BERL Monthly Monitor

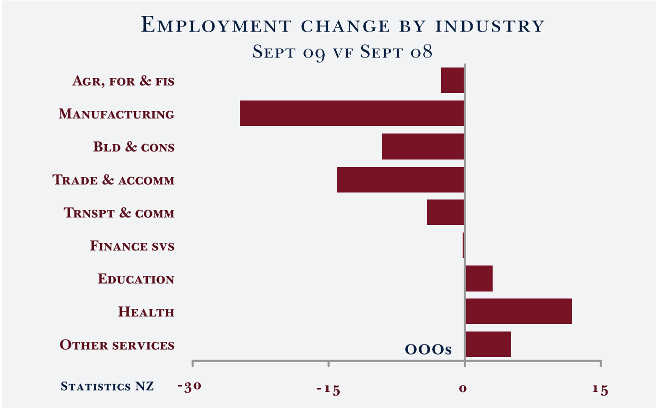
November 2009

Employment falls - infrastructure projects yet to deliver

We suggested a year ago that it would, and now the employment decline has arrived. Total employment in September 2009 was 40,000 lower than a year earlier, a big fall from the 18,000 drop recorded in the year to June 2009. And should we be surprised? Not really, because there has been a steady decline in employment growth over the past two-to-three years. This follows our high interest rate/high exchange rate policy that has put the squeeze on employment in any goods and services that are internationally tradable. Add to this the financial bubble pumped into the prices of houses and farms by the hot money dragged into our 'safe-haven currency', and we had the formula for a decent crash.

The employment losses recorded in the year to September were mainly in the tradable agriculture, processing and manufacturing sectors, as well as in construction trades supporting the house building and infrastructure sectors. We had expected a moderate increase in employment in the construction sector due to infrastructure projects including broadband. However, if that investment has finally started it is not yet showing through to employment figures.

With job numbers falling in the key driver industries of export processing, manufacturing and construction, the



indirect effect is now showing through to a reduction in employment in the retail trade sector. We can probably expect these effects to also feed through to reduced employment in business services in the coming quarters.

'Up-skilling' for the recovery?

The well-functioning labour market has mitigated the employment decline, as we have come to expect. In summary, while employment fell by 40,000, there was net inward migration of 14,000 people 15 years plus, and a net natural increase of about 33,000 people 15 years plus. This could have increased unemployment by a total of 87,000. However, with reduced opportunities available in the labour market, an additional 35,000 'decided' either to

Forecast for Auckland makes sombre reading

In association with AUT's Institute of Policy Studies, BERL has released a report assessing the current situation of the Auckland economy. Also containing a forecast of the short-to-medium term prospects for the Auckland economy, the report is available at http://www.berl.co.nz/1108a1.page.

The report notes that the short-term outlook for the Auckland economy is best described as unstable. The next few months are expected to be better than the first half of 2009, but there will be little to celebrate with:

- a sombre export picture for manufacturing
- modest, at best, employment growth
- a subdued outlook for retail trade
- import growth slightly above national
- net inward migration gains
- moderate house price growth
- growth in house building activity
- guest nights treading water

Longer-term challenges were also canvassed at a presentation accompanying this report. With the tradable primary, processing and manufacturing sectors accounting for 15% of Auckland's employment, compared to the national average of 21%, discussions concentrated on barriers to the Auckland economy becoming more export oriented and outward focussed. The role of government, both central and local, in providing a stable and certain environment in which businesses can make long-term investment plans were noted as important.

These, and other issues, will no doubt be canvassed further in future editions of these regular reports on the Auckland economy.

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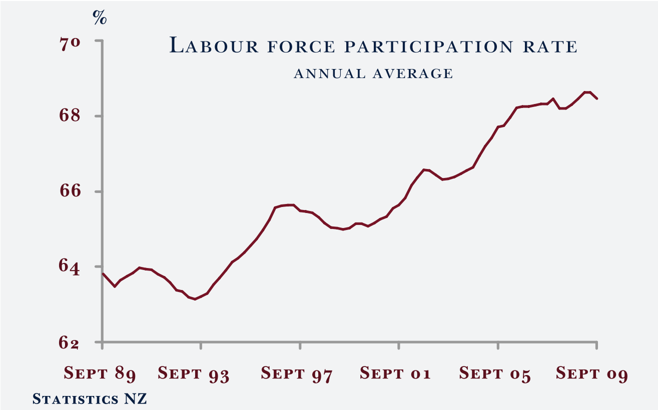
leave or not to enter the labour force. This is measured as a decline in the labour force participation rate, as illustrated. Consequently, unemployment increased by 'only' about 50,000 people.



