



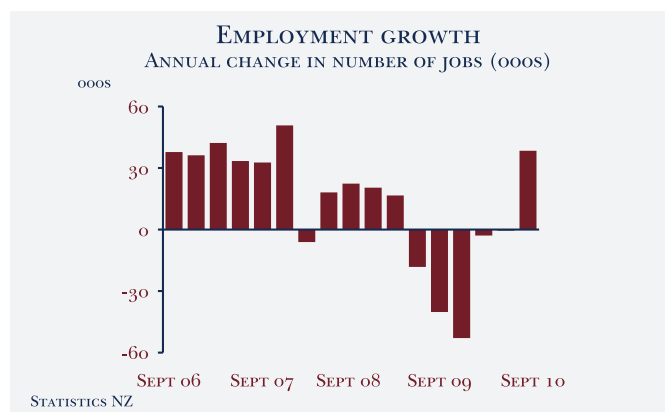
# BERL Monthly Monitor

## November 2010

### Labour market numbers erratic – a reflection of the economy?

The employment numbers coming from Statistics NZ Household Labour Force Survey (HLFS) have most labour market analysts puzzled, especially given the mixed messages of recovery, or not, from the rest of the economy.

The survey measures from a sample of households the number employed and unemployed. The HLFS figures for employment in the September quarter 2010 are 38,400 higher than in September 2009. This increase comes from a series which was down at minus 40,000 in year ended September 2009; minus 53,000 year ended December 2009, then minus 2,900 and minus 600 for the next two quarters. Then we have the jump to plus 38,400. This is a big change in a series that has been somewhat erratic in recent years. Either the survey's sample is becoming more erratic, or (perhaps) it is the economy that is becoming more erratic. It may well be the latter.

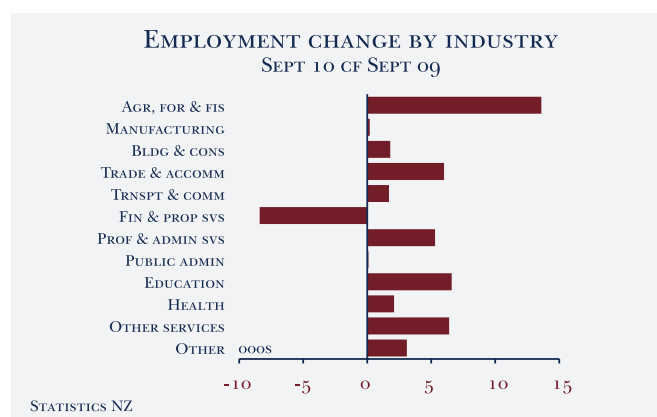


One reason why we could believe that employment has jumped is another survey, which asks businesses how many jobs they have filled. The Quarterly Employment Survey (QES) shows an increase in the 'fulltime equivalent' number of jobs by 2% in September quarter 2010 compared with a year earlier. The 38,400 more employed measured by the HLFS is similarly about a 2% increase in the fulltime equivalent employment.

However, the concern about the HLFS figures returns when we look at some of the components of change. Any survey becomes less reliable as we look at the smaller components, but some of the variations are quite large. The occupations show big changes with managers and professional combined increasing by 53,000, while clerical and administration workers declined by 24,000. The regional distribution seems a little counter-intuitive with an increase by 19,000 in Otago – accounting for about one half of the national increase.

At the industry level, increases in jobs are recorded across a range of sectors. The finance and property services sector is

the one exception in the accompanying chart, with job numbers down 8,000 on that of a year ago. But, further worries about the credibility of the HLFS figures arise when we look at some of the other components of change. In particular, the 12,000 annual increase in jobs in the agriculture, forestry and fishing sector seems too large to believe – it represents an expansion in this sector of nearly 10%! Similarly, the rise in jobs in the trade and accommodation sector contradicts other information of struggling retail sales and flat guest night numbers.



