



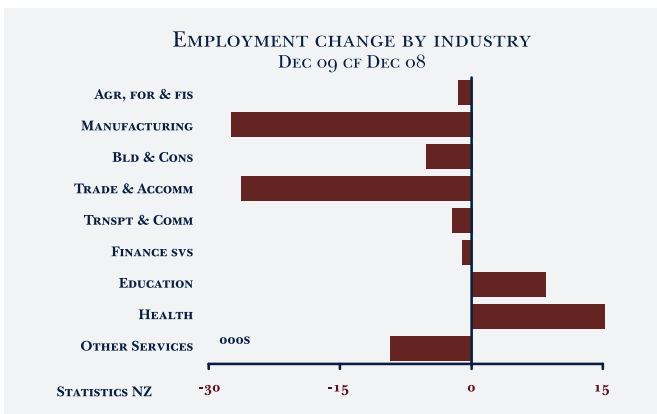
BERL Monthly Monitor

February 2010

Employment's red ink spreads

Employment in December 2009 quarter was 53,000 lower than in December 2008, according to the Household Labour Force Survey (HLFS) released by Statistics NZ this month. This drop was one step worse than the 40,000 drop from September 2008 to September 2009. The real concern to us is that the declines are now spread across a lot of the industries, and there are no strong white knights riding up to pull employment out of the mire.

Major industries badly hit and getting worse are manufacturing (including processing) and retail trade. Each of these lost over 27,000 employed in the twelve months to December. The only small positives within these sectors was the food processing sub-sector of manufacturing, and the cafes, restaurants and accommodation subsector of the retail industry. While the primary sector is not losing so many jobs, the communications, property and business services and construction industries are badly affected.



The real disappointment is that construction activity has not kicked in, despite the announcement of a number of projects. As the migration inflow remains strong we can hope for a reasonably early response from the house-building industry, provided there is sufficient credit available.

In contrast, still ticking away in positive employment terms are jobs in health and community services, education, finance and insurance services, and transport and storage.

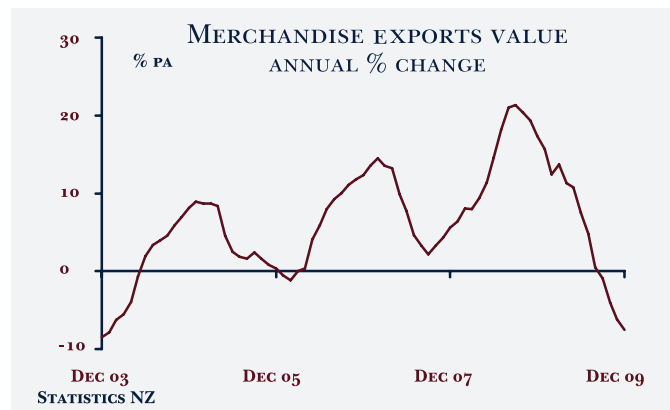
There has been a 56,000 increase in the number unemployed over the last twelve months, pushing the total number to 159,000 or 6.8% of the labour force.

There has also been a considerable increase in the number not in the labour force. This is consistent (in current conditions) with some people bringing forward their retirement, or positively taking up the opportunity for fulltime training.

Where have all the export \$s gone?

Despite pronouncements to the contrary, the reality check provided by the latest labour market figures should suggest to others the need to assess fundamental concerns facing the NZ economy. While others may continue to point to buoyant confidence indicators and/or recovering house prices, it doesn't take us much effort to identify the key issue. Put bluntly, the prosperity (or otherwise) of NZ Inc relies on the performance of NZ's export sector.

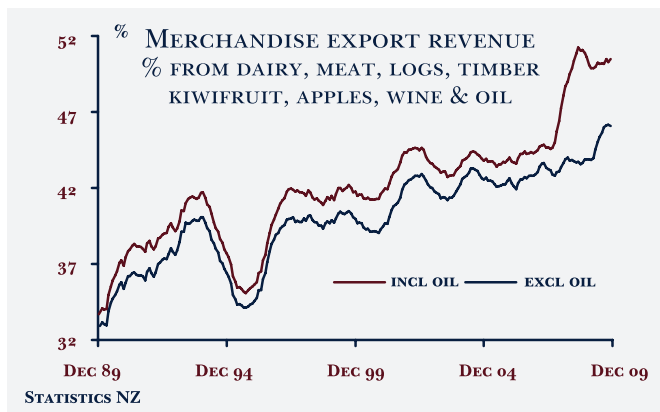
Much has been written about the need to export, but, when push comes to shove, little is done to safeguard (or, indeed, nurture) NZ's exporting sector. And behind the numbers the much-needed export-led recovery remains worryingly conspicuous by its absence.



That some export volume numbers are currently on the upswing may seem promising. Dairy and log export volumes are, in particular, resoundingly buoyant, with the last three months of 2009 recording numbers 20% to 30% above year-earlier levels.