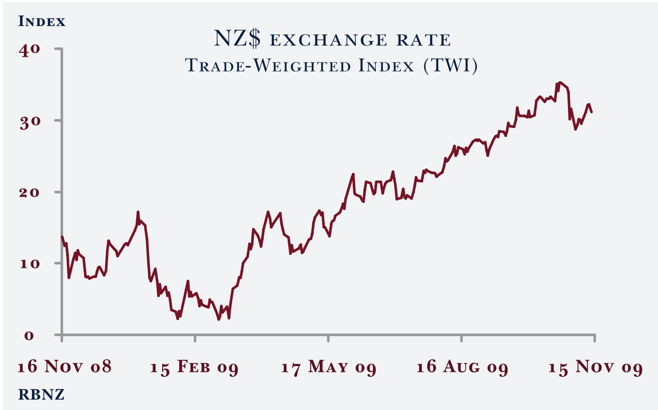
The test as to whether we come out of the 'world' recession any better than other countries will be whether these additional people classified as 'Not in the Labour Force' have been able to obtain the resources to access further skills training and improve their life-long education experiences. If they haven't we, as a country, have lost a golden opportunity. If so, expect to hear employers again saying they can't get the skilled workers they need, as soon as the economy starts to recover over the medium term.

Officials fret over NZ$, but then revert to TINA

Short-term wholesale interest rates have continued to be relatively stable within a five points range; the 90-day rate currently being 2.83% compared with 2.82% a month ago. The 10-year bond rate has, however, risen from 5.76% a month ago to as high as 6.12% and stands at 6.07% as we go to press.

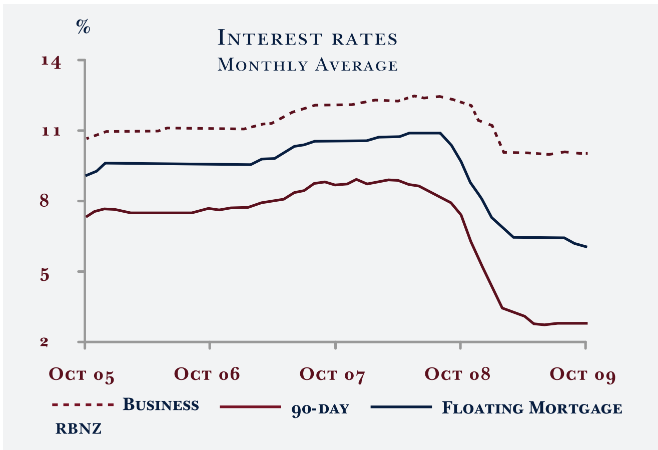
With regard to credit availability, latest RBNZ data (that for September) still points to extreme tightness in business and consumer finance conditions. More timely figures for household mortgage approvals, i.e. up to November 6, also fail to show any easing, despite assertions from the real estate sector that greater availability of finance is a partial factor in the recent buoyancy in the housing market. It is true that there was an increase in credit to businesses. But, at 0.4% on the previous month, it is seasonal or in the random error range, or a mere offset to the virtually continuous decline throughout 2009. The latest figures for household mortgage approvals are stable, but at a level consistent with 2005 prices and about 25% lower than today, rather than generating inflationary pressures.

Exchange rates have continued to be volatile, in a 30 point range, with the Trade Weighted Index (TWI) at 66.2 as we go to press compared with 66.5 last month and a mean for the month of 66.1. We hesitate to make any call as to trend, but we do note that on all the cross-rates included in the RB 14-currency TWI, except the Canadian dollar, the NZ$ has depreciated fractionally over the past month. The weakness is therefore no longer the mere net effect of variations in the major currencies off-shore, but could in fact reflect belated recognition that the market may have got it wrong, and that a rate close to the fundamentals is about to be delivered.



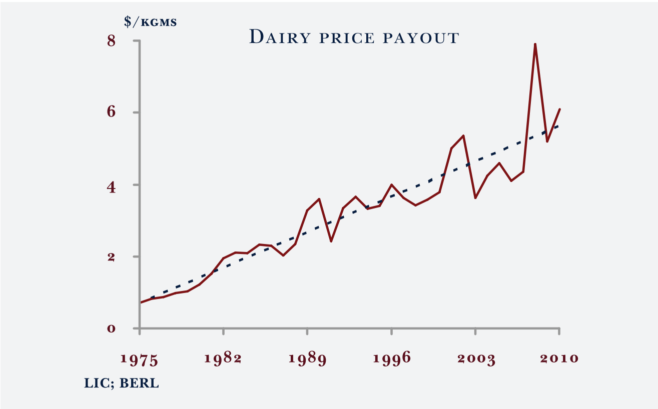
Meanwhile, statements from commentators, officials and others continue the hand-wringing over the damaging level of the NZ$. That the high exchange rate is harming prospects for an export-led recovery appears, now, to be accepted by most. But, in reverting to the time-honoured TINA (there is no alternative) argument they reveal an unsurprising reluctance to take action.