The labour market cannot give us a strong steer on the future of the economy at this stage. The negatives coming through from lower household spending figures, house prices a little shaky and government revenue down seem to say the immediate past and present are not strong. Some small underpinning in future could come from the net inward migration flows (although lower than it was, still a positive net inflow); an impetus for the construction sector in the re-building around the Canterbury region, not to mention the 2011 Rugby World Cup.

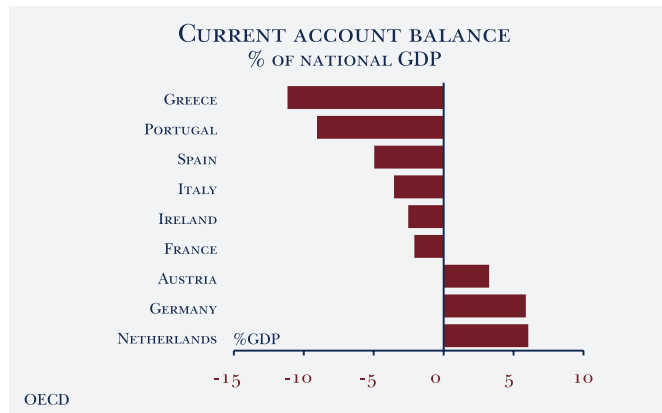
### Euro turmoil latest reflection of global financial imbalances

The world situation remains in turmoil as the Euro area struggles to correct problems inherent in its system of a single currency for members with widely different economies. The value of the currency is an average that is appropriate to very few. To some such as Germany it delivers trade surpluses, while to others it delivers trade deficits.

These were manageable when the financial system had abundant funds to lend but have become a problem since funds became scarce, lenders became more selective and raised interest rates. The classic corrective mechanism of exchange rate depreciation is, of course, not an option for them.

The problem from NZ's perspective stems from the fact that the Euro depreciates whenever these difficulties surface, thereby

appreciating the cross-rate for an important part of our export market.



The G20 meeting in Seoul, not surprisingly, has failed to reach agreement on adequate measures to correct the imbalances in the world financial system.

We say “not surprisingly” because it is, and always will be, too much to expect the ‘surplus’ economies to take corrective measures to reduce the trade imbalances of the world. Such corrective measures would help the United States and others (like us) who have borrowed those surpluses and allowed their (and our) exchange rates to appreciate, to the detriment of their (and our) own export industries.

Consequently, a situation of chronic low profitability has been created in the previously flourishing industries of the ‘deficit’ countries, as well as excessive private sector debt. Consequently, the deficit economies need to take corrective measures themselves.

The options are clear. The first, and economically best, solution is for the deficit countries by means of ‘sterilized interventions’ to depreciate their currencies to levels that for each economy will achieve an appropriately balanced current account such that capital flows are not excessive. The less preferred way is to use direct controls of capital flows to indirectly achieve much the same result. Unfortunately, the required action is most unlikely because it requires a retreat from the neo-classical economic theory that still dominates the mindset of authorities in the deficit economies.

In the meantime our forecasts must accept that reality and the picture that emerges is far from bright.

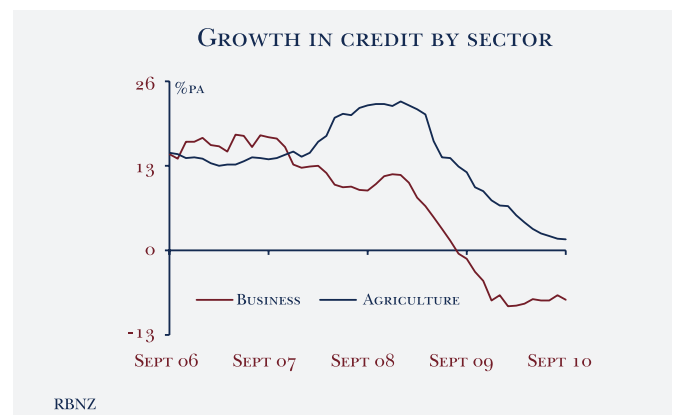
Specifically for New Zealand, the NZ\$ will remain over-valued as other countries manage their currencies down and as our authorities continue to assert the ‘purity’ of our float. As a result, profitability in export industries and other tradable sector businesses will, as has been the case for the past twenty-five years, be insufficient to attract investment in these industries necessary to generate high productivity outcomes.

