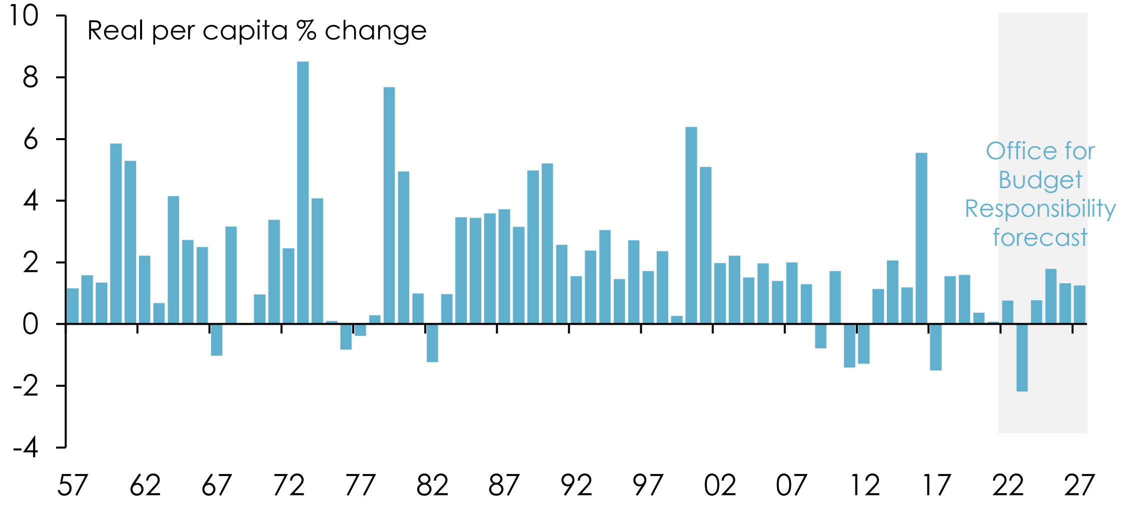
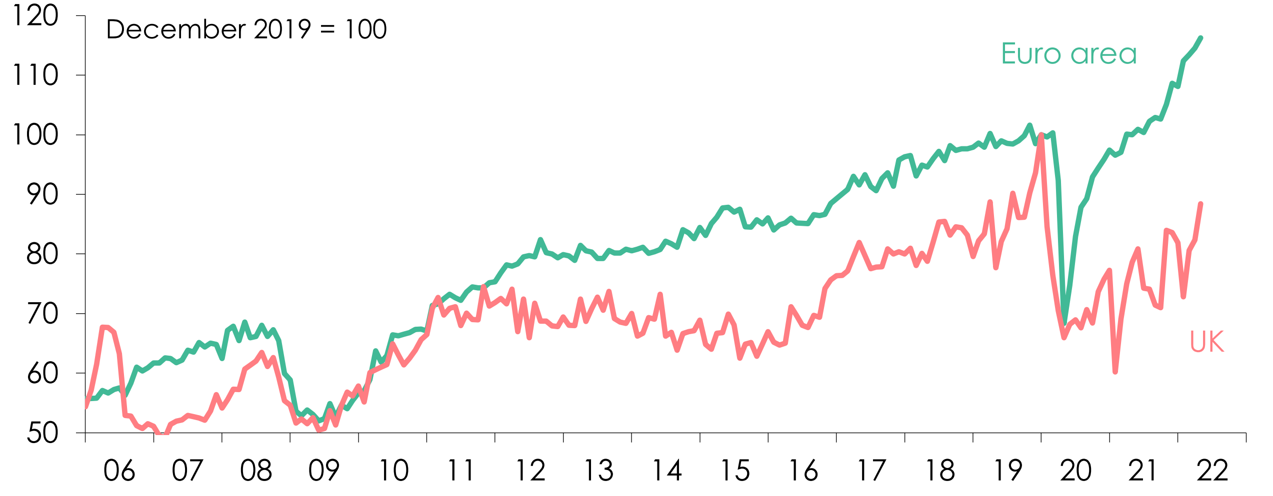
The near-term outlook for the UK economy is particularly gloomy, in large part because of the Johnson Government's "own goals"

