



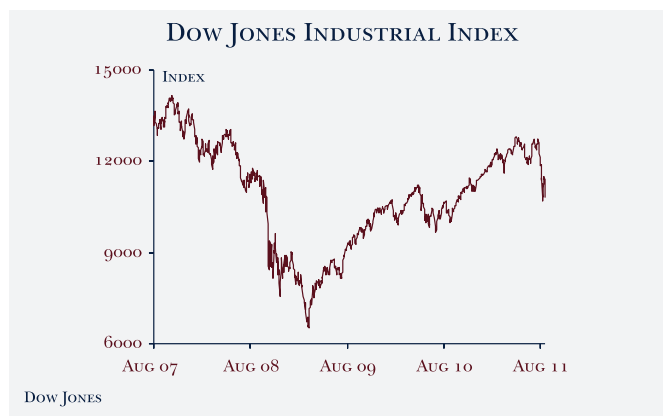
# BERL Monthly Monitor

## August 2011

### She'll be right, mate

Politicians playing chicken with debt ceilings, the world's largest economy being downgraded, volatile share prices, Japanese and Swiss authorities actively intervening in foreign currency markets and EU authorities buying Italian and Spanish bonds all underline a renewed sense of economic uncertainty.

While the events of the past few weeks will undoubtedly feature in historians analyses in years to come, it remains too early to tell whether recent events will, in terms of repercussions, rival those of September 2008.



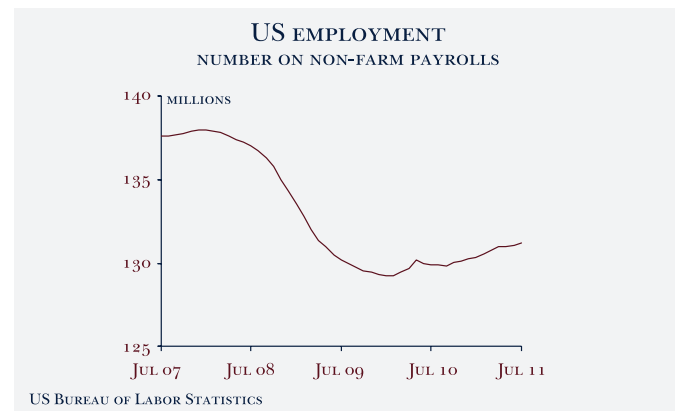
However, the common theme of any analysis – as was the case for the 2008 experience – is debt. And the recovery from the 2008 recession is now in jeopardy. It appears that the financial imbalances (the difference between individual nation's earning and spending) were only papered over during the recovery; and that paper is now wearing thin.

For New Zealand, the consequences may not be as dramatic as for other countries. But some consequences cannot be escaped. In a nutshell, the world is now both weary and wary of debt. And we must understand that New Zealand is an economy currently reliant on (if not constrained by) its ability to finance its outstanding debt. Despite government debt being relatively low by international standards, New Zealand's national debt remains high and underlies our vulnerability.

Despite the turmoil abroad, our ability to earn income (i.e. export revenue) remains sound, as is our increasingly Asian customer market. Yes, there will be further uncertainty as US and Europe grapple with reining in debt and shoring up fragile balance sheets. And, yes, there will be repercussions through Asia as US and European demand stutters.

But, if New Zealand and its businesses focus on earning export income then the negative impact of the global

turmoil and uncertainty can be limited. And, as has been widely noted, the rise of the economic powerhouses of the Asian hemisphere should also work in our favour over the longer term.



Of course, there is considerable irony in the NZ\$ exchange rate being bid up along with recent claims of 'safe haven' status, when viewed in the context of our national debt situation. This reinforces concern that the financial markets (and associated commentators) remain fixated on the excesses of government, while ignoring the underlying state of the economies themselves. As a result, many are claiming that New Zealand is 'well-placed' to ride through the latest financial crises. This may well be the case over the immediate short term.

However, the fundamental imbalances that continue to jeopardise the viability, sustainability and profitability of the New Zealand export sector should not be ignored. Ultimately, New Zealand's vulnerability to its debt situation can only be reduced through earning higher income. And that task, in turn, can only be achieved through a profitable, burgeoning export sector.

If policy advisors, commentators and leaders continue to pretend that 'rebalancing' the government's books is the critical task, then they have not learnt from previous experiences. Lessons from the exploits of the previous government are stark. That government focused on accumulating fiscal surpluses to pay down government debt. While succeeding on that front, what they really achieved was a transfer of public debt to the private sector. And this transfer, along with an inflation-targeting mechanism that effectively taxed exporters and subsidised consumers, had the compounding effect of considerably worsening the nation's debt.

