Business NZ Economic Conditions Index\(^1\) for March quarter 2009

EXECUTIVE SUMMARY

The overall Business NZ Economic Conditions Index (ECI) sits at -5 for the March quarter 2009, an improvement of 4 from the -9 recorded for the December 2008 quarter. The overall ECI has been in negative territory since March 2008 although tentative signs of improvement are evident in some sectors e.g. agriculture.

Figure 1: Overall economic conditions index

---

\(^1\) A Background to the Economic Conditions Index (ECI), including measuring movements in the indicators and a glossary of terms, is contained in the Appendix. It is important that the caveats to the Index as outlined in the Appendix are clearly understood. The ECI represents a snapshot in time. Business NZ also produces a Quarterly Business Planning Forecast.
In terms of the sub-indexes:

1. **Economic growth/performance indicators** sit at -4, the same as for the December quarter 2008 but up 2 on a year ago. Negative economic growth was experienced for all quarters of 2008, with the biggest drop recorded for the December 2008 quarter of 0.9 percent. Expectations are for several more quarters of negative growth although there is tentative evidence that world commodity prices have bottomed out which is good news for NZ’s major export commodities e.g. dairy.

2. **Monetary policy/pricing indicators** sit at 4, up 2 on the December 2008 quarter and up 7 on a year ago. Falling interest and exchange rates, which acted as buffers for exporters facing significant declines in export prices, have now begun to pick up. Nevertheless, expectations of improved prices for international commodities should see increased exporter profitability over the medium term. Whether the Reserve Bank moves to lower the OCR further is a moot point, given the need to ensure that interest rates in New Zealand remain attractive to overseas investors in order to fund our external deficit. As has been stated on previous occasions, it is not inevitable that lowering the OCR will automatically result in one-for-one cuts to rates facing households and businesses. This is because of the extent to which banks borrow on wholesale markets and the increasing demand for longer-term debt which is forcing up the international price of capital.

3. **Business/consumer confidence indicators** sit at -1, an improvement of 2 on the December 2008 quarter and an improvement of 6 on a year ago. While business and consumer confidence are still in negative territory, there are some signs of improvement of late, albeit from a very low base. While low international demand for goods and services is still a major issue for many businesses, the very negative pessimism experienced in the 4th quarter of 2008 and earlier weeks of 2009 appears to be lifting, with both business and consumer confidence surveys showing some slight improvement of late. Consumer confidence also does not appear to be as low as earlier expected, although households have clearly moved to shut their wallets, reflected in reduced retail sales as consumers take a more cautious approach to non-essential expenditure. On the other hand, household debt levels are starting to retreat slowly as households focus on retiring debt. Debt reduction will be boosted somewhat through the recent tax cuts and lower interest rates which are reflecting very positively on debt servicing costs.
4. **Labour market indicators** sit at -4, the same as the December 2008 quarter and a deterioration of 2 on a year ago. Negative sentiment surrounding labour market outcomes is almost universally the case at present. Perhaps the one bright spot is that net migration appears to have bottomed out as NZ becomes a more attractive destination for expats given the deep recession in many developed countries. This is a two-edged sword. On the one hand, it could well boost demand for housing and provide this market with a healthy boost, given its continuing sagging fortunes. It may also be positive in increasing the human capital of the workforce given the expertise and experience that many expats have gained while overseas. On the other hand, it could boost numbers of people looking for work, adding to pressures on expenditure in terms of unemployment and other assistance.
BUSINESS NZ ECONOMIC CONDITIONS INDEX

Sub Index 1: Economic growth/performance indicators

Economic growth/performance indicators sit at -4, the same as for the December quarter 2008. Negative economic growth was experienced for all quarters of 2008, with the biggest drop recorded for the December 2008 quarter of 0.9 percent. Expectations are for several more quarters of negative growth although there is tentative evidence that world commodity prices have bottomed out which is good news for NZ’s major export commodities e.g. dairy.

Figure 2: Economic growth/performance sub index

Both domestic and international economic growth forecasts continue to be revised downwards in light of the global recession. New Zealand, despite negative growth, is still in a much better position than many of its competitors.

The International Monetary Fund (IMF) is forecasting that the global economy will shrink by between 0.5 percent and 1 percent this year, which represents a sharp fall from the IMF forecasts of January 2009 which predicted that the global economy would grow 0.5 percent. The US economy is now forecast to contract by 2.6 percent this year with continuing flows of negative news in both the business and household sectors. New Zealand, thankfully, does not have many of the problems associated with toxic debt which the US and some other countries have. The difficulty for the global economy is that confidence has not only vaporized in the business sector, but also amongst households and consumers in general.

The Organization for Economic Cooperation (OECD) has revised its Economic Outlook for the OECD countries for the years 2009-10.
Some of the highlights include:

- **OECD GDP** will fall in 2009 by -4.3 percent followed by economic stagnation in 2010. World GDP will shrink in 2009 by 2.7 percent.