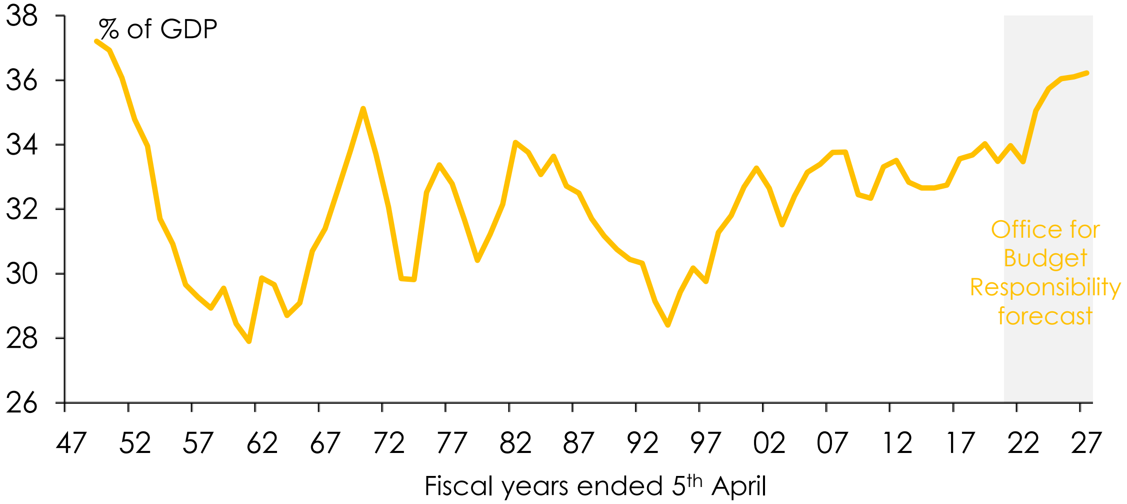
Real household disposable income



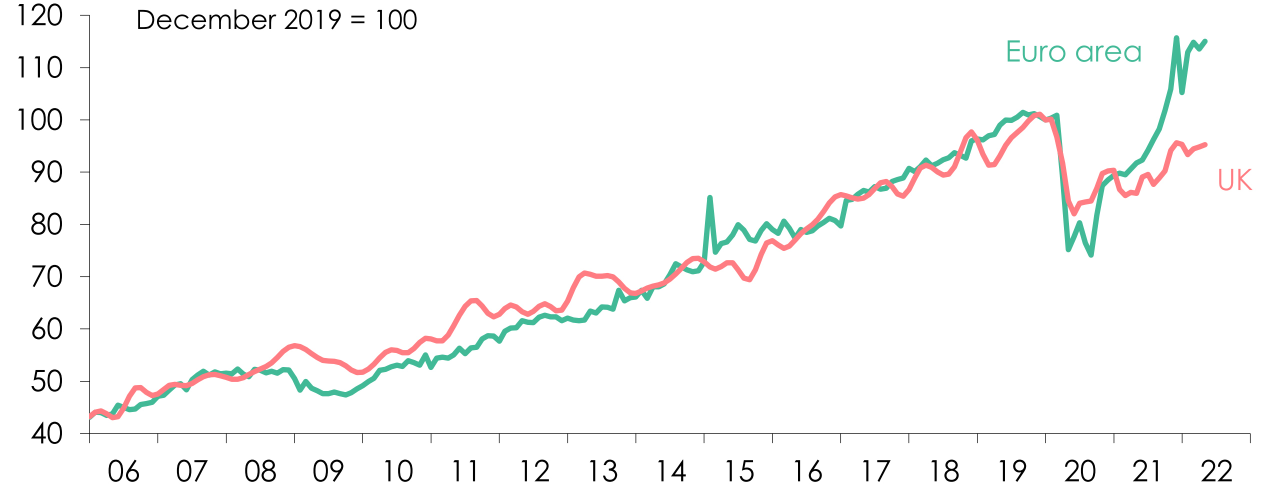
Merchandise exports



Taxes as a pc of GDP



Services exports



Sources: UK Office for Budget Responsibility; UK Office for National Statistics; European Central Bank Statistical Data Warehouse.

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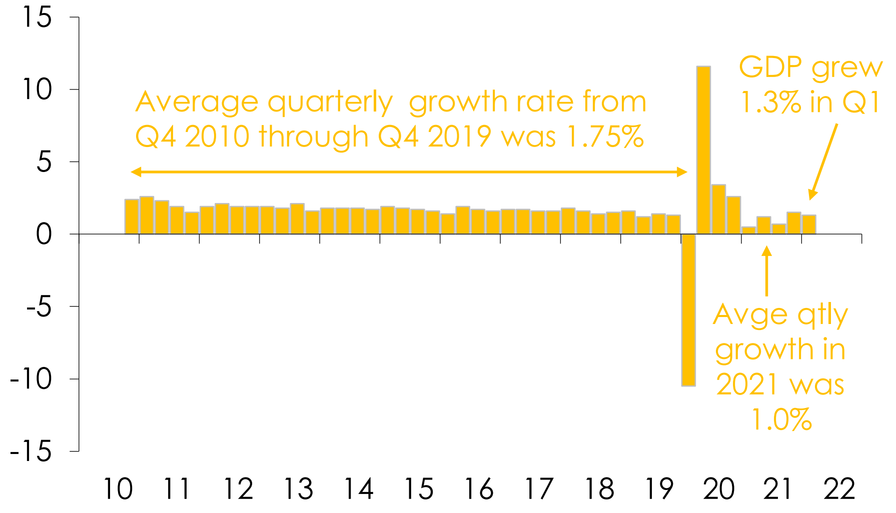
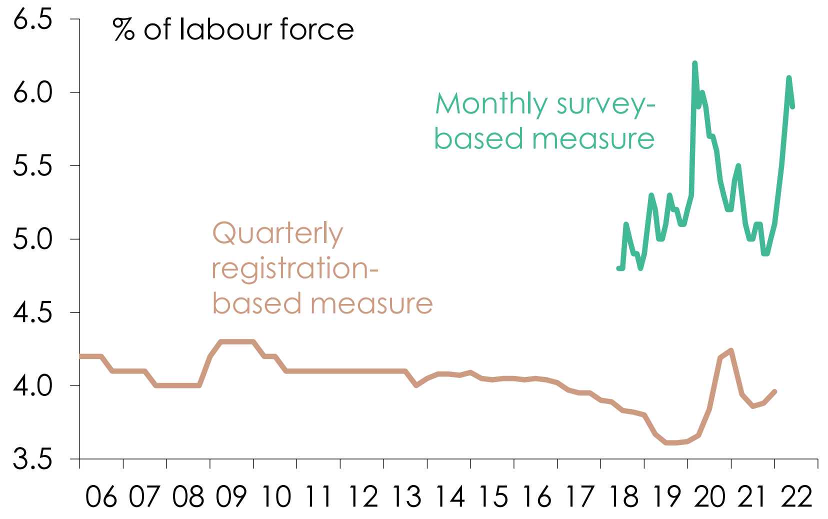
China's recovery from the initial downturn in 2020 wasn't all that strong, and it has faltered again this year due to the pursuit of 'zero Covid'