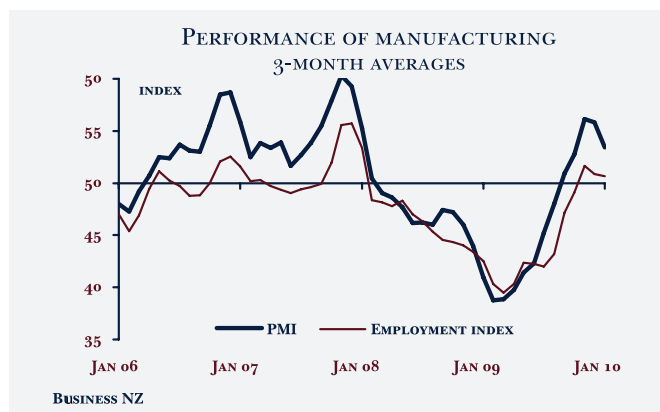
But even with the help of these stellar performers, the export sector in general is best described as struggling. Translating into revenue terms, merchandise receipts in calendar 2009 totalled just under \$38bn, or some 8% short of the previous year. And in the last quarter, total merchandise export revenues were more than 17% below year-earlier levels.

Looking in more detail, we find that more and more of NZ's export burden is being shouldered by a narrow group of commodities. In particular, dairy, meat, logs, timber, kiwifruit, apples and wine accounted for approximately a third of our merchandise export revenues in the late-1980s. Two decades later – after a combination of inflation targeting, knowledge-wave conferences, economic transformation, export years, job summits, growth agendas, and so on – these same categories now account for more than 45% of our export \$s. If we add in our new-found export earner oil, then we can now easily account for over a half of NZ's merchandise export \$s .



This will no doubt serve as cold comfort for those pre-occupied with the economic development of a super city and associated metropolitan house prices. Perhaps others will view, more correctly, the importance of our regional powerhouses in being the primary source of the bulk of our export \$s and re-orient efforts and policy settings accordingly.

Manufacturing indicators re-surface (just)

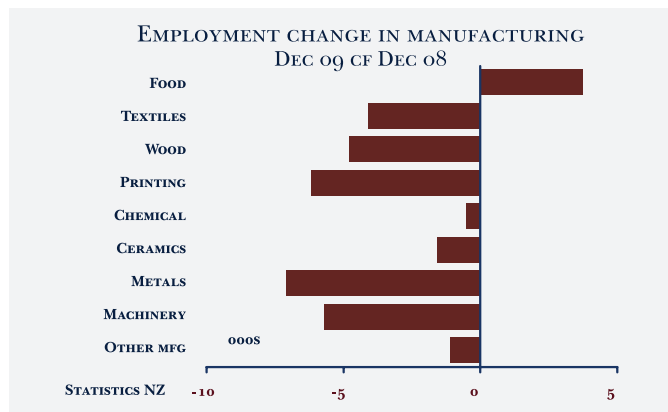


Following about eighteen months in below-50 territory, the Performance of Manufacturing Index (PMI) has surged into the above-50 zone. This change should indicate that the manufacturing sector has moved from contraction into expansion mode. Over the latest three months the PMI averaged 53.4, well above the 40.9 recorded over the same period a year earlier. In addition, the production (53.4), employment (50.7) and new orders

(57.7) indices were also noticeably higher than those of a year ago. A similar story is also apparent from the regional indices, which are all above 50 as well as being above their comparative year-earlier levels.

However, the HLFS employment numbers suggest a picture somewhat different to that depicted by the responses to the PMI survey. As noted earlier employment in manufacturing slumped 27,400 over the year to December 2009. This slump comprised employment contractions in 8 out of the 9 sub-sectors within manufacturing. In particular, job reductions were largest in metal product manufacturing (down 7,100), printing & publishing (down 6,200) and machinery and equipment (down 5,700).

And while employment in the food processing sub-sector rose, this can be attributable in part to drought conditions in previous seasons. That livestock slaughter numbers for sheep and cattle are not promising (down 10.5% for the 2009 year) does not bode well for the sustainability of this job figure.



Similarly, manufacturing export figures show a markedly gloomier result. For example, Statistics NZ trade figures indicate receipts from mechanical and electrical machinery and equipment exports for the calendar 2009 were down 14.4% on the previous year. And for the three months to December 2009 export revenue from these categories were down 15%, indicating that the recent sales situation is no better than earlier in calendar 2009.

And more sobering data is contained in Statistics New Zealand's Economic Survey of Manufacturing for the September quarter. As reported in our December 2009 BERL Forecasts, the volume of manufacturing sales declined 1.4% in the September 2009 quarter after rising 1.5% in the June 2009 quarter. Six industries showed an increase in sales volumes while six showed a decline over the September quarter.