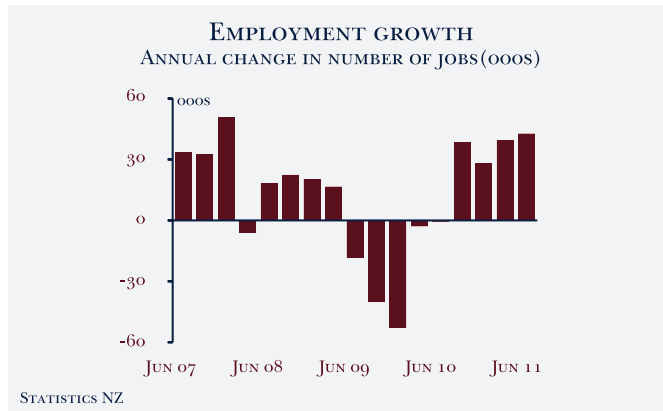
The focus of this year's Budget announcements, and the accompanying Treasury forecasts, indicate that we risk repeating these same mistakes.

## Promising employment growth, but...

The latest employment data suggests a modest recovery continues to accumulate.

In particular, gains in employment numbers over the past twelve months have solidified. The number of people in jobs in June was 42,700 higher than a year earlier. Full-time positions were up by 25,200, with 17,500 more part-time positions. And unemployment is 5,000 less than a year earlier, at a shade under 150,000.

This increase in jobs is equivalent to a 2% increase in employment, which is a healthy figure. However, as always the survey numbers tend to fluctuate in cycles, and the increases over the last four quarters has averaged 37,000, or about 1.7%. It is quite possible that the next set of survey figures will be lower.



The increases, unsurprisingly with our strong commodity markets, were in agriculture, not much joy in processing, but manufacturing activity in the 'fabricated metal products and machinery' sector is steadily strengthening. This group covers things from white-ware to complex equipment and is likely to be benefitting from the relatively competitive exchange rate with the A\$. Cafes and restaurants seem to be gearing up for the RWC 2011, and employment in social services also grew. The latter included tertiary education and other, which hopefully is around skills training. In health and community services there were small increases across the sector.

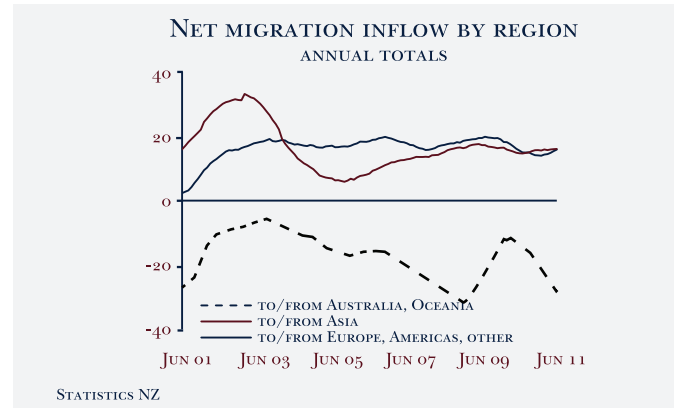
However, there remain questionable and concerning features in this data. The main employment losses were, quite worryingly from the construction sector, which lost a further 13,000 employees. There were also some small losses from the hard-hit retail sector. More questionable is the recorded 5,200 additional jobs in the adult, community and other education sector, which belies the funding constraints imposed on this sector.

Nevertheless, the employment picture is looking brighter than earlier thought.

The unemployment rate was 6.4%, close to the average for the last year, which was 6.5%; and similarly the participation rate of 68.1% was near last year's average of 68.3%.

So, unless you were looking for a catchy headline, there was not a lot of change in the labour market in the June

quarter. While not ideally placed, our latest assessment puts the New Zealand economy in a position to at least withstand the latest shocks from abroad.



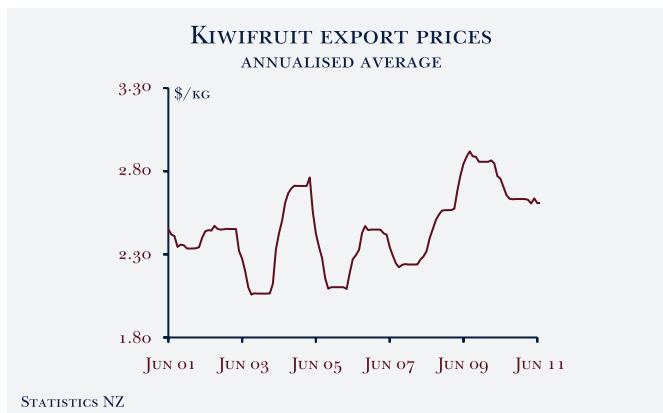
At the same time the migration flows continued on their track, with the Christchurch exodus continuing the strong net outflow to Australia. The net inflow from Europe, North America and 'Other' picked up a little, to reach about 16,000 in the year, whereas it was below 14,000 at the beginning of 2011. This lift could be the beginning of people coming down for extended holidays including RWC 2011. Our longer term perspective on migration is that if we follow our behaviour over the period since 1972, we will have to lift our GDP growth back above 2.5% to 3% if we are to make New Zealand attractive enough to achieve a steady net inflow of migrants.