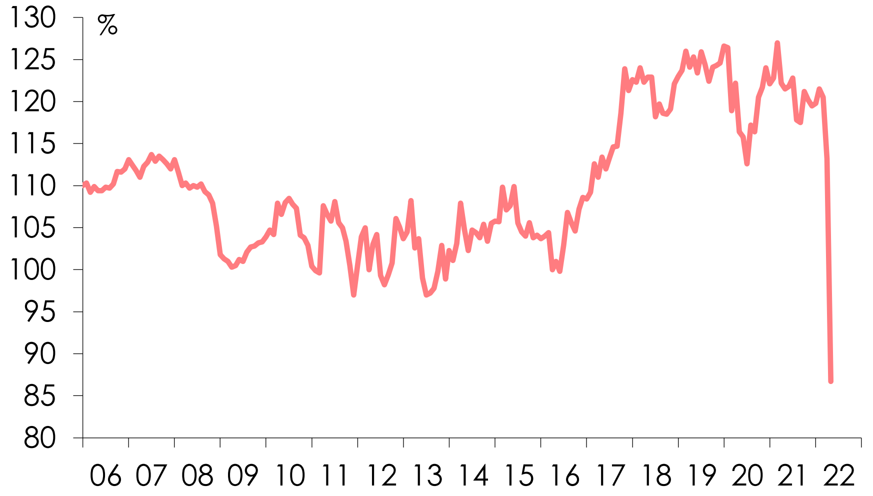
Quarterly real GDP growth



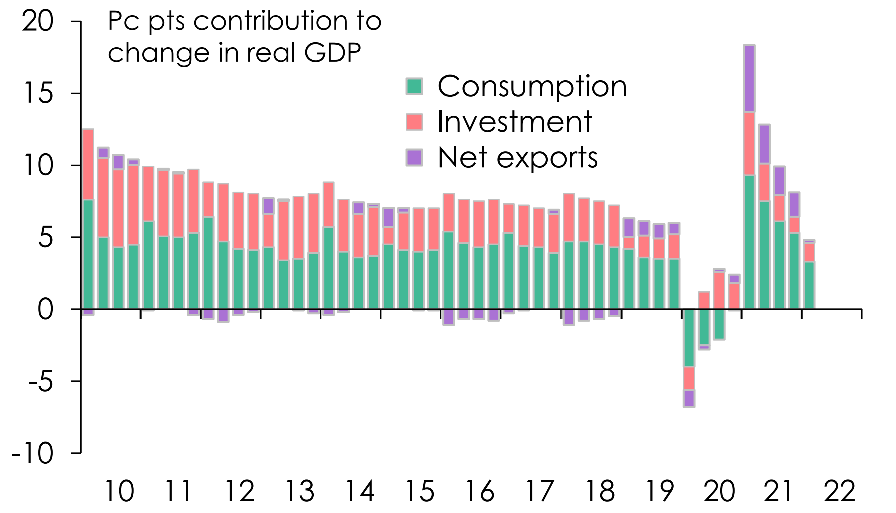
Urban unemployment rate



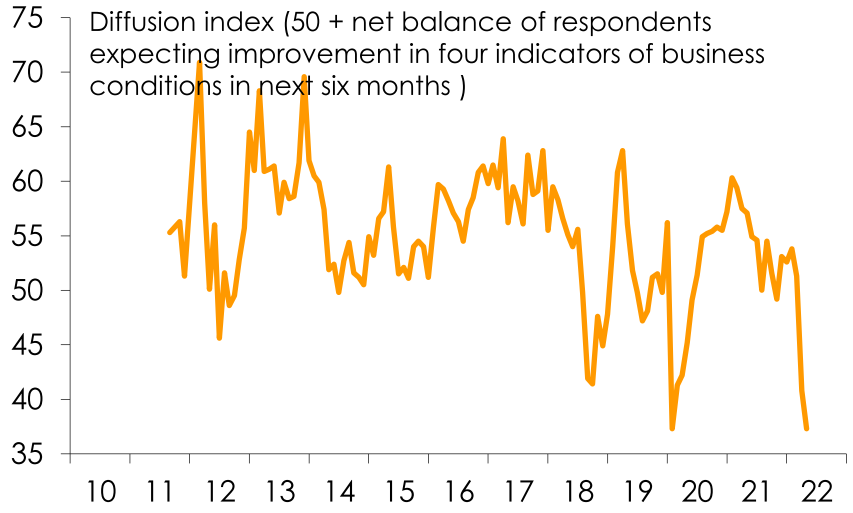
Consumer sentiment



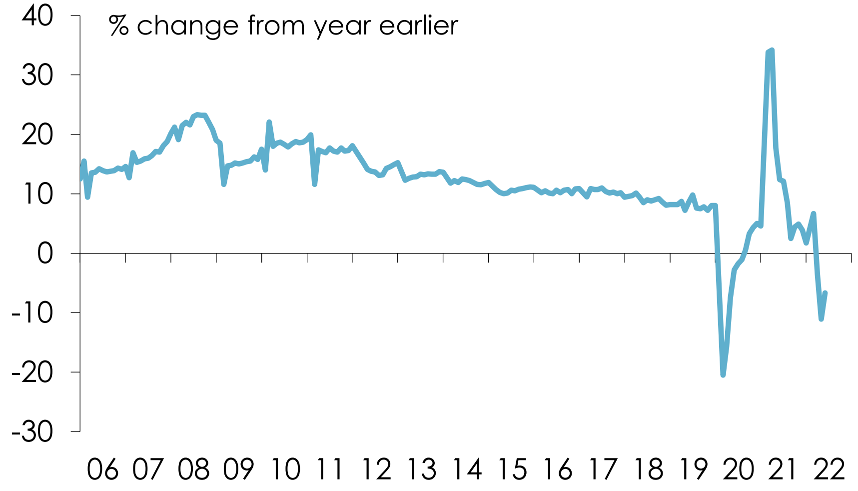
Sources of real GDP growth



Business conditions index



Retail sales



Sources: China National Bureau of Statistics; Cheung Kong Graduate School of Business.

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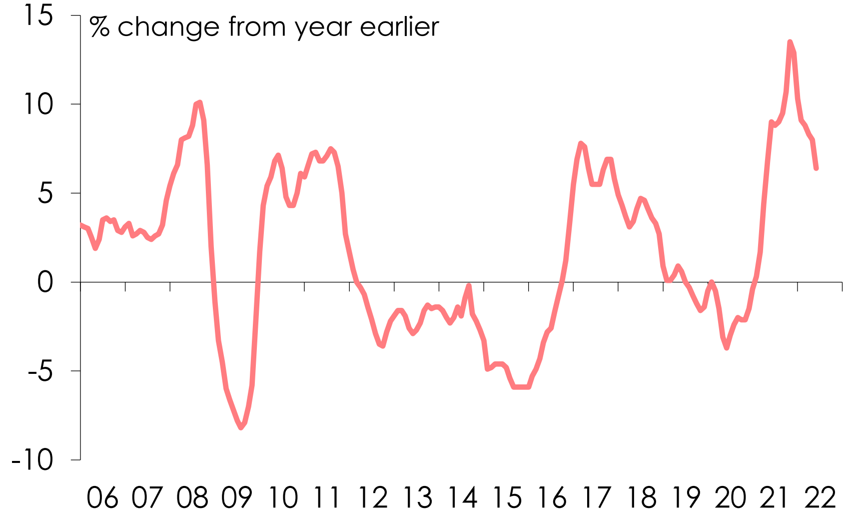
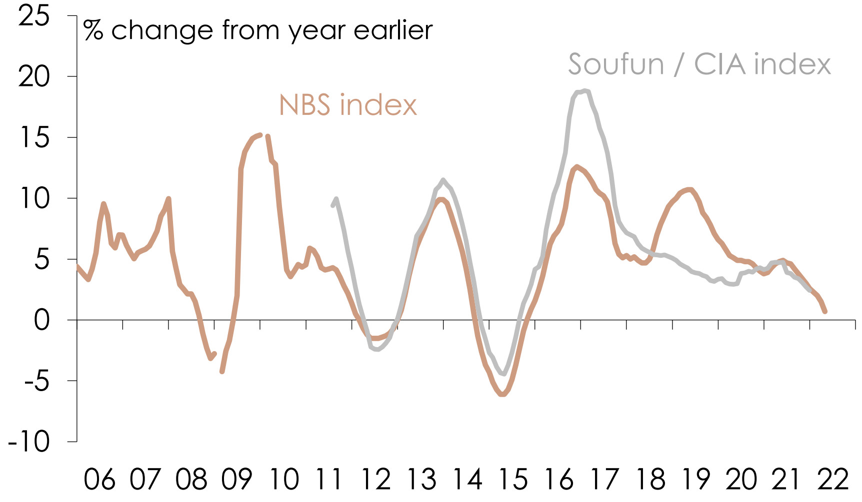
China is one of the few big economies in the world where inflation isn't rising – yet 'the authorities' seem reluctant to do much to boost growth