And those using the reason that 'we can't take on the markets' misunderstand the situation. If the situation required the propping up of an overvalued currency then, yes, the concept of 'taking on the market' would be relevant. But the current situation requires bringing down an overvalued currency. This situation does not require 'taking on the market'. Rather, it requires a simple statement from the authorities backed up by transparent action selling NZ$ and buying foreign currency. And, importantly, there is no limit to this course of action, as there is no limit to the quantity of NZ$ available to the authorities to sell. More on this in next month's BERL Forecasts.



Export recovery not yet sighted

The Fonterra announcement of a 95 cent increase in its forecast payout to $6.10 is welcome news. With demand returning for dairy products around the world, leading to buyers rebuilding their depleted dairy stockpiles, international dairy prices are surging. The milk price component of the forecast increased $1.10, up to $5.70 reflecting improved world conditions. However, the value return component was down 15 cents. This was attributed to the high and volatile NZ$, which Fonterra warned was hurting earnings while making it difficult to make accurate forecasts. The $6.10 forecast payout is just above the long-term trend.



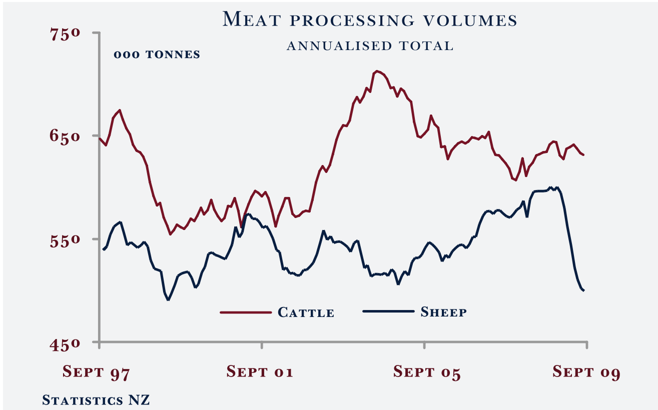
Despite this boost, inspection of latest export data suggests the long awaited export recovery remains but a speck on the horizon.

Milk, butter and cheese export volumes in the year to September 2009 were a healthy 18% up on year-earlier levels. This is a welcome rebound on the 8% slump recorded in the year to September 2008. In value terms, though, the picture is not as rosy as the NZ$ exchange rate and commodity price movements conspire to play havoc with the fortunes of the tradable sector. Milk, butter and cheese export earnings for the September 2009 year were down 4% on the previous year - the first September year decline since that recorded in the September 2003 year.

In contrast, meat export volumes for the September 2009 year were more than 21% down. And immediate prospects here don't look great with total slaughterings in the three months to September still 8% down on year-earlier levels. But a recovery in commodity prices have helped lift meat export earnings to over $5.3bn, some 8% up on the September 2008 year.

On the forestry side, a surge in logs and timber exports has seen volumes soar to 35% above the September 2008 year. This has translated into a 25% increase in annual export revenues.

Putting these top three (dairy, meat and forestry) exports together, revenue for the September 2009 year was 2.5% higher than for the September 2008 year. Yes, there are some promising numbers. But, all in all, the much needed recovery based on long-term sustained export growth remains elusive.



The announcement of a seven year investment between Zespri and the Foundation for Research, Science and Technology (FRST) to develop new kiwifruit varieties is set to enable further growth in this sector. The $35.7m project will be jointly operated by Zespri and Plant and Food Research, and is expected to be the world's largest kiwifruit research programme. Ultimately it will help with the horticulture industry's quest to double its export earnings to $10bn by 2020. Latest export figures report kiwifruit export earnings up 8.4% at just over $1bn in the year to September 2009, despite volumes being down 6%.

Housing-related retail sales picking up slowly

We pointed last month to net inward migration lifting to 20,000 for calendar 2009, driven by a continuing long-term inflow of people from Europe and North America, and the recent reduced outflow of Kiwis. This change is strengthening the fundamental demand for accommodation - houses and apartments. It is not, as some bank economists are saying 'fuelling a house price boom, that will likely bust later in 2010 or 2011'. The sound underlying demand for accommodation will only turn into a house price boom, followed by a bust, if the banks again embark on their destructive mortgage lending spree.