## Exports continue to grow despite global, and currency, problems

In a year that has seen the economy creeping into recovery, the export effort has been central to determining the sustainability of the recovery. With exports for meat, dairy and wool fetching record high prices, along with ongoing demand for logs, revenue for 2011 looks promising. Putting these commodities aside, other export earners are also worthy of inspection. For example, horticulture, forestry, and viticulture, each earned over a billion dollars in 2010.

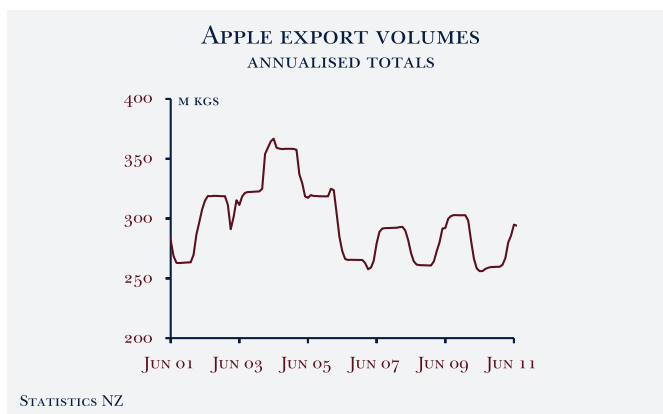
Kiwifruit export receipts for the year ending June 2011 declined 3.3% on year earlier, while export volumes increased by 2.1% over the same period. Volumes have been declining since April this year, but for the last couple of months, volumes have increased for all kiwifruit varieties since the same months last year. Prices have been less than favourable for the industry, declining by 5.4% to an average \$2.62/kg for the year ending June 2011 on year-earlier levels. And this fall is on top of a 3.1% fall in the year to June 2010, as illustrated. This price slump is likely to be related to the state of the UK economy – our main kiwifruit export market – along with the impact of the high NZ\$ exchange rate.

Of course, the seasonal nature of the industry needs to be noted. And with June figures, we are only really half-way through the six main months for export receipts. Consequently, we will reserve final comment on the performance of the industry until more is known on exports during the winter months as this is when PSA is meant to



take its strongest toll on the industry. In particular, volume numbers for the next three months will be critical, given there is little likelihood of a pickup in price given the state of the UK economy and the NZ\$ exchange rate.

The apple industry is similarly about halfway through its export season. For the year to June 2011, export volumes and receipts are both up, by 15.2% and 11.9% respectively, on year-earlier levels.



Volumes and receipts being up are pleasing results, especially given sluggish economic growth in its major UK and European markets arising from ongoing debt problems. However, reduced demand appears to be showing through in lower prices. Average apple export prices for the year to June 2011 are currently 2.9% below those of the previous year. Indeed, prices for the latest three months (being the first-half of this year's export season) averaged only \$1.18/kg, down from the \$1.24/kg for the same period a year ago, and well down on the \$1.32/kg received for the three months to June 2009.

Of course, the big news in the industry is the long-awaited opportunity to sell into the Australian market. Whether this shot in the arm will be sufficient to boost a struggling industry remains to be seen.

Wine export receipts for the year ending June 2011 were up 4.2% on year earlier. However, the rate of growth in export receipts for this billion dollar earner is slowing markedly, with this growth now well below the double-digit rates consistently experienced from 2004 to the early months of 2010.

The shortage in the global supply of logs arising from the high demand from Asian markets, with their preference for

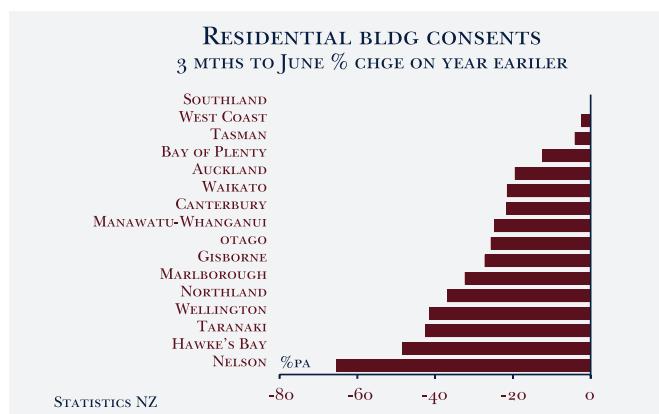
pinus radiata, has seen log prices continue to escalate. Log exports have had a solid year with volumes, receipts and prices all up for the year to June 2011. In particular, volumes were up 22.4%, receipts up 37.2%, and prices up 12.1%. The double-digit rates of growth in volumes and receipts were also on top of double-digit growth rates recorded for the year to June 2010.