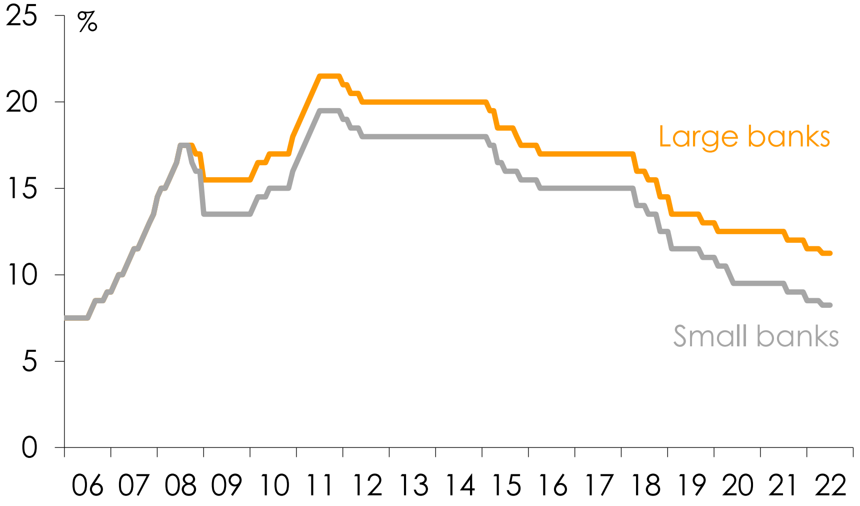
Producer prices



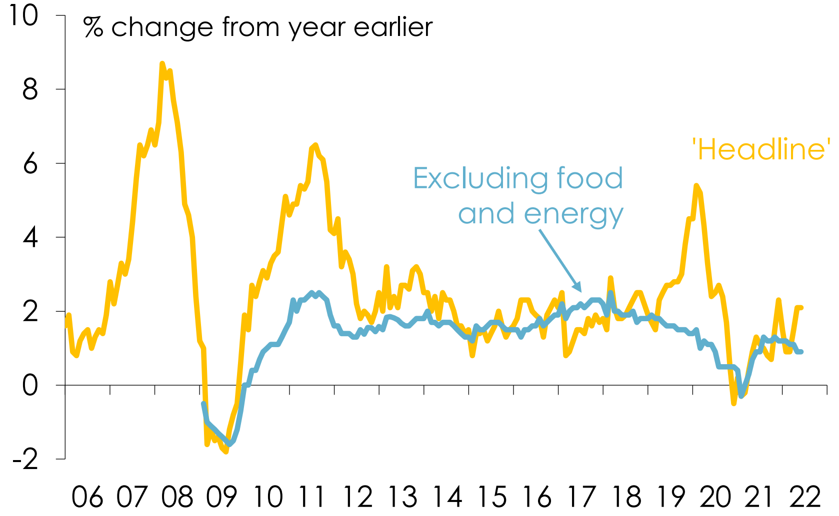
Residential real estate prices



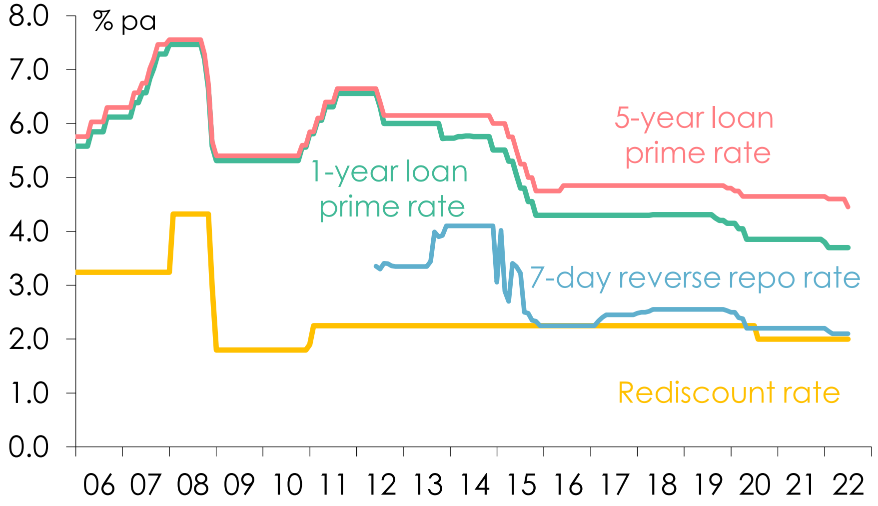
Bank reserve requirement ratios



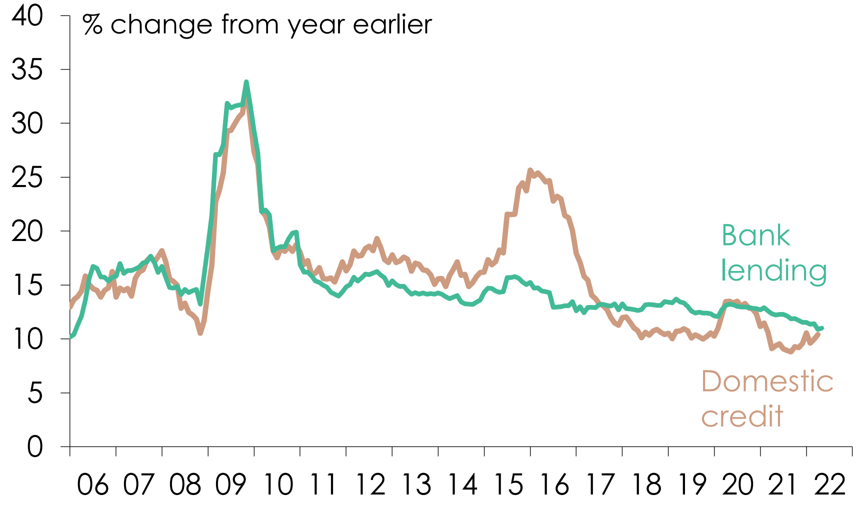
Consumer prices



PBoC policy interest rates



Credit growth



Sources: China National Bureau of Statistics; People's Bank of China.