- **OECD unemployment rates** will rise sharply from 6 percent in 2008 to 8.4 percent this year and 9.9 percent in 2010.

- Amid the deepest and most widespread recession for more than 50 years, **international trade** is forecast to fall by more than 13 percent in 2009.

- The most important **risk** is that the weakening real economy will further undermine the health of financial institutions, which in turn deepens the slump in economic activity.

The NZ economy contracted 0.9 percent in the December 2008 quarter, which was the fourth consecutive decline in economic activity.

The main drivers of the decline in the December 2008 quarter were the manufacturing and wholesale trade industries (which is consistent with the negative data from a number of surveys e.g. the BNZ Capital – Business NZ Performance of Manufacturing (PMI) and Performance of Services (PSI) Indexes).

Manufacturing activity declined 3.8 percent in the December 2008 quarter, with a reduction in activity broadly across most manufacturing sub-industries. Partly offsetting the decline in GDP was finance insurance and business services, which was up 2.2 percent in the December 2008 quarter.

Activity in primary industries increased 1.6 percent in the December 2008 quarter, with agriculture being the main contributor (up 4.0 percent). Dairy production was the main driver within the agriculture industry.

On an annual basis, GDP was actually up 0.2 percent for the December 2008 year. Annual GDP was higher than for the December 2007 year, despite four quarters of declining activity. This was because the economy grew at a faster pace in 2007 than it contracted in 2008.

Gross fixed capital formation, which measures capital investment in fixed assets, decreased 5.3 percent in the December 2008 quarter. The main categories in which investment declined were residential building (down 14.0 percent), and plant, machinery and equipment (down 4.8 percent). Investment in residential building has decreased for five quarters in a row, reflecting the decline in new housing construction.

Merchandise imports continue to trend down while merchandise exports have continued to trend up slowly. While monthly changes in exports and imports can be particularly lumpy due to seasonal factors, the trade balance for February 2009 was a surplus of $489 million, or 14.2 percent of exports – the largest surplus since 2001.
The current account deficit for the year ended December 2008 was $16.1 billion (8.9 percent of GDP, which compares to a deficit of 8.6 percent for the year ended September 2008. A services imbalance and investment income deficit are the main drivers for the increased current account deficit.

New Zealand’s high current account deficit has the effect of increasing its net overseas liabilities, as financing it requires external funding.

**Figure 3: Current account deficit**

![Current account balance graph](image_url)

Source: Statistics New Zealand. 2008 uses latest available figure (December quarter).

New Zealand’s sizeable and growing external liabilities represent a significant drag on the ability to reduce the current account deficit over the short to medium term. Debt makes up the vast bulk of New Zealand’s international liabilities (around 90 per cent of the total), and potential increases in interest rates will make servicing the debt more expensive.
Table 1: New Zealand's overseas debt

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Corporate sector ($ millions)</th>
<th>Official Government ($ millions)</th>
<th>Total ($ millions)</th>
<th>Total (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec 2000</td>
<td>107,410</td>
<td>17,349</td>
<td>124,760</td>
<td>108.9</td>
</tr>
<tr>
<td>Dec 2001</td>
<td>115,606</td>
<td>16,719</td>
<td>132,326</td>
<td>108.2</td>
</tr>
<tr>
<td>Dec 2002</td>
<td>123,466</td>
<td>18,024</td>
<td>141,489</td>
<td>109.2</td>
</tr>
<tr>
<td>Dec 2003</td>
<td>124,288</td>
<td>18,580</td>
<td>142,867</td>
<td>104.2</td>
</tr>
<tr>
<td>Dec 2004</td>
<td>141,106</td>
<td>18,740</td>
<td>159,846</td>
<td>107.7</td>
</tr>
<tr>
<td>Dec 2005</td>
<td>148,112</td>
<td>17,829</td>
<td>165,940</td>
<td>106.8</td>
</tr>
<tr>
<td>Dec 2006</td>
<td>173,669</td>
<td>14,760</td>
<td>188,429</td>
<td>115.5</td>
</tr>
<tr>
<td>Dec 2007</td>
<td>198,195</td>
<td>17,402</td>
<td>215,597</td>
<td>123.1</td>
</tr>
<tr>
<td>Dec 2008</td>
<td>229,155</td>
<td>18,861</td>
<td>248,015</td>
<td>131.0</td>
</tr>
</tbody>
</table>

The extent of NZ’s external imbalance leaves the country vulnerable given that international investors are re-pricing risk and long-term credit is becoming internationally more expensive. In this respect, NZ’s large external deficit does leave it susceptible to a change in investor sentiment given that NZ relies heavily on external funding for its investment needs. While rating agencies have continually voiced concern about New Zealand’s high current account deficit, this has not been a major issue until recently, given that the Government recorded strong operating surpluses. However, the situation has changed suddenly with projections of significant operating deficits over the next five years and little light at the end of the tunnel. This has prompted the Minster of Finance to state that such deficits will not be tolerated and is putting the potential for future personal tax cuts under serious jeopardy.

