



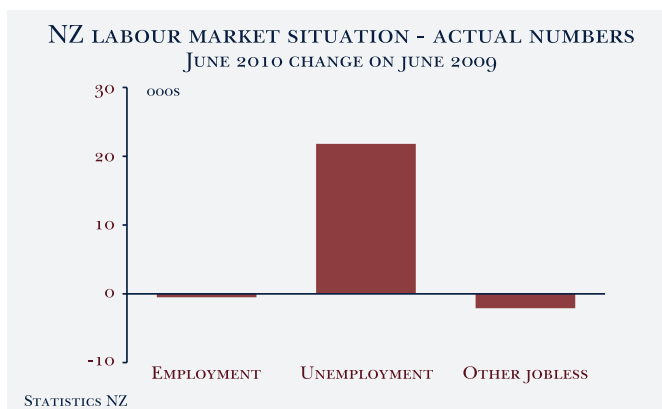
# BERL Monthly Monitor

## August 2010

### Jobless numbers no surprise

Household Labour Force Survey (HLFS) for the June quarter provided little comfort to those looking for convincing evidence of a robust recovery taking hold. Rather, the quarterly rise in seasonally-adjusted unemployment numbers, along with little growth in employment, confirmed the existence of a 'phantom' recovery. As discussed in our July Monthly Monitor, a significant proportion of the recovery can be put down to the fall in imports – itself a result of diminished spending by businesses and consumers – rather than increases in industry activity within New Zealand.

Headline numbers put employment numbers at the same as this time last year, while those officially unemployed were up 22,000 along with a 2,000 fall in the number in the 'other jobless' category (i.e. those who are jobless but do not meet the official definition of unemployed). A positive sign in the details was the shift from part-time positions to full-time positions – indicating a degree of resilience in the economic situation.

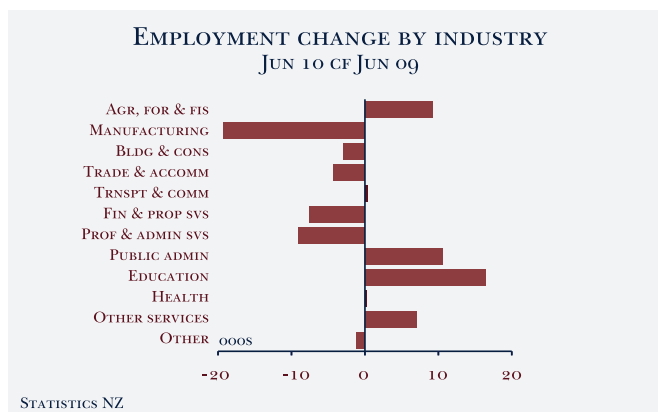


However, of concern is not the zero change in employment over the past year, but the industrial composition of that change. In particular, manufacturing employment has plummeted by nearly 20,000 (at a time when we are, allegedly, in the midst of an export-led recovery). Employment in building and construction was recorded as down 3,000 (at a time when, allegedly, there is a concerted effort to upgrade the nation's infrastructure deficit). Reductions in trade and accommodation employment – despite relatively positive visitor and guest night figures – further indicate the fragility of the incipient recovery. And reduced employment in the financial, professional and administrative services also reflect subdued business activity in the domestic sector.

These employment reductions are balanced by a promising expansion in the primary (agriculture, forestry and fishing) sector. This is the first time primary sector employment has

recorded growth on year earlier since March 2008. However, historical volatility of this particular component means it may be premature to ascribe too much to just one quarter's figure.

But, the largest contribution to holding up job numbers were some remarkable figures for public administration and education – together up by 27,000 on year-earlier levels. These are not one-off numbers, with public administration employment being noticeably higher than year-earlier since June 2009, and education higher since June 2008. The 27,000 number includes an astonishing year-on-year increase in recorded employment in the pre-school and school sector of more than 14,000. These numbers appear to contradict the message of a public sector subject to significant budgetary constraints. Frankly, we are at a loss to explain (or believe) this figure and reinforces our concern of a fundamental weakness underlying the labour market.



Irrespective of the detail, the numbers clearly sent shivers down the spines of members of the recovery cheerleading squad. Having forgotten their earlier euphoria over the March numbers showing a dramatic fall in unemployment, many have now re-written the history books and claimed they always saw the March numbers as suspect. Surprisingly, however, few are taking back their earlier advice regarding the need for interest rate tightening. Unfortunately, we fear that those still expecting a rapid return 'business as usual' are going to be sorely disillusioned.

To us, the HLFS numbers were unsurprising. The New Zealand economic recovery was always going to be a long, flat, dull affair. Furthermore, given that employment is amongst the last economic indicator to turn positive following a downturn, it was clear to us that job numbers were never going to be quickly rectified. And, so, unemployment numbers were likely to remain relatively high for a lengthy period of time. Of course, we were also never expecting double-digit unemployment rates as some others were suggesting. What has surprised us is the shortness of some memories!