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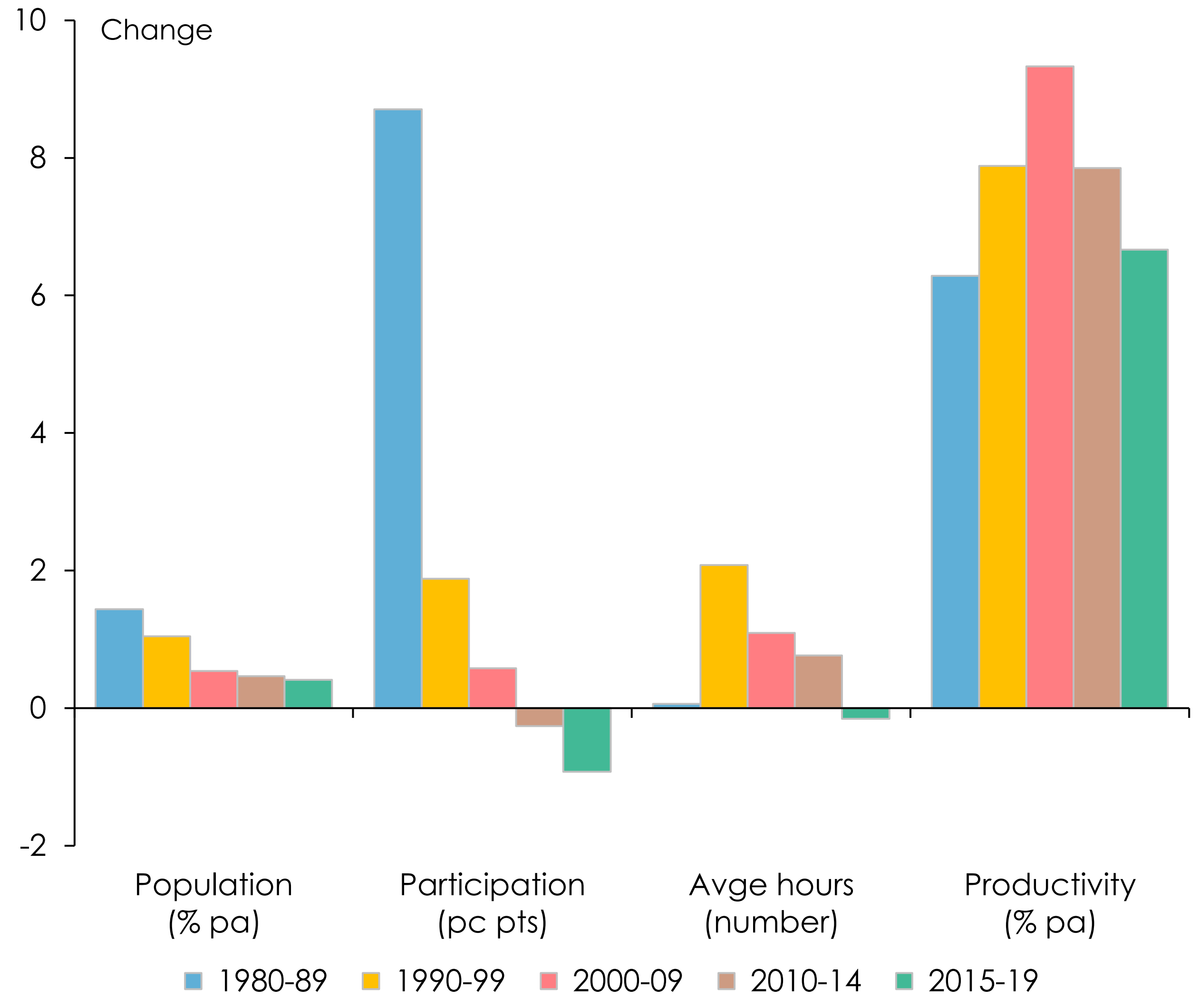
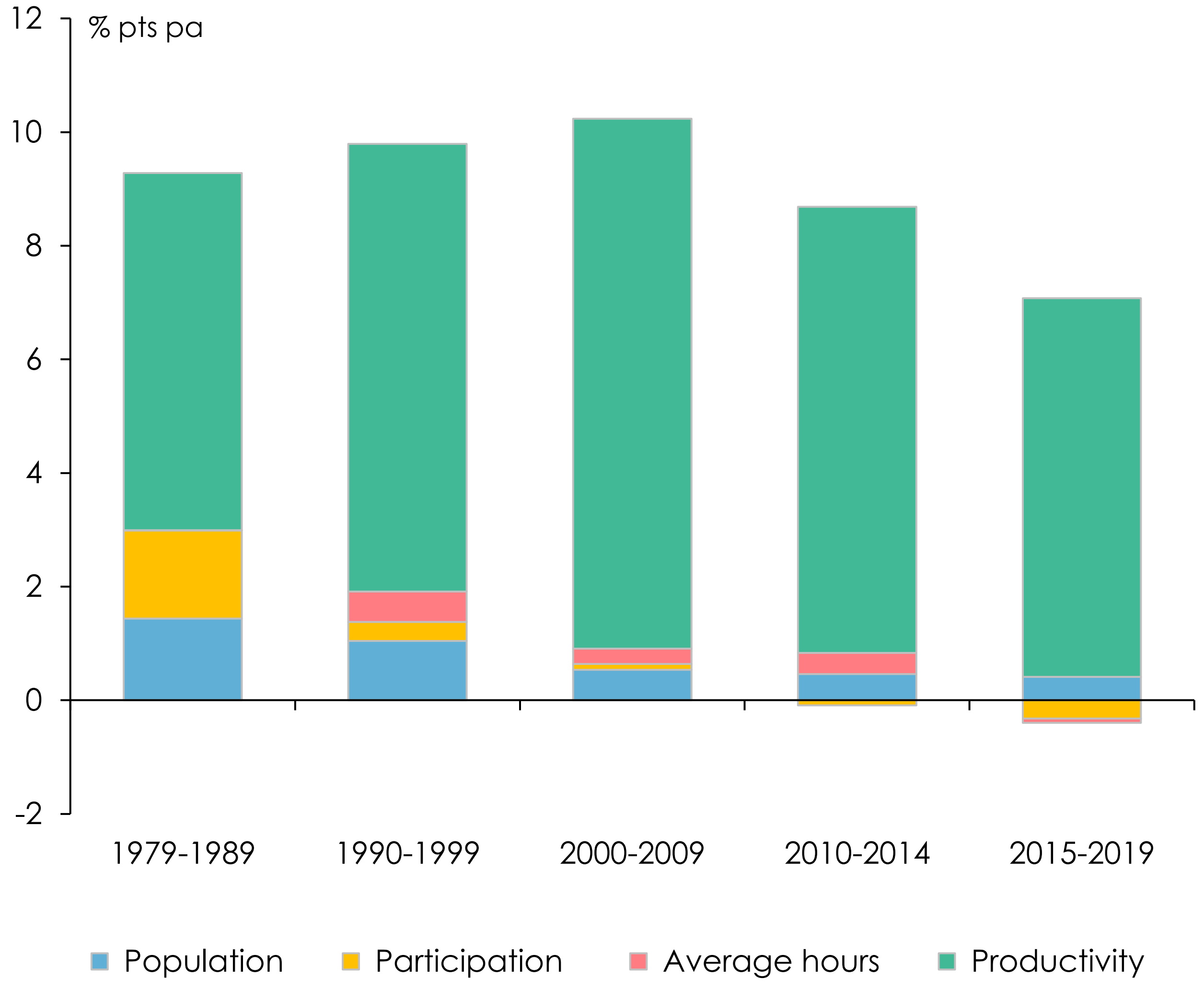
But China's longer-run potential growth rate is also declining markedly, for demographic and 'structural' reasons

Sources of Chinese real GDP growth



Contributions to Chinese real GDP growth



Source: The Conference Board, Total Economy Database, 2021; Corinna.