There has been some talk of delaying payments into the NZ Superannuation (“Cullen”) Fund given the deteriorating government accounts. Delaying payments would make sound sense given that it is ludicrous to borrow money and pay interest on that money, as a means of storing up reserves. It could be likened to householders deciding to invest money in Government stock rather than pay off more of their mortgage. It defies logic.

Despite the above, one could argue that there may be a case for Government to continue investing in the “Cullen” Fund for two reasons. One is that it creates a degree of certainty that those retiring in 20 years time can be assured they will receive superannuation. The second, and one which can be debated, is that given world stock markets have taken a pounding over the last year, now is arguably a good time to be entering the market to pick up bargains. However, it is not the role of government to gamble taxpayers’ money on risky investments as such decisions are best made by individuals and households based on their unique risk profiles.
Sub index 2: Monetary policy/pricing indicators

Monetary policy/pricing indicators sit at 4, up 2 on the December 2008 quarter and up 7 on a year ago. Falling interest and exchange rates, which acted as buffers for exporters facing significant declines in export prices, have now begun to pick up. Nevertheless, expectations of improved prices for international commodities should see increased exporter profitability over the medium term. Whether the Reserve Bank moves to lower the OCR further is a moot point, given the need to ensure that interest rates in New Zealand remain attractive to overseas investors in order to fund our external deficit. As has been stated on previous occasions, it is not inevitable that lowering the OCR will automatically result in one-for-one cuts to rates facing households and businesses. This is because of the extent to which banks borrow on wholesale markets and the increasing demand for longer-term debt which is forcing up the international price of capital.

Figure 4: Monetary policy/pricing sub index

While the Reserve Bank lowered the OCR further to 3.0 percent in March 2009, there is a question-mark over whether there will be any further cuts, despite some bank economists suggesting that the OCR could settle as low as 2.0 percent.

Reserve Bank Governor Alan Bollard is likely to be relatively cautious about lowering the OCR further for two important reasons.
The first is he wants to have something “in the bank” if things get decidedly worse and will probably remain a little cautious, unlike some countries.

The second, and probably much more important reason, and one which the Reserve Bank Governor outlined in the press release coinciding with the cut in the OCR (by 50 basis points to 3.0 percent on 12 March 2009), is that New Zealand must remain “internationally competitive”:

“We do not expect to see in New Zealand the near-zero policy rates of some countries. New Zealand needs to retain competitiveness in the international capital markets.” Given that New Zealand has a large external deficit which must be funded by overseas borrowing, this is code for: it is important that New Zealand maintains an interest rate differential with the rest of the world to ensure that New Zealand’s borrowing needs are meet. This implies that any further cuts to the OCR are likely to be minor.

Notwithstanding the above points, the Reserve Bank is in the fortunate position of having room for further cuts if necessary to stimulate activity. This is a luxury that many other countries do not have as they have already expended that option.

### Table 2: World interest rates

<table>
<thead>
<tr>
<th>Central bank rate (%)</th>
<th>Current rate (%)</th>
<th>Previous rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve Bank of Australia</td>
<td>3.00</td>
<td>3.25</td>
</tr>
<tr>
<td>US Federal Reserve</td>
<td>0.25</td>
<td>1.00</td>
</tr>
<tr>
<td>Bank of Canada</td>
<td>0.50</td>
<td>1.00</td>
</tr>
<tr>
<td>Bank of England</td>
<td>0.50</td>
<td>1.00</td>
</tr>
<tr>
<td>European Central Bank</td>
<td>1.25</td>
<td>1.50</td>
</tr>
<tr>
<td>Japan</td>
<td>0.10</td>
<td>0.30</td>
</tr>
<tr>
<td>Reserve Bank of NZ</td>
<td>3.00</td>
<td>3.50</td>
</tr>
</tbody>
</table>

Now that inflationary pressures are subdued, and there has been some appreciation of the NZ dollar of late (particularly against the US), the risk of lax monetary policy fuelling inflation is slight. Nevertheless, it is increasingly likely that world commodity prices are close to bottoming out (see below) so the potential exists for some increase in inflationary pressure as world demand picks up over the medium term.
There is a question mark over whether any further cuts will necessarily flow through to the cost of borrowing for households. Strong responses from households to fix mortgage rates for the long-term (3-7 years) taking advantage of historically low interest rates, is putting mounting pressure on the cost of long-term funds.

All the main trading banks have increased their medium to long-term fixed interest rates by up to a full percentage point. In contrast, short-term rates have remained at low levels or increased only marginally.