Even more sobering are the longer-term data trends, with the total manufacturing sales volumes for the year to September 2009 down by nearly 7% on the previous year – taking the \$54.8bn total (measured in constant 1997 prices) to under the \$55.3bn recorded eight years earlier in the September 2001 year.

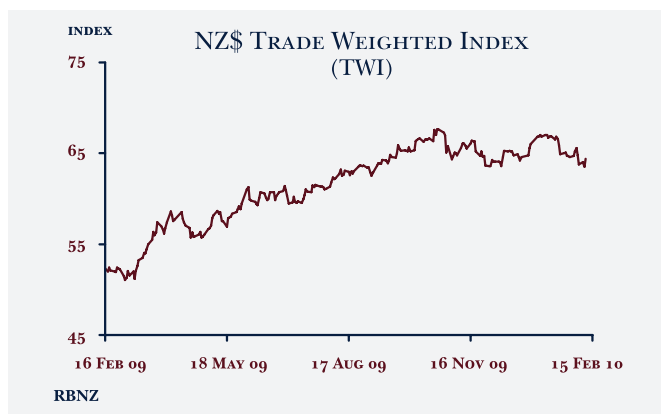
NZ\$ remains high and credit remains tight

While retaining the Official Cash Rate (OCR) at 2.5%, the Reserve Bank's (RBNZ) review of 28 January indicated that it could be raised slightly earlier than June as implied in the RBNZ's December Statement. This was a trifle unexpected and, consequently, both the NZ\$ exchange rate (as measured by the trade-weighted index (TWI)) and the 90-day interest rate increased a few points. However, these increases were reversed upon the release of unexpectedly high unemployment figures a week later resulting in expectations of a later date for the OCR increase.

Consequently, we expect the RBNZ's Monetary Policy Statement to be released on 11 March to hold firm in its stance that OCR increases will not occur until the latter half of 2010.

The 90-day interest rate, after rising to 2.82% at one point since our December issue of BERL Forecasts, is currently at 2.74%. This is virtually unchanged from 2.75%, but the 10-year bond rate has declined significantly from 6.06% to 5.75%. The TWI is down from 65.2 to 64.8, but has fluctuated within a range of 63.8 to 67.0.

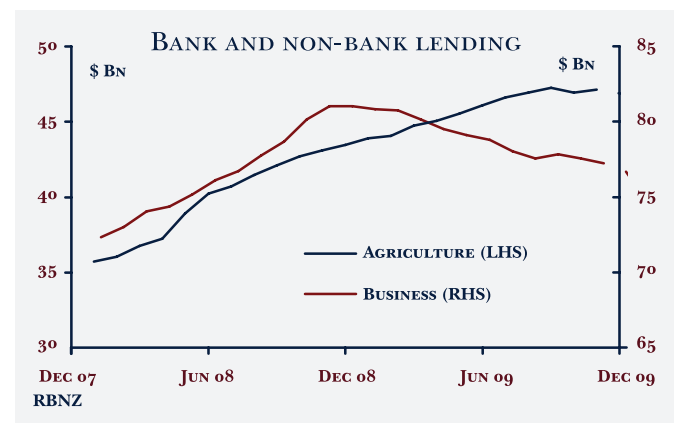
In a recent address, the RBNZ Governor Dr Bollard maintained that the OCR had worked reasonably well



since its inception. However, he did indicate acceptance of shortcomings and went on to say work was being done at the Bank to improve it, noting changes in prudential requirements and other areas that could possibly, as a by-product, increase its macro-orientation.

While it is good to know the Bank is working to improve its policies, the Governor showed a degree of conservatism that was disappointing, though not surprising. In particular, he ruled out suggestions from outside commentators, notably the idea of a common currency with Australia (on grounds of the need to maintain independence because of differences in the two economies) and adoption of the Singaporean system of foreign exchange management, also because of our economy being different.

While we would (probably) agree that a common currency with Australia is undesirable, we cannot agree with his dismissal of the Singaporean model. The Governor argued the system would not work as well here because we have a smaller tradable sector, making greater exchange rate changes necessary to achieve given changes in the CPI. That may be true. But the main benefit of the Singaporean system is that it manages capital flows from abroad. And this management acts in a manner that, without direct controls, prevents capital inflows from providing a base for inflationary credit expansion. Similarly, it prevents capital outflows from precipitating credit contraction.



New Zealand has experienced the ill-effects of an inflationary credit expansion in recent years when excess credit availability, based on capital inflow, led to housing and other inflationary "bubbles". And we could easily experience severe contraction if world markets continue to be tight or become more so. Thus the Singaporean system reduces one of the root causes of both inflation and deflation. This is the very opposite to a "dilution of focus on medium-term inflation" about which the Governor expresses concern. To the contrary, it would be a hugely effective addition to the OCR in the Bank's anti-inflationary arsenal.