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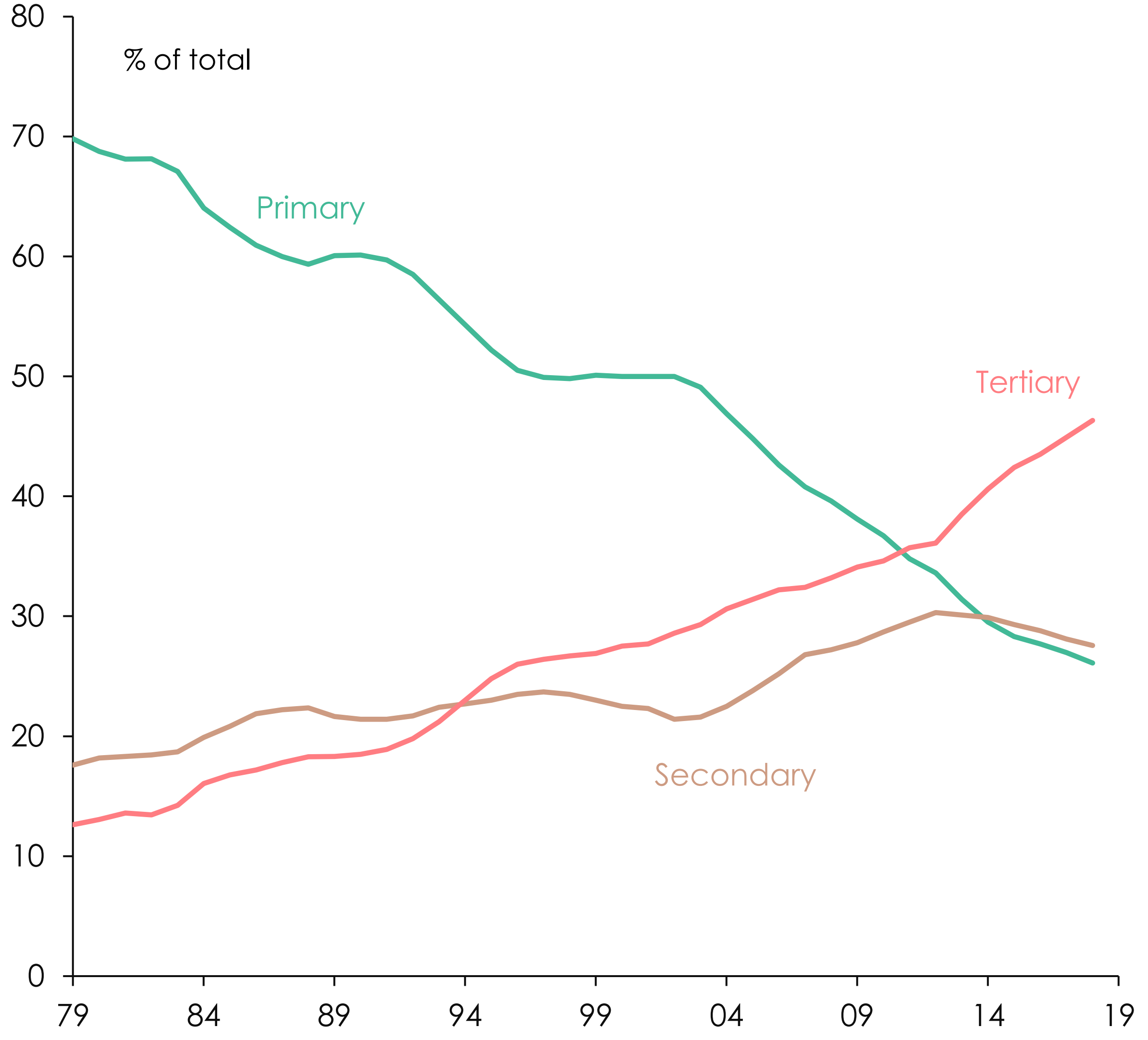
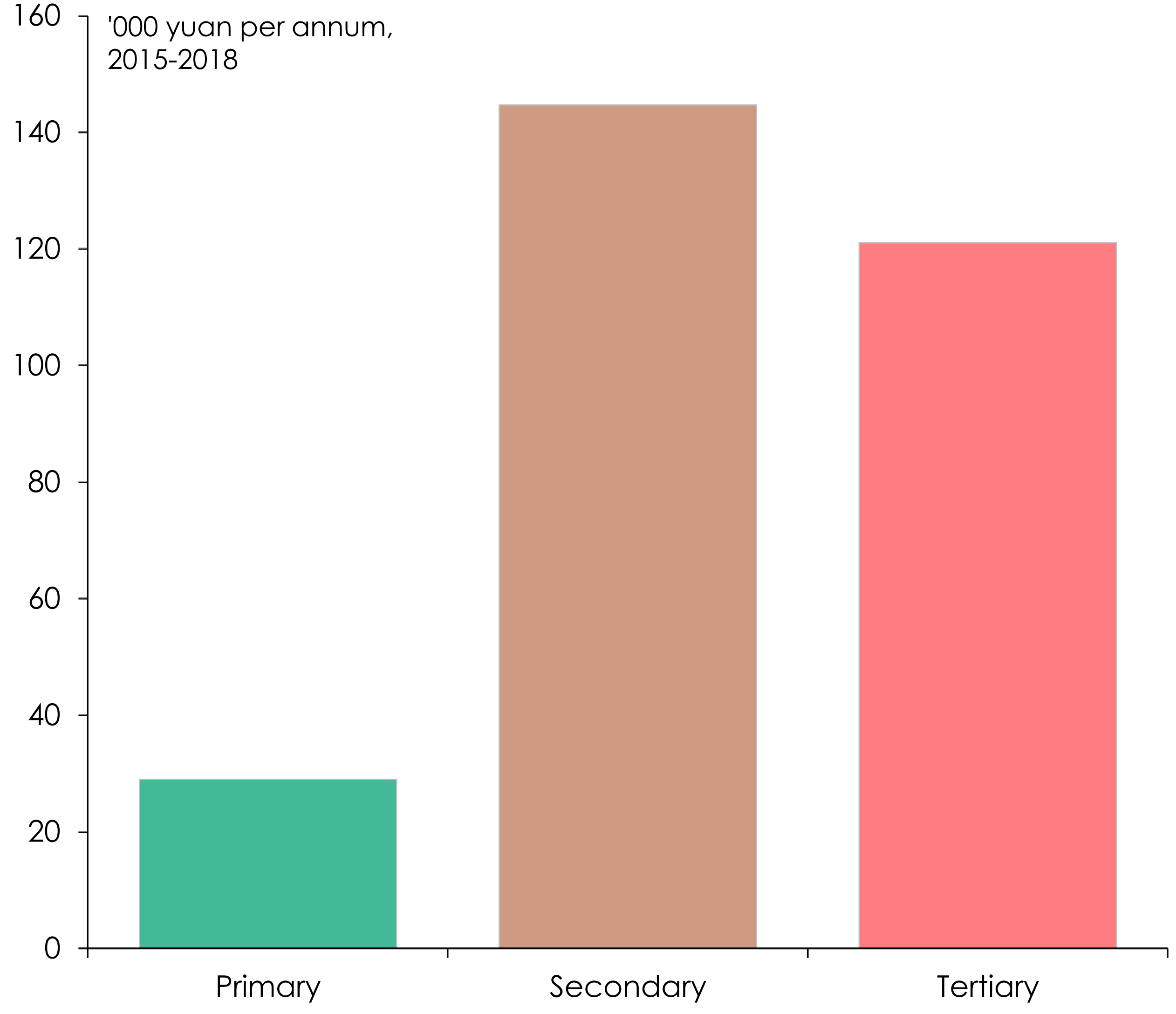
The scope for boosting productivity in China by moving 'factors of production' out of agriculture into manufacturing is just about exhausted

Share of total employment by sector



Output per person employed, by sector, 2015-2018



Source: China National Bureau of Statistics, *China Statistical Yearbook 2019*; Corinna.