The ANZ Commodity Price Index stood at 149.8 in March 2009 (up 1.0 percent from the previous month) but down 31.3 percent from a year ago.
Beef and lamb prices recorded the largest percentage rise in the month, up 4.2 and 3.9 percent, respectively. Wool prices rose 3.1 percent, while dairy prices increased 2.8 percent.

When converted into NZ dollars the ANZ NZ Dollar Commodity Price Index went down 3.4 percent in March 2009 to 144.1. On an annual basis commodity prices, when converted into NZ$, were only down marginally (by 4.0 per cent), reflecting the fact that a sliding NZ$ against our major trading partners, particularly the US, has acted to offset the slump in international commodity prices. However, this has changed over the last few weeks with the rise in the NZ$ against the $US likely to arrest improving world prices when converted back into NZ$.

Table 3: ANZ Commodity Price Index (July 1986=100)

<table>
<thead>
<tr>
<th>Month</th>
<th>World Price Index</th>
<th>NZ Dollar Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 2003</td>
<td>121.1</td>
<td>113.8</td>
</tr>
<tr>
<td>Mar 2004</td>
<td>137.2</td>
<td>111.4</td>
</tr>
<tr>
<td>Mar 2005</td>
<td>156.6</td>
<td>115.4</td>
</tr>
<tr>
<td>Mar 2006</td>
<td>146.9</td>
<td>123.3</td>
</tr>
<tr>
<td>Mar 2007</td>
<td>172.0</td>
<td>134.0</td>
</tr>
<tr>
<td>Mar 2008</td>
<td>218.3</td>
<td>150.1</td>
</tr>
<tr>
<td>Apr 2008</td>
<td>217.7</td>
<td>151.8</td>
</tr>
<tr>
<td>May 2008</td>
<td>219.7</td>
<td>155.6</td>
</tr>
<tr>
<td>Jun 2008</td>
<td>219.6</td>
<td>158.8</td>
</tr>
<tr>
<td>July 2008</td>
<td>223.5</td>
<td>163.2</td>
</tr>
<tr>
<td>Aug 2008</td>
<td>216.0</td>
<td>166.4</td>
</tr>
<tr>
<td>Sep 2008</td>
<td>204.9</td>
<td>164.6</td>
</tr>
<tr>
<td>Oct 2008</td>
<td>189.4</td>
<td>165.3</td>
</tr>
<tr>
<td>Nov 2008</td>
<td>175.4</td>
<td>162.9</td>
</tr>
<tr>
<td>Dec 2008</td>
<td>162.5</td>
<td>153.0</td>
</tr>
<tr>
<td>Jan 2009</td>
<td>155.5</td>
<td>146.4</td>
</tr>
<tr>
<td>Feb 2009</td>
<td>148.3</td>
<td>149.2</td>
</tr>
<tr>
<td>Mar 2009</td>
<td>149.8</td>
<td>144.1</td>
</tr>
</tbody>
</table>

It is important that the drop in commodity prices over the last year or so is put in context. In terms of historical results, international prices are still relatively robust but with a likelihood that they are close to bottoming out. This is reflected in improved prices on the spot market and the fact the significant stockpiling of milk products on international markets is starting to move.

Milk powder prices in Fonterra’s monthly online auction have risen for the second month in a row.

Fonterra sells about 10 percent of its whole milk powder through its global dairy trade auction, with the prices achieved seen as a useful barometer of international dairy markets.
Last month (March 2009) the average price achieved across all products and contracts for whole milk powder was just under $NZ 4,000 a tonne – up 3.5 percent on February, but well below February’s monthly rise of 16.6 percent.

The firmer prices indicate that supply and demand fundamentals are now coming back into balance.

The future outlook might also be positive for NZ producers given significant slaughtering of capital stock in the United States. On the negative side, recent decisions by the European Union (EU) to reintroduce export subsidies for their agricultural producers may encourage greater production which could suppress international prices although subsidies to date have been set at a relatively low level thus having minimal effect so far. With NZ being such a significant player in international dairy trade, the implications of the above are mixed.
Sub Index 3: Business/consumer confidence indicators

Business/consumer confidence indicators sit at -1, an improvement of 2 on the December 2008 quarter and an improvement of 6 on a year ago. While business and consumer confidence are still in negative territory, there are some signs of improvement of late, albeit from a very low base. While low international demand for goods and services is still a major issue for many businesses, the very negative pessimism experienced in the 4th quarter of 2008 and earlier weeks of 2009 appears to be lifting, with both business and consumer confidence surveys showing some slight improvement of late. Consumer confidence also does not appear to be as low as earlier expected, although households have clearly moved to shut their wallets, reflected in reduced retail sales as consumers take a more cautious approach to non-essential expenditure. On the other hand, household debt levels are starting to retreat slowly as households focus on retiring debt. Debt reduction will be boosted somewhat through the recent tax cuts and lower interest rates which are reflecting very positively on debt servicing costs.