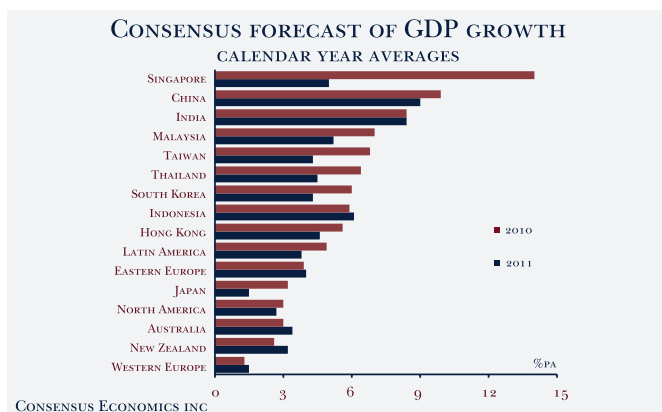
## As the world experiences more shudders

Prospects for the global economy have swung between mildly optimistic and darkly negative (and back again) several times over the past few months. From sovereign debt crises, to oil spills; from promising job numbers in the US one week to anaemic expansion in Europe the next; from soaring stock market indices one day followed by a concerted retreat the next. Such volatility in data (and fickleness in sentiment) is symptomatic of inherently uncertain times.

The uncertain times reflect the instability arising from the large financial imbalances between the global powerhouses and the reluctance of authorities to address the regulatory failures that caused the 2008 financial crisis.

In the interim, commentators continue to search for convincing evidence that not only is the recession behind us, but of a robust and enduring recovery.

While it is a gross simplification, it is difficult not to see the world in two large blocks – the fast growing Asian region and the struggling Western Europe and North American hemisphere.



As the chart shows, all of the Asian economies have rebounded significantly this year, from what was – for most – a difficult 2009. We should add to this group the Latin American and Eastern Europe regions, both of which are expected to continue to grow into next year.

Indeed, the widely reported growth in the Chinese economy, along with noticeable strength in South and South-East Asia provides a basis for guarded optimism. In addition, this means the Australian economy is also well-positioned to continue its impressive performance.

However, the Western Europe and North American economies remain hamstrung with debt and the need for financial sector restructuring. These factors mean that those expecting a rapid return to ‘business as usual’ recovery are likely to be disappointed.

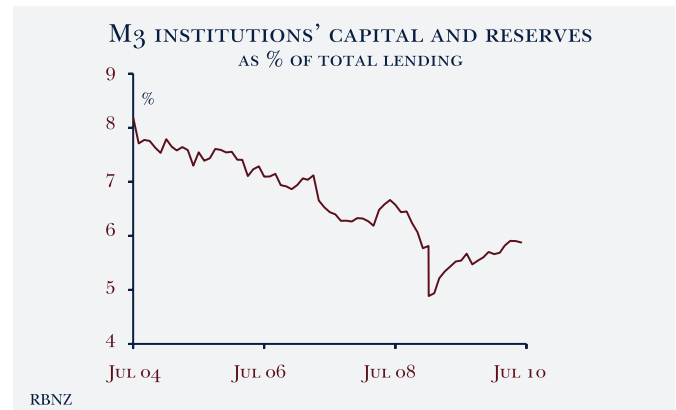
## Credit remains central to recovery prospects

The next OCR review date is September 16 and markets are already signalling that the Reserve Bank (RBNZ) will keep it at

the current 3.0% level. Hence the 90-day wholesale interest rate has been unwound from 3.29%, as at our last issue, to 3.21% and the TWI has fallen from 67.3 to 66.5. Also the 10-year bond rate has declined from 5.45% to 5.15%, but this is more to do with falling long-term rates abroad. We are in agreement with the market’s assessment of zero change in the OCR. In view of the current economic outlook being decidedly less favourable than in June when the current program of “reducing stimulus” commenced, we hope suggestions of increases in the last quarter of this year are also revisited.

The decline in the TWI was welcome, but it is still well above the level of March this year when the IMF, even then, assessed the NZ\$ as being 5%-25% over-valued. Clearly it would require a significant change in the stance of the RBNZ – say a decision to return the OCR at least to 2.5% – to correct this over-valuation.

Retail interest rates have tended to rise over the past month and the volume of lending to contract. There remains no sign that banks’ capital-to-liabilities ratio is improving, nor that funding from abroad is becoming easier to obtain. Major banks remain reliant on parent banks and RBNZ support to retain AA credit ratings, so prospects for sufficiently easier credit conditions to support growth are dim. A small plus is the government’s decision to underwrite Kiwibank’s growth plans via the medium of uncalled capital in its parent, NZ Post. While it lessens the risk of default of that bank, it does little to improve the system’s overall capital-to-liabilities ratio, the main constraint at present.