## Conditions suggest OCR hikes may be put on hold

Disturbingly, these negatives are being confirmed by latest data.

In particular, since our last issue, the NZ\$ has appreciated against every currency in the RBNZ’s 14-country TWI. Thus it is up, not only against the US\$ (2%) and Yen (4.7%) but, the Euro most of all (5.5%) and even the A\$ (2.9%). The 5-currency TWI has risen by 3.6% to 69.1. It is anyone’s guess how high the NZ\$ will go, but there is little possibility it will decline to a level compatible with export-led growth given the reluctance of our authorities to intervene.

As to the availability of credit to finance expansion, latest RBNZ data show bank lending to business in September continuing to decline at a rate of approximately 0.5% per month. Interest rates to business declined from 10.36% to 10.23% in September but figures for October show the average up again at 10.34%.



On the property market, REINZ figures for house sales in October at 3,903 were the lowest on record for October. The stratified House Price Index showed a drop of 0.9% on September and is now down 6.5% from the November 2007 peak. Rural property sales are also down with recorded sales of 147 farms in the three months ended October compared with 205 in the same period last year.

There is now accumulating evidence that the recovery has, at best, stalled and it is becoming unlikely that the RBNZ will raise its OCR in March as currently expected. The 90-day interest rate has recently drifted lower to 3.16% from 3.20% a month ago and this could even signal a market expectation of an OCR reduction now on the horizon.

To finish on a positive note, the vastly better situation in Australia is likely to enable the RBA to continue raising its OCR for some time, which could deliver a lower NZ\$/A\$ cross-rate with benefit to New Zealand’s manufacturing exporters.

## Government finances worse than expected

The latest government accounts data came as somewhat of a surprise to many. The Core Crown OBEGAL (operating balance excluding gains and losses) for the three months to September 2010 was a deficit of \$2.8bn. This was over \$920m worse than forecast. Although Core Crown expenditure was just over \$100m lower than forecast, actual Core Crown revenue was substantially at odds with the forecasts. However, we suggest that some caution should be applied when reading these figures, as a large proportion was due to a below forecast

GST take. These figures could be subject to revision due to late GST filings or payment.

There was some evidence of a pre-GST spend-up, but it was nowhere near as large as Treasury's forecasters expected. The government's tax revenue for the three months to September 2010 were over 5% below forecast (around \$860m), but still substantially higher (7.5%) than the same period last year.

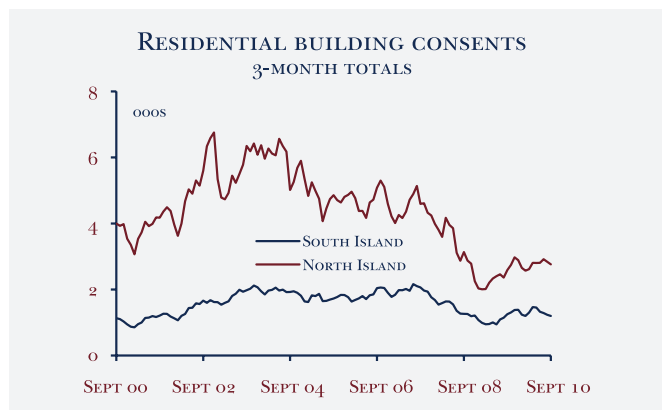
There was also a substantial variance in corporate tax revenue – over \$460m, around 22%, below forecast. The Treasury suggests that this result reflects that corporate profits were higher than they were at the same time last year, but lower than anticipated. This is consistent with a slower than expected, or weak, recovery. But perhaps reflecting the budding recovery in the labour market, Core Crown social security and welfare spending was \$37m below forecast.