Figure 7: Business/consumer confidence sub index

Despite both business and consumer confidence continuing to remain very negative, there are some glimmers of hope with confidence starting the rise from the ashes of 2008.

The National Bank’s Business Outlook (March 2009) shows that business confidence lifted a whisker in March 2009 with a net 39 percent of respondents expecting a deterioration in business conditions over the year ahead compared with a net 41 percent in February. On the positive side, these latest results at least show that things are not getting worse and businesses’ perceptions of their own prospects have stabilised, even though at a relatively low level.
Expectations for profits, employment intentions, investment and exports continue to be all negative, while pricing intentions have nudged lower. A net 9 percent of respondents expect to raise prices over the year ahead, which is close to a six year low. Inflation expectations continue to ease. Underlying all these results the theme is clearly one of uncertainty.

Figure 8: National Bank Business Confidence Index

Retailing, Manufacturing, Services and Construction all remain pessimistic although some results need to be interpreted with a degree of caution as they may not necessarily explain confidence going forward for their individual businesses.

Business negativity may reflect short-term views (e.g. reduced profitability for some in the agricultural sector) rather than general doom and gloom going forward. This is particularly evident when one looks at the activity outlook for agriculture in which a net 6.3 percent of respondents are positive about the future compared to the net -74.6 percent of respondents who are gloomy about the economy as a whole. This is an important indication of how we should not talk ourselves into a doom and gloom outlook but look at what is happening at the coal face rather than assume things are universally bad.

In summary, sector performance remains mixed.
Manufacturing continues to remain in the doldrums as evidenced by both official Statistics from Stats NZ, and other surveys such as the BNZ Capital – Business New Zealand Performance of Manufacturing Index (PMI). On the bright side, the PMI has improved slightly over the last couple of months although it still remains firmly in negative territory.

In terms of services, the slide in activity experienced recently appears to be abating with the PSI improving to 47.1 in March 2009 compared to 46.3 in February 2009. New orders have improved and are now positive although employment continues to move lower. The hospitality and retail sectors continue to be negatively affected by cautious household spending and moves towards “down-sizing” in terms of wining and dining. Motor vehicle sales continue to take a hit.

**Figure 9: Retail Trade**

The tourism sector has also been affected, not only in terms of domestic consumption, but also given the depressed international market. Despite a significant reduction in the value of the NZ dollar, which should be making NZ a favourable destination for international tourists, this market has declined with more tourists being of the “backpacker variety” who tend to spend much less than traditional tourists to NZ. Potential international visitors are now simply taking holidays domestically, rather than venturing down under as the recession bites – particularly in terms of employment security.

The construction sector remains in the doldrums although there are mixed messages for this sector. Residential housing, while stabilising of late, is well
down on the significant growth experienced up to 2 years ago. On the other hand, commercial building activity has tended to hold up, largely as a result of projects already under way and capacity constraints which resulted in delays for some projects. Nevertheless, a number of projects which have been put on hold for various reasons e.g. reduced demand. And, increasingly, some construction companies/developers are going into receivership.

Figure 10: Consents

There are mixed fortunes for the agricultural sector with land prices, particularly dairy, falling of late on the back of a significantly reduced payout for the 2008/09 year and expectations of potentially lower payouts in the out-years. Many dairy farmers were relying on a pay-out of around $5.50 to just break even, which means that a sizeable portion of the farming sector will make a loss for the current season. This obviously has flow-on effects for rural communities and for investment in capital equipment (tractor sales etc). Notwithstanding the above, there is positive news in respect to lamb prices and with the absence of any serious drought conditions, the outlook is generally positive for this sector.

Consumers remain somewhat pessimistic at the present time, despite a number of factors which should arguably have impacted positively on consumption. Significant reductions in interest rates, reduced inflationary pressures including a major drop off in petrol prices, and rolling personal tax cuts (although future cuts signalled for 2010 and 2011 may be under threat) have not been enough to offset consumer pessimism generated by a relatively bleak employment outlook and associated rises in unemployment.

The Westpac McDermott Miller Consumer Confidence Index fell slightly from 101.3 in December quarter 2008 to 96.0 for the March quarter 2009, down 4.3 points.