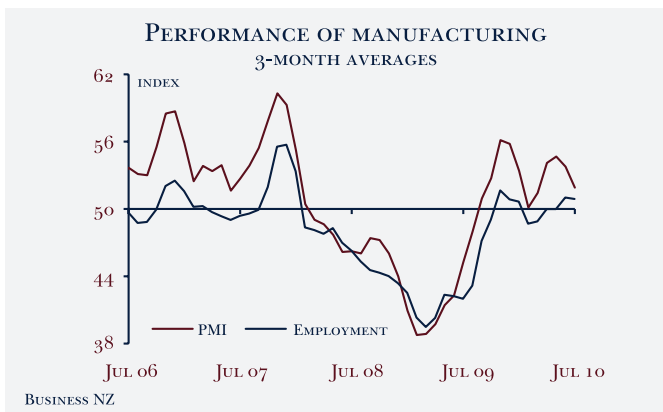


It is widely believed that large corporates have substantial funds available to self-fund increased investment when the economic outlook improves. Such funds, however, are not showing up in the monetary statistics and we still believe that such spontaneous recovery as could occur will, if not already, be stifled by credit constraints arising out of the financial sector.

In this situation firms would be well advised to remain focused on survival strategies and remain cautious until more convincing evidence of recovery appears.

## Manufacturing reverts to holding pattern

The seasonally adjusted PMI for July 2010 stood at 49.9. This figure is down six points on the June reading and 4.6 points from the May. This is the lowest PMI reading since August 2009; but it is a similar reading to the seasonally adjusted

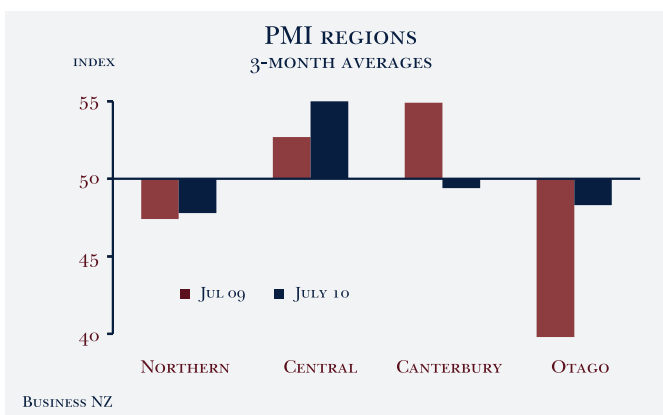


PMI in July 2009 (49.5), and above that recorded in July 2008 (48.0). Note that a reading above 50.0 indicates that manufacturing activity is generally expanding while a reading below 50 indicates contraction.

The seasonally adjusted production (52.1), employment (52.5), and finished stocks (52.6) sub-indices continue to indicate weak expansion while new orders (46.4) and deliveries (49.5) are lagging.

Comparing figures month-on-month, the employment sub-index has hovered around the 49 to 52 mark throughout 2010. And when we compare three monthly averages of unadjusted employment readings there is a slight indication of 'head above water' but definitely not an underlying recovery.

Respondents' negative comments about market conditions were higher than last month, and these comments were focused on orders slowing and flat customer demand. Positive comments were largely focused on offshore orders, particularly to Australia, and seasonal increases.



Turning to the regions, the Central region (56.0) was the only region to show a seasonally adjusted PMI above 50 in July. This is the highest reading for July this region has seen over the last three years.

The Northern region had the lowest reading this month (47.8), followed by the Otago/Southland (48.3) and the Canterbury/Westland regions (49.4). Looking at the average PMI over a three monthly period, and comparing this to a year earlier, indicates that while manufacturing activity in the Central region may be improving, there is no sign of any underlying recovery in the other regions.

This sentiment is supported by the latest HLFS figures, particularly when we consider the sub-industries within manufacturing.

HLFS numbers indicate that employment between the June 2009 quarter and the June 2010 quarter in the pulp, paper & paper product manufacturing, beverage & tobacco product manufacturing and textile industries has remained fairly stable. Employment in food manufacturing has increased by 3,000. On the negative side, there have been declining job numbers in the chemical manufacturing sectors, in non-metallic mineral product manufacturing and in metal product manufacturing. In addition, there was a 4,300 decline in jobs in the large machinery and equipment manufacturing, which can be considered as a bellwether of manufacturing in general.