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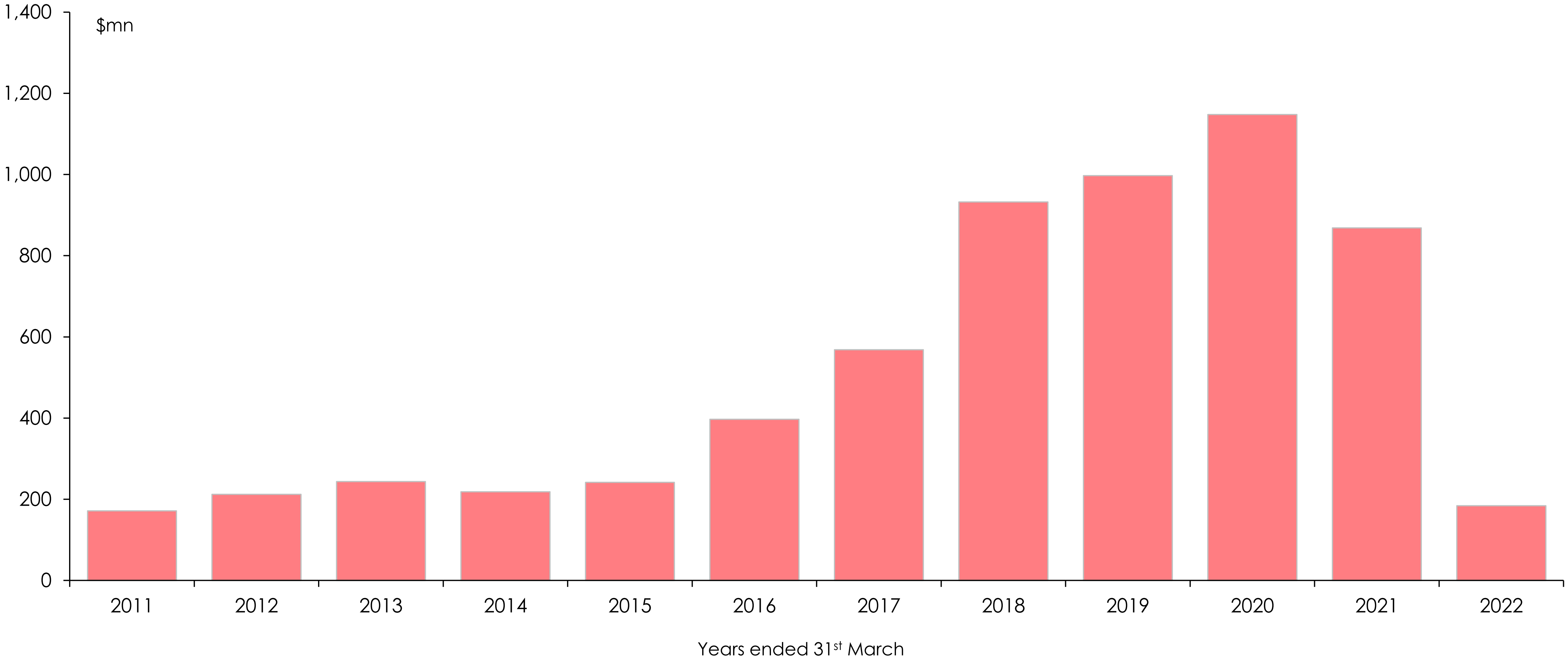
There's no obvious reason to think that bi-lateral political and economic relations between Australia and China will improve any time soon

Australian wine exports to China



Source: Wine Australia.

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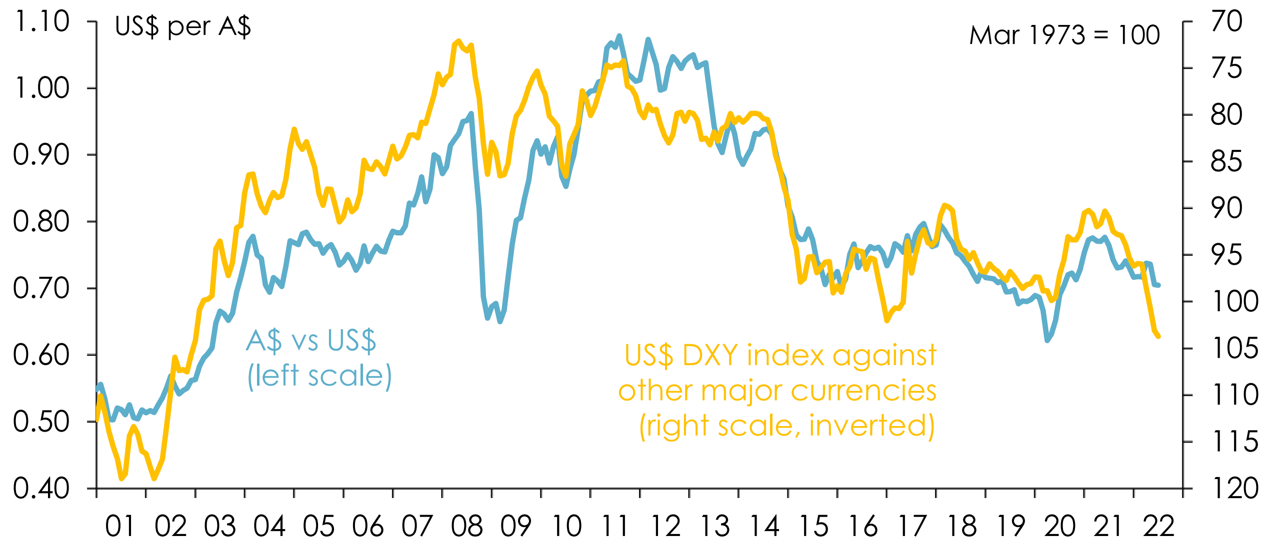
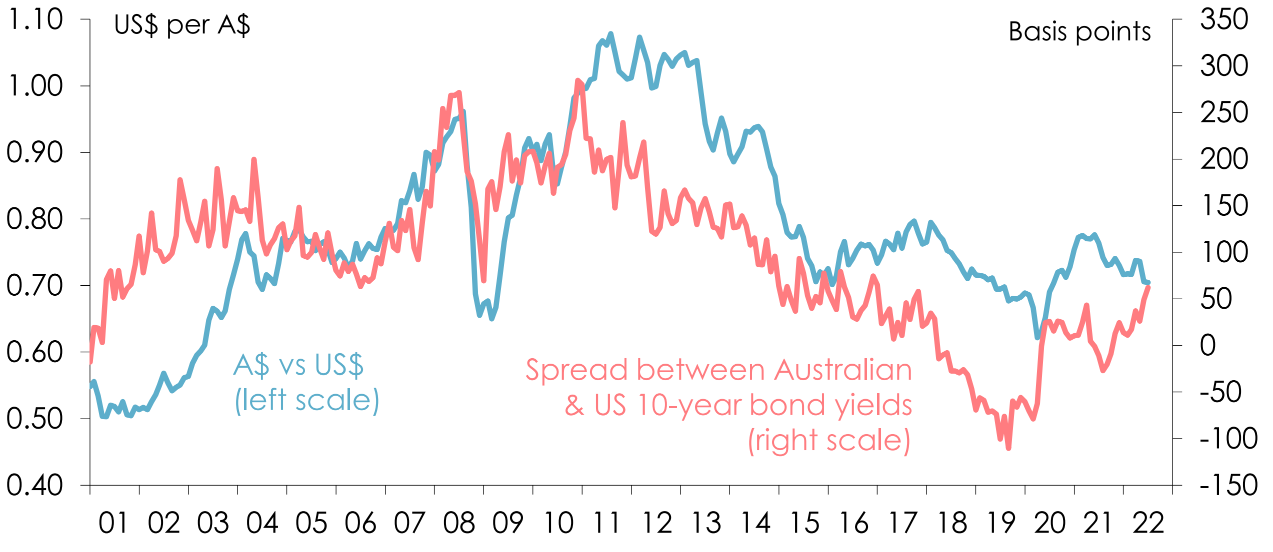
One 'silver lining' to all these clouds is that the A$ is likely to move lower