Notwithstanding the recent decline, confidence levels are still well above the low reached in June 2008 (when the Index fell to 81.7).
Table 4: Westpac McDermott Consumer Confidence Index

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec 04</td>
<td>130.2</td>
</tr>
<tr>
<td>Mar 05</td>
<td>126.7</td>
</tr>
<tr>
<td>Jun 05</td>
<td>120.2</td>
</tr>
<tr>
<td>Sep 05</td>
<td>120.2</td>
</tr>
<tr>
<td>Dec 05</td>
<td>110.1</td>
</tr>
<tr>
<td>Mar 06</td>
<td>109.3</td>
</tr>
<tr>
<td>Jun 06</td>
<td>106.0</td>
</tr>
<tr>
<td>Sep 06</td>
<td>111.7</td>
</tr>
<tr>
<td>Dec 06</td>
<td>119.7</td>
</tr>
<tr>
<td>Mar 07</td>
<td>117.7</td>
</tr>
<tr>
<td>Jun 07</td>
<td>111.4</td>
</tr>
<tr>
<td>Sep 07</td>
<td>113.5</td>
</tr>
<tr>
<td>Dec 07</td>
<td>110.0</td>
</tr>
<tr>
<td>Mar 08</td>
<td>96.5</td>
</tr>
<tr>
<td>Jun 08</td>
<td>81.7</td>
</tr>
<tr>
<td>Sep 08</td>
<td>104.8</td>
</tr>
<tr>
<td>Dec 08</td>
<td>101.3</td>
</tr>
<tr>
<td>Mar 09</td>
<td>96.0</td>
</tr>
</tbody>
</table>

The BNZ Confidence Survey of Weekly Overview readers (6 April 2009) has revealed an improvement in expectations for the economy over the coming year to a net 0% optimistic/pessimistic from a net 23 percent negative in March 2009.

Taking on board the significant negative international news and some pressures on the domestic economy it is pleasantly surprising that consumers appear to still be relatively positive about the future. This could be for two reasons. One that they are naïve as to the potential ongoing fall-out associated with the global economy, or two, they may be aware that New Zealand is in a much better position to cope with the international down-turn than many other countries.

There are numerous reasons why NZ consumers might feel a lot more positive than consumers in a number of overseas countries where consumer pessimism rules (and for good reason). Given New Zealanders’ high dependence on debt and exposure to the housing market as a major form of “investment”, they have not been hit to the extent of many overseas households with significant exposure to financial assets are currently taking a bath. In fact, New Zealanders might well do better over the long-run given that we do not have a surplus of housing and potentially face a housing shortage over coming years, dependent of course on the future direction of net migration, which is looking increasingly positive.

While house prices are still under pressure and time taken to sell continues to blow-out, there is reason to be positive about the future direction of house prices.

With interest rates falling rapidly, there will be opportunities for investors to enter the market and this will act as a buffer against significant further falls in
house prices. Also acting as a buffer is the fact that building consents have continued to trend down, meaning less housing stock is available for purchase at a time when the expectations for net migration are rising. Rising expectations are the consequence of individuals and households returning to NZ given the depressing outlook for many developed countries. Perhaps of more fundamental importance to housing prices is that unlike many other countries, New Zealand does not have a surplus of housing stock nor have banks, in general, supplied finance to those unable to service housing debt. This means that forced mortgagee sales are still not having any major effect on the market - yet.

Property information company Terralink reported that there were 150 mortgagee sales in January – down from 191 in December – but up 121 percent on January 2008. Auckland was the worst affected region with 76 sales in January. In Wellington there were seven. It is important these figures are put in context. Mortgagee sales represent only 3 percent of total sales so are relatively inconsequential in the big picture.

On a positive note, household debt levels have started to decline (at last), while debt servicing costs have fallen significantly, which is positive news for consumers. Household debt has dropped from a peak of 162 percent of household disposable income in early 2008 to 158 percent currently. At the same time, debt servicing costs have fallen from 14.7 percent of income in the 3rd quarter of 2008 to 14.3 percent currently. Despite this positive result, current household debt levels and debt servicing costs are still extremely high by historical standards. A decade ago, household debt was around 100 percent of income and debt servicing costs around 8 percent of disposable income.

There are a number of reasons why consumers and businesses should continue to remain positive about future prospects. These include:

- Government debt is still low by international standards.
- Unemployment is still low.
- There is still room for further interest rate cuts if necessary.
- Lower interest rates are helping many households to service and progressively rein in debt.
- NZ does not have a surplus of housing stock nor have banks, in general, supplied finance to those unable to service housing debt.
- NZ’s banking system remains stable, even if credit is somewhat harder to come by.
- NZ has not had any shock collapses of banks or large companies.
- Although commodity prices are only just starting to bottom out, NZ sells the kind of things that the world wants, namely food and fibre.
- The Government’s fiscal stimulus package(s) can be used for constructive infrastructure investment rather than being poured down bottomless pits as has occurred in a number of overseas bailout packages.
Sub Index 4: Labour market indicators

Labour market indicators sit at -4, the same as the December 2008 quarter and a deterioration of 2 on a year ago. Negative sentiment surrounding labour market outcomes is almost universally the case at present. Perhaps the one bright spot is that net migration appears to have bottomed out as NZ becomes a more attractive destination for expats given the deep recession in many developed countries. This is a two edged sword. On the one hand it could well boost demand for housing and provide this market with a healthy boost, given its continuing sagging fortunes. It may also be positive in increasing the human capital of the workforce given the expertise and experience that many expats have gained while overseas. On the other hand, it could boost numbers of people looking for work, adding to pressures on expenditure in terms of unemployment and other assistance.