## Building recovery losing steam

September saw 1,262 new dwelling units being authorised. This is a small increase from the 1,229 new dwelling units authorised in August 2010, but a decline from the number authorised in September 2009 (1,430). Noting that consents during 2009 were at a very low level, this year has seen consents well up on year-earlier levels – to the tune of double-digit increases. However, the total for the latest three months was only 3.3% up on year earlier, signalling a rapid easing to the fledgling house building recovery.

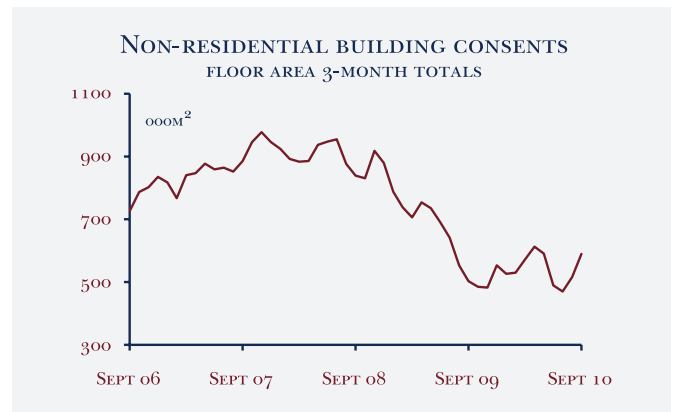
This easing shows through in the annual total for the year to September being just under 16,300, compared to the annual total to August being above 16,450. Of course, these are well up on the 13,600 for the year to September 2009. In contrast, though consents remain well down on the 21,000 recorded for the year to September 2008.

Looking at the regions, in the three months to September 2010, the number of new dwelling units authorised grew in 9 of the 16 regions. It fell in 5 of these regions, while there was no change in two of the regions. Nelson had the largest increase in new dwelling units during this period, up 67%, followed by the Tasman (up 43%) and Bay of Plenty (up 42%) regions. However, a large decline was recorded in Marlborough (down 40%). Double-digit percentage decreases were also reported in the Taranaki (-15%) and Canterbury (-11%).



Employment figures from the latest HLFS indicate that employment in the building construction industry grew (finally) between September 2009 and September 2010 by 1.8%. However, this growth is coming from the construction services and heavy and civil engineering construction sectors rather than building construction itself. This means employment has not been in residential and non-residential building construction, but in areas such as earthmoving and building installation.

The number of non-residential building consents was up slightly in the three months to September at 3,627, compared to the 3,546 for the same months last year. The floor area totals for the consents in the latest three months were a promising 17% up on year earlier. Within the sectors, the largest increase (in floor area terms) was in the shops & accommodation and factories categories.



## September retail numbers indicate price deflation

Retail sales for the September quarter were up 3% on year earlier levels, with volumes up a surprisingly strong 3.6%. Excluding the motor vehicles sales and servicing categories, core retail sales was recorded as up by only 1.3%, but volumes up by an again surprisingly strong 2.7%.

The data appears to indicate some rise in spending on consumer durables before the GST rise, but as noted by the government accounts data the pre-GST spend-up was not as large as some had expected.

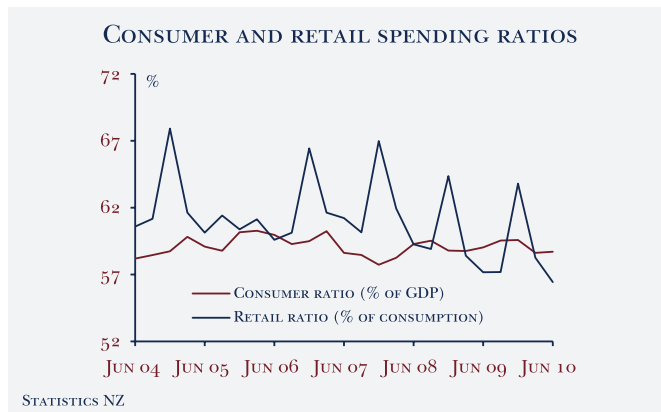
Comparing the above sales and volume growth figures, indicate significant downward pressures on prices, with the implicit average for retail prices across all categories declining 0.6%. For the core categories prices were down, on average, by a remarkable 1.4%. This deflation appears to confirm the struggling state of the retail sector, as well as the weakness of consumer confidence. It also reinforces the argument against the need for OCR increases anytime soon.