It is a somewhat different story for timber and pulp. Despite timber prices being down 2.4% for the year ending June 2011 from last year, volumes were up 3.8% with receipts slightly up on last year by 1.3%. Pulp prices, on the other hand, have skyrocketed with prices up 17.8% for the year to June 2011. Pulp export receipts have also increased, up 7.5% on last year for the year to June 2011. However, pulp volumes have declined by 8.8% over the same period.

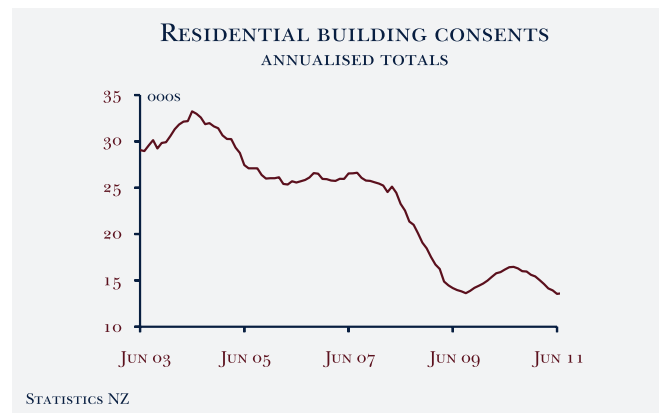
Again, these high prices appear to be coming from high demand in Asian countries such as China, South Korea and India. However, it seems curious that export volumes have declined, given its close association with the quantity of logs and timber products in its production process.

Overall, exports seem to be weathering the global uncertainty and the high NZ\$ exchange rate. But, for how much longer remains a relatively big unknown.

## Construction sector still in limbo



In the three months to June, the number of residential building consents has declined across all of the regions compared to the same time last year. The latest data indicates that less than a 1,000 residential building consents were issued in June, leaving the three month total at just over 3,000 consents.





Even more sombre is the annualised total for consents to June of 13,500. As illustrated, activity in the house building sector remains very low.

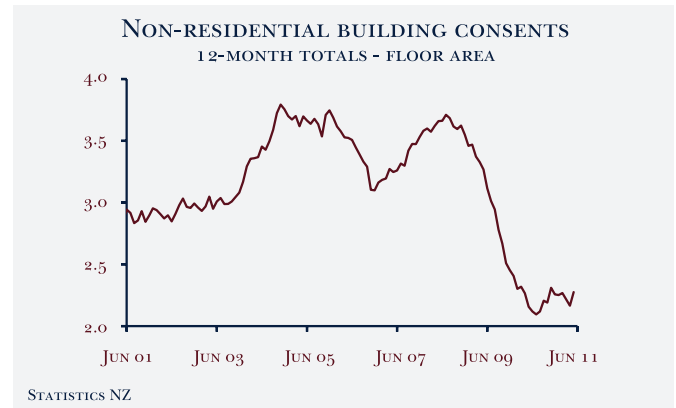
As reported in our article on the HLFS, the main employment losses in the June 2011 quarter were from the construction sector, which lost a further 13,000 employees. Building and construction is a sector of SMEs. While this allows some flexibility in terms of tradespeople being able to adapt and move to find work, this is difficult when consents are down across the board.

This is a concern from the point of view of training opportunities and potential productivity growth. It is well known that the construction sector has relatively low productivity growth and work is being undertaken by various industry training organisations to address this through skills strategies. However, encouraging the industry to step up and train people will be a challenging task in this climate of low activity.

In the North Island, residential building consents were down 15.2% in the year to June 2011 compared to the previous June year. For the South Island, consents were down 18.6%. With the rebuild of Christchurch yet to gather momentum, the annualised total for residential building consents in Canterbury stood at just under 2,300, about 600 consents short of those of the previous year.

The financial results for the year to June 2011 of Fletcher Building Limited were released this month. These results and the commentary from Chief Executive Officer Jonathan Ling, indicates the uncertainty that continues in the non-residential building sector. Mr Ling states that Fletcher Building Limited is uncertain as to when the upturn in the construction industry will occur and at what pace that recovery will take.

Since October 2009, the 12-month running total for non-residential building consents has been less than 14,000; but the figure for the year to June 2011 figure is a new low, sitting at 13,050.



This fall in non-residential activity, and the sentiments of Mr Ling, is reinforced by actual floor area data of consents issued. As illustrated, the annualised totals using this measure have plummeted to about 2.2 million m<sup>2</sup>. Year-on-year there has been some improvements in the area of buildings gaining consents. For example, consents for factories, shops and accommodation based on area have improved in the 12 months to June, but these remain low compared to earlier years. The value of work on factories, shops & accommodation, and farms has also improved year-on-year; however, social buildings and offices have recorded declines.

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