Figure 11: Labour market sub index

Labour input has grown at a record rate of 2.1 percent annually since 2000 (represented by increased employment) while growth in output (real GDP) averaged 3.4 percent over the same period. This combination resulted in labour productivity growth halving, from an annual average of 2.6 percent during the 1990s, down to 1.3 percent since 2000.

Increased business investment in fixed assets such as buildings, plant, machinery and equipment have driven capital input rates up by an average of 3.9 percent annually since 2000. The rate of output was less than the rate of input growth, leading to an annual fall in capital productivity of 0.4 percent for the period. From 1990 to 2000, the combination of lower capital input and higher output growth led to an annual average increase of 1.1 percent in capital productivity. Average annual capital productivity fell 0.4 percent over the 2000-2008 period compared with an annual fall of 0.5 percent from 1978-2008.

Average annual multifactor productivity (defined as growth that cannot be attributed to capital or labour, such as technological change or improvements in knowledge, methods and processes) grew by 0.6 percent over the 2000-08 period, compared with growth of 2.0 percent during the 1990s.

Figure 12: Productivity

Putting aside issues surrounding measurement problems, and the fact that the ‘measured sector’ only accounts for about two-thirds of the economy, the results are clearly a wake up call for both policy makers and businesses alike.
There are a number of possible explanations for the continuing low productivity figures. One theory is that the utilization of capital capacity falls as demand slows, which would lead to a fall in output growth. Another arguable case is that a change in the skill composition of the employed labour force, due to skill shortages, may reduce the average productivity of the labour force. This is possible given the low unemployment rate until recently and a record high labour force participation rate. Other theories include the possibility of labour hoarding i.e. employers reluctant to dismiss staff for fear of having significant transaction costs of recruiting new staff when the economy picks up.

While there is likely to be an element of truth in all of the above points, perhaps the most concerning fact is that over recent years New Zealand’s productivity record has continued to be mediocre. The trend line is clearly downward. This suggests that the above “short-term” theories are not necessarily valid when productivity is measured over the longer term. This makes it all the more important to address as many factors as possible which impact on productivity.

Forward looking indicators of likely labour market activity such as the NZIER’s Quarterly Survey of Business Opinion (QSBO), and the Department of Labour’s (DOL) Job Ads series show that the employment outlook has turned negative at a rather alarming rate.

As would be expected, there has been a notable easing in the difficulty of finding skilled and unskilled staff.

The Department of Labour’s Job Ad Series shows that the Job Ad Rate (number of Job Ads)/(Number of employed, from the HLFS) continues to decline along with the number of job ads (both newspaper and Internet job ads). While it is important to clearly understand the caveats associated with this data, given that the Job Ad counts are derived from only 7 major regional newspapers across NZ and 4 major websites, the direction of job ad rates is clearly down.

The general pessimism about future labour market conditions is starting to impact on wage and salary rates, although by historical standards wage and salary rates are still robust. However, a number of businesses are working from the starting premise of no rises at all for 2009.
Table 5: Job Ads: Monthly (Seasonally adjusted)

<table>
<thead>
<tr>
<th>Month</th>
<th>Newspaper Job Numbers</th>
<th>Internet Job Ad Numbers</th>
<th>Total Job Ad Numbers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 04</td>
<td>32,796</td>
<td>12,890</td>
<td>45,686</td>
</tr>
<tr>
<td>Jan 05</td>
<td>29,189</td>
<td>17,227</td>
<td>46,416</td>
</tr>
<tr>
<td>Jan 06</td>
<td>28,200</td>
<td>22,661</td>
<td>50,861</td>
</tr>
<tr>
<td>Jan 07</td>
<td>28,264</td>
<td>32,371</td>
<td>60,635</td>
</tr>
<tr>
<td>Jan 08</td>
<td>23,999</td>
<td>43,070</td>
<td>67,069</td>
</tr>
<tr>
<td>Feb 08</td>
<td>21,377</td>
<td>42,867</td>
<td>64,244</td>
</tr>
<tr>
<td>Mar 08</td>
<td>18,717</td>
<td>41,343</td>
<td>60,060</td>
</tr>
<tr>
<td>Apr 08</td>
<td>21,424</td>
<td>41,006</td>
<td>62,430</td>
</tr>
<tr>
<td>May 08</td>
<td>17,276</td>
<td>40,199</td>
<td>57,475</td>
</tr>
<tr>
<td>Jun 08</td>
<td>16,064</td>
<td>36,840</td>
<td>52,904</td>
</tr>
<tr>
<td>Jul 08</td>
<td>15,399</td>
<td>35,450</td>
<td>50,849</td>
</tr>
<tr>
<td>Aug 08</td>
<td>14,177</td>
<td>32,359</td>
<td>46,536</td>
</tr>
<tr>
<td>Sept 08</td>
<td>14,056</td>
<td>31,361</td>
<td>45,417</td>
</tr>
<tr>
<td>Oct 08</td>
<td>13,438</td>
<td>29,906</td>
<td>43,344</td>
</tr>
<tr>
<td>Nov 08</td>
<td>11,606</td>
<td>28,836</td>
<td>40,442</td>
</tr>
<tr>
<td>Dec 08</td>
<td>11,144</td>
<td>28,314</td>
<td>39,458</td>
</tr>
<tr>
<td>Jan 09</td>
<td>9,843</td>
<td>24,085</td>
<td>33,928</td>
</tr>
</tbody>
</table>