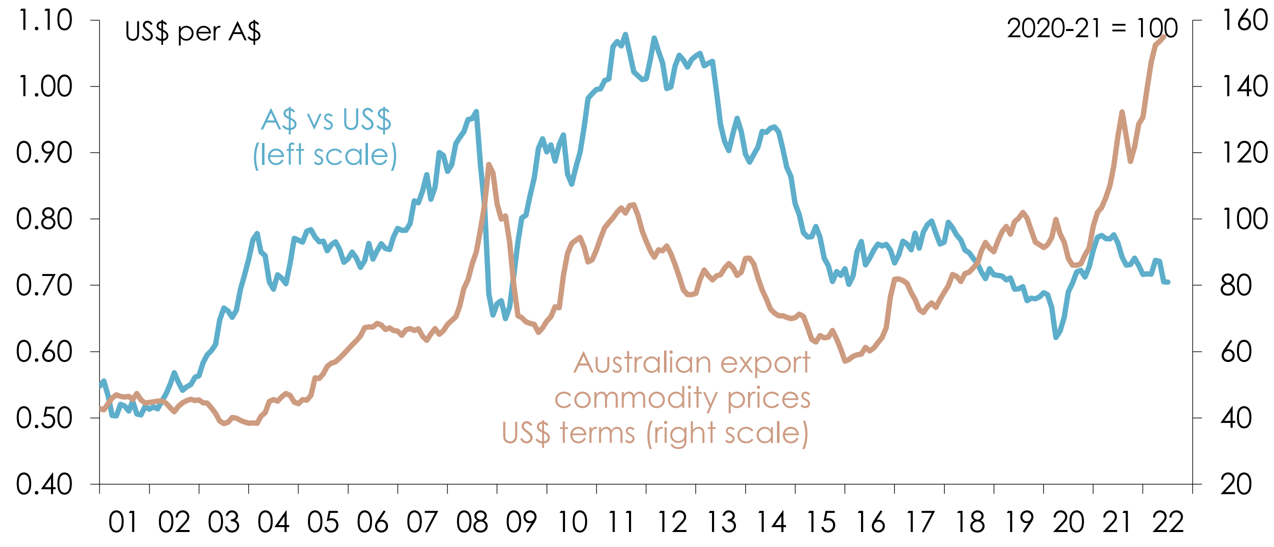
A$-US$ and US$ trade-weighted index



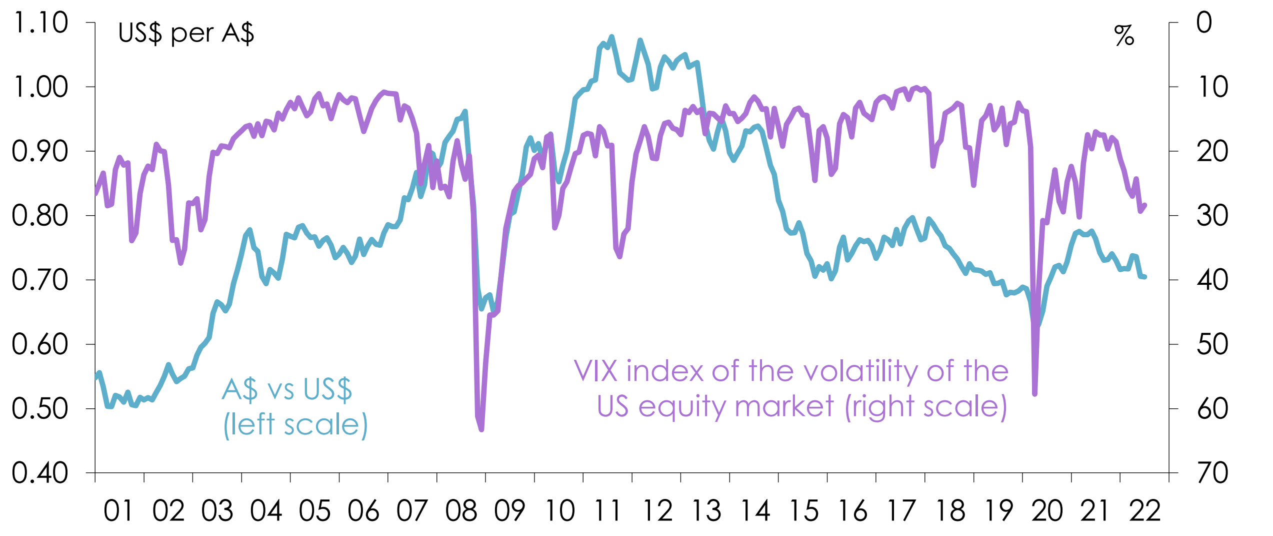
A$-US$ and Australia-US 10-year bond yield spread



A$-US$ and commodity prices



A$-US$ and US equity market volatility



Note: The DXY is an index of the value of the US dollar against 6 other currencies (the euro, yen, pound, Canadian dollar, Swedish krona and Swiss franc). The VIX index is a measure of the implied volatility of S&P500 options and is widely interpreted as an indicator of investor risk appetite or aversion.
Sources: Reserve Bank of Australia; US Federal Reserve; Chicago Board Options Exchange.

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