The underlying drivers of retail trade remain employment, house prices and tourism, coloured by consumers' expectations. These have all been weak, which has contributed to the softness in the retail trade sector.

Nevertheless, it has been argued by some that this situation suggests New Zealand consumers changed their spending habits towards increased savings. Looking at some ratios,



consumption, as a share of GDP has remained relatively constant over the last decade at between 58 and 60%. Retail trade is a bit more variable, and as a percentage of consumption expenditure it has ranged between 59 and 67% recently. Looking over the last two years, there does appear to be some change in New Zealander's retail behaviour.



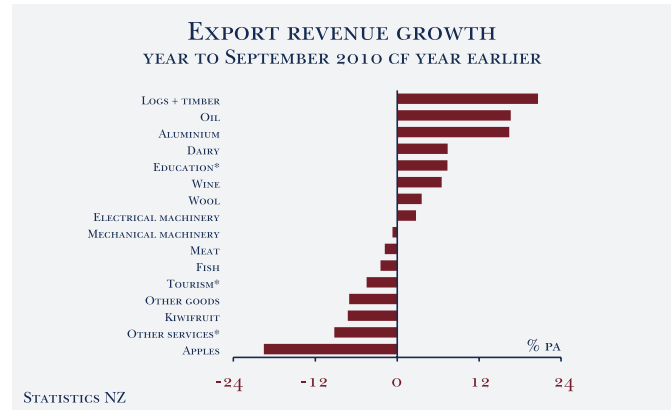
It may be true that some households are consolidating and reducing debt. But, in aggregate New Zealand households continue to spend more than they earn, although admittedly the growth in household debt has slowed. But it may be too early to conclude that that household's underlying behaviour has changed. It would, indeed, be difficult to argue in favour of a sea change in spending behaviour. And as the cool winds of the recession pass, old habits could return.

## External trade slowly improving

The latest set of export information reveals evidence of a gradual turnaround in export performance. The year to September records export receipts up 1% on those of a year earlier. Indeed, receipts for the latest three months were more than 12% higher than the same period last year – although we should note that exports in that earlier period were subdued.

As the chart shows, the leading category for export revenue growth is logs and timber, closely followed by oil and aluminium. The widely reported strength in commodity prices continues to favour dairy exports – with annual receipts now totalling close to \$9.4bn, which is back above the previous high of 9.3bn reached in November 2008.

Interestingly, education export receipts have also staged a recovery being nearly 7.5% up on year-earlier. Note, however,



that the latest data available for the service sector categories (labelled with an asterisk) is for the June quarter. Annual export revenue from this category has now topped the \$2bn mark according to Statistics NZ's figures. It appears this sector is beginning to recover ground lost over the latter half of the 2000s, noting its peak contribution of \$2.4bn recorded during its heyday around 2003/04.

At the other end of the spectrum were the kiwifruit and apples industries, both experiencing disappointing seasons. The apple industry has been struggling for some time, with the latest season reporting declines in prices and volumes. The \$330m total export return this season is a shadow of the impressive half-billion dollar annual returns being recorded a decade ago.

In contrast, the kiwifruit industry has been one of the success stories of the past decade. Total export returns have grown from \$550m in the 1999/00 season, to over a \$1bn for 2008/09. However, difficult trading conditions (in the UK, in particular) over the latest season have seen an 8% decline in prices leading to a 7% fall in export revenue for 2009/10.

The outbreak of the bacteria PSA could be a severe setback. It is still too early to properly assess the extent of the damage this could impose on the industry. The importance of the industry and its contribution to NZ's export sector should not be understated. Consequently, there will also be an impact on the wider economy. The extent of this impact will depend on whether the spread of the bacteria can be successfully managed and hopefully its effect will be limited to the short term.

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