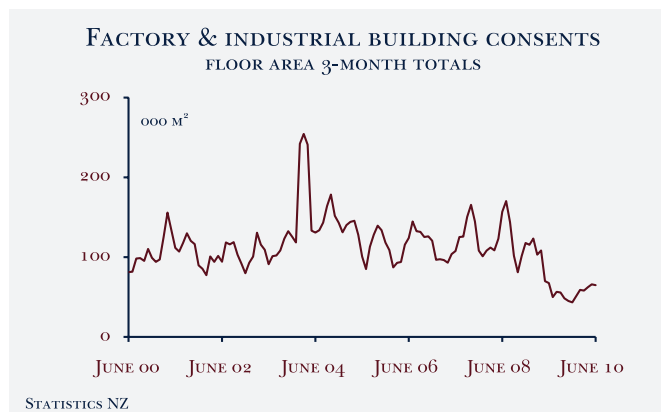
In total, there are now 18,900 fewer people working full-time in the manufacturing sector in June 2010 than there was a year ago, and 800 fewer people working part-time.

It appears the chances of a rapid fundamental recovery in the fortunes of the manufacturing sector continue to remain remote.

## Building activity also subdued

The downturn in the building construction industry is also a reflection of subdued business activity in general, and of business investment spending in particular. Non-residential building consents are significantly down on year-earlier levels. In value terms, consents for the three months to June are down 36% on those of a year earlier, with the latest twelve months being more than 18% below those of the previous year. The numbers are similarly bleak in terms of total floor area of work consented. By this measure, activity over the latest three months were 29% down on year earlier, while the past year was 32% below those of the previous 12 months.

The decline in activity over the past year has been spread across most of the categories of non-residential building. In floor area terms, hotels and accommodation consents fell the most (down 64%) followed by offices buildings (down 59%), factories & industrial buildings (down 43%), farm buildings (down 36%) and shops (down 24%). Notably, the categories countering the gloom were led by hospitals buildings, (up 69%) and social & cultural buildings (up 22%), while education building consents remained flat on those of a year ago.





Looking at the shorter-term numbers, there are tentative positive signs arising from the factories & industrial buildings and the shop buildings categories. The latest three month change on year-earlier levels (-4% and 9%, respectively) indicate the rapid decline of the past couple of years may have halted. However, as the picture shows, percentage growth figures may mask the low base from which the industry is now operating.

What does this mean in terms of construction employment? Comparing year on year, the number of people employed as technicians and trades workers has remained the same (289,000) while the number of people employed as labourers has declined by almost 6,000 to 244,800. Overall, the building construction industry has seen a drop in employment of 2,900 people to sit at total employment of 183,800.

And what are the signs in terms of growing the industry and encouraging new people to enter the trades? The example of building construction is illustrative. BCITO is the industry training organization for the building and construction industry. It sets the standards and develops and implements industry qualifications. According to the Ministry of Education, 689 new learners commenced industry training in the building construction industry in 2009. This was 300 fewer new learners entering industry training than in 2008, and 1,200 fewer than in 2007. There were also fewer new learners entering industry training in other trades such as joinery, electricity supply, electrotechnology, and plumbing, gasfitting and drainlaying.

Considering the time it takes to train for a trade, and the backlog of programmed infrastructure projects in roads, hospitals and schools (not to mention the need for new housing construction services), and the prospect of a skills-constrained industry could, yet again, become apparent.

## Tourism and accommodation holding up

The year to June saw the annual number of international visitors top 2.5 million for the first time. This milestone had been anticipated much earlier in line with the remarkable growth achieved over the first five years of the decade. However, a combination of bird flu, SARS, unhelpful exchange rates movements, financial crisis, and swine flu saw numbers effectively flat line over last few years.

The recovery in the past year has been dominated by a surge in visitors from Australia. The 2.5 million total for visitors from all countries represents a 3.7% increase on the previous year. In comparison, visitors from across the ditch rose more than 11%.

Recently, in line with the re-establishment of growth around the region, there appears to be a re-emergence of growth in tourists from Asia. The June quarter recorded visitors from Asia nearly 19% higher than year-earlier levels. Numbers from South Korea were up 40%, Japan 33%, China 25% and from India 13%.

The return of these markets will be sorely welcomed by NZ tourist businesses. Positive signals from these markets provide an increasing buffer against the ongoing dismal picture from our number two and three markets (UK down 17% in the latest quarter on a year ago, and US down 6.5%).



Prospects for accommodation businesses similarly hinge on continuing to attract Australian visitors and the return of Asian tourists. International guest nights passed beyond year-earlier levels during the latter-half of 2009.

The domestic visitor market provided a relative fillip for accommodation businesses over the mid-2008 to mid-2009 period. However, the current weakness in domestic guest nights is expected to remain over the coming year as the GST increase – along with muted employment and income growth – continues to constrain household budgets.

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