The same logic and argument applies to prices for dairy farms and cows, faced with stronger basic demand due to the lift in the dairy payout. In the short run, the supply of dairy farm land and of milking cows is largely fixed, so if banks and other lenders throw millions of dollars at industry players again they will probably ensure that their forecast of a boom, followed by a bust eventuates.

Back to the household sector, indications are that the fundamental demands associated with increased housing are appearing. The latest retail trade data shows the volume of spending on appliances increasing, with September 2009 quarter up 9.2% on September 2008. Spending on

economics

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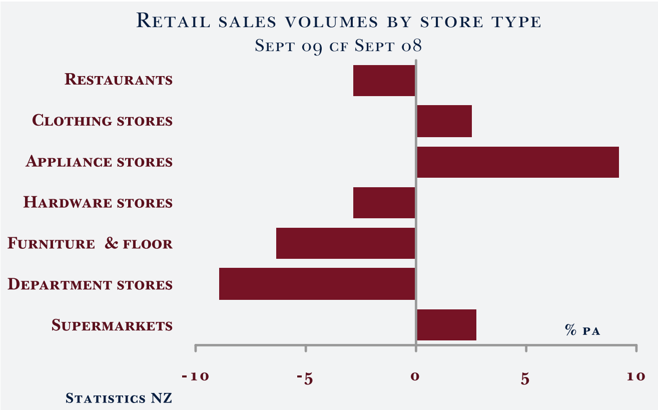
hardware, and furniture & floor coverings in the September 2009 quarter was still a little below the volumes a year earlier, but has been progressively heading upwards again quarter-by-quarter.



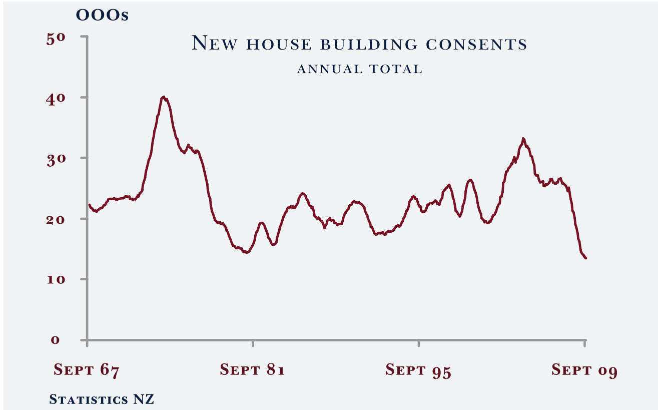
Eventually we expect the positive net migration balance to continue to stimulate demand for house building, and the associated demands for appliances and furnishings et al. Whether there is enough productive capacity here to benefit local employment or whether it will cause another increase in our import propensity remains to be seen.

On the discretionary spending side we are back into buying more clothes and even spending on accommodation seems to have bottomed; however, we aren't eating and drinking out so much. Regionally, Auckland and Waikato are back into positive growth for two quarters in a row as is the remainder of the South Island. Retail growth in the Wellington and Canterbury regions are still negative.

Looking forward, as the rural scene picks up on the back of dairy payout expectations, and the housing-related demand firms, we expect modest positive figures more generally.

But construction industry remains on sidelines

Latest building consent data indicates that residential and non-residential construction activity remains anaemic.



New residential consents for the year to September were the lowest September year total for over 40 years. The 13,616 total for the September 2009 year (compared to the next lowest over the past 40 years of 15,043 recorded in the year to September 1980) was a dramatic 35% down on the previous year. Further, whereas reduced activity earlier in this cycle had been dominated by falls in the Auckland region, the house building industry is now in nationwide recession. All but one regional council reported reductions in annual new house consents for the September year, with the declines ranging from 22.5% in Southland to a 49.3% collapse in the Wellington region. Tasman was the one region not recording a decline, with total new house consents issued up 1.3%.

And there is not much joy for builders and construction firms on the non-housing side. Non-residential consents issued have exhibited a similar decline as businesses shelve expansion plans and defer maintenance. The total number for the year to September was down by 16% on the previous year, while the floor area measure was over 23% down. This decline has been exhibited across most of the larger non-residential construction categories - with shops, restaurants & taverns consents down 19% (in floor area terms); storage buildings down 37%; offices & administration buildings down 5%; and factories & industrial buildings and farm buildings both down 28%.

These numbers are consistent with a general decline in business investment spending and do not engender much confidence in prospects for longer-term productivity improvements.

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