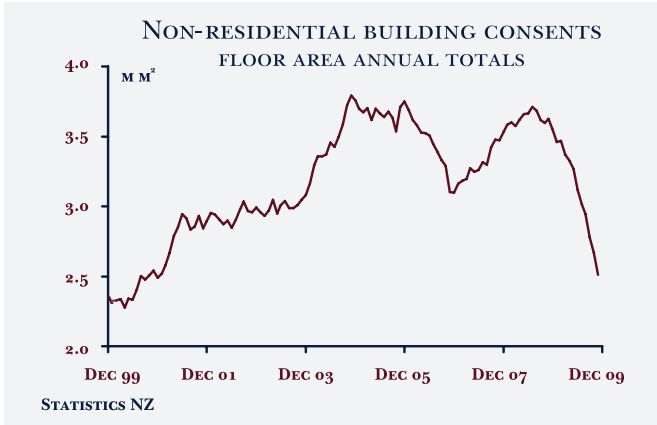
A minor example of the deflationary aspects touched on in the last paragraph is the tightness of credit now being experienced as banks find loanable funds scarce on world markets. Thus latest RBNZ data show bank and non-bank lending to business contracted by over 7% during 2009; lending to agriculture, after peaking in September, has been virtually unchanged since; consumer credit is down by 5%; and only housing lending is in positive territory.

It is hard to believe that this degree of tightness in credit conditions is not a major reason for the worsening state of the economy. The unexpectedly high unemployment figures for the latest quarter and the continuing struggles in the export sector, are but reflections of this worsening state. Consequently, significant, sustained or fundamental improvement is unlikely for as long as there remains difficulty in sourcing funds from abroad.



February 2010

Construction industry slumps in line with business investment



An upturn in residential building consents issued was widely reported following Statistics New Zealand's release of building consents data for December 2009. For the first time in more than two years, this data showed residential consent numbers significantly above year-earlier levels. In particular, the December 2009 quarter was 23% above that of the comparable period a year ago.

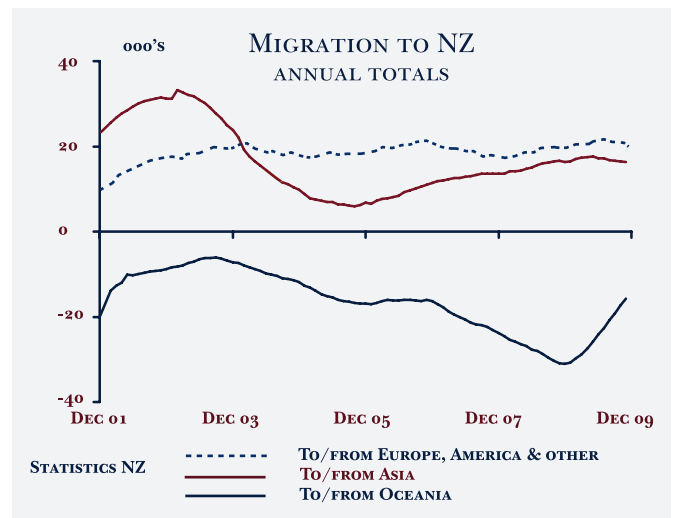
However, closer investigation of these figures show little overall pick up in the construction industry. For residential consents, the calendar 2009 total of 14,425 was 22% below the 2008 figure and, indeed, represented the lowest annual figure since the commencement of this series of data in 1973.

On the non-residential side of the industry, activity remains in the doldrums. Total consents in terms of floor area for the past year were over 30% below year earlier. Amongst the larger categories, the greatest falls over the year were recorded in storage buildings (down 48%), factories & industrial buildings (down 44%) and farm buildings (down 42%). In contrast, social & cultural buildings (up 45%) and education buildings (up 12%) were the only significant categories to register increased activity.

These figures are closely consistent with the picture arising from the employment, export, manufacturing sales and bank lending data. So, while confidence

may have returned, the production and tradable sector powerhouses of the New Zealand economy are far from any recovery phase, let alone a sustainable growth scenario.

Migration exceeds forecasts



For a while we have been forecasting net inward migration for calendar 2009 to be about 20,000. The actual number has come out at 21,300, which is a good solid base for ensuring some recovery in demand for dwellings, consumer durables and other expenditures associated with increased household formation. The present track of the migrant flows indicates that for the year ending June 2010 we could be expecting a net inflow of 24,000 people.

The increases are largely due to a reduction in the outflow of Kiwis, but it is also still heavily underpinned by a continuing strong gross inflow from Europe and North America of about 40,000 per year, as well as skilled migrants from Asia.

As we say often, the inflow of quality migrants is a strong driver of economic growth. This influence should be strengthening the base economy later in the year. The migration story is the one silver lining on an otherwise bleak cloud.

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