Net migration (which is a good leading indicator of general economic activity for the future), appears to have bottomed out and modest gains are evident for the month of February 2009.

Figure 13: Net permanent long-term migration

While it is too early to categorically state that the tide has turned, there are plenty of anecdotal stories which would suggest that many expats intend to
return to NZ given job prospects overseas have taken a dive. In this respect New Zealand is perhaps better positioned than many countries to weather the current global crisis. Many countries overseas are in deep recession with rapidly rising unemployment. Given that the NZ dollar has been low (until recently), this will provide added incentives for expat New Zealanders to return home, along with the opportunity to purchase relatively cheap housing (by international standards), and with low debt servicing costs (although rising slightly of late).
APPENDIX 1: Background to the economic conditions index

The Economic Conditions Index tracks 32 indicators on a quarterly basis. The overall index value for any particular quarter represents the net balance of the 32 indicators (generally the number increasing minus the number decreasing) thus providing an overall measure of performance.²

For the purpose of this index, if an indicator improves it is given a ranking of 1. If it stays the same it is ranked as a 0 (no change) and if it deteriorates it is given a ranking of -1. For example, if 15 indicators improve, 15 deteriorate and two stay the same, then the overall index would state no change (i.e. 0).

The index backdates data to mid-2000 to provide for a reasonable time series.

The 32 indicators contain official ‘hard’ data (e.g. employment/unemployment rates) and more qualitative data (e.g. business/consumer opinion surveys).

In general, increases in an indicator are seen as positive (for example, growth in Gross Domestic Product or employment) while declines in an indicator are generally seen as negative. However, this is not universally the case. For example, declines in unemployment are considered to be positive and increases in unemployment negative.

It should be noted that some indicators are difficult to categorize as good or bad, depending on the relative state of the economy (e.g. a rising/declining exchange rate relative to our trading partners). Therefore, certain indicators have not been included in the index, such as exchange rates, while others, such as net permanent and long-term migration, have been included (increases positive, declines negative).

Similar concerns can be expressed in relation to movements in the Consumers Price Index (CPI) where generally speaking, a rising CPI is considered to be negative for the economy while declines or even negative CPI growth for a quarter or so can be considered positive.

Despite this, significant and persistent declines in the general level of prices can have adverse impacts on asset prices and households’ general net wealth, so prolonged deflation can be negative on the economy. For this reason a rising CPI is to be considered negative but smaller quarterly rises are seen as positive.

² Note: where monthly data only is available (e.g. Business NZ’s PMI and some interest rate measures) it has been averaged over the relevant quarter for consistency.
Declines in the CPI are seen as positive for a quarter as well as positive thereafter, providing the CPI decline is relatively smaller. In most cases this has minimal effect on the overall measure of inflation given that the occasions on which measures of the CPI (tradables/non tradables inflation) have been persistently negative, are infrequent.

As there is a significant time-lag between the end of a quarter and obtaining its official data, the last quarter measured in the index will contain only partially official figures with which to identify changes from the previous quarter. For this reason, where updated figures are not yet available at the time of release, the previous quarter's index value will be generally carried forward (e.g. previous quarter 1, current quarter 1; previous quarter -1, current quarter -1; previous quarter 0 (no change), current quarter 0 with the latest quarter being updated as new information comes to hand.

While the Economic Conditions Index provides a useful measure of overall performance, it is desirable to group indicators into sub indexes so the main drivers of quarterly economic performance can be identified. Four sub-indexes (each with eight indicators) record movements in the following categories:

**Sub Index: Economic growth/performance indicators**

(a) Gross Domestic Product  
(b) Export volumes  
(c) Export value  
(d) Import volumes  
(e) Import value  
(f) Current Account balance  
(g) NZ’s overseas debt  
   (i) Corporate sector  
   (ii) Official Government debt  

**Sub Index: Monetary policy/pricing indicators**

(a) Producers Price Index (Inputs)  
(b) ANZ Commodity Price Index  
   (i) World Price Index  
   (ii) NZ $ Index  
(c) Official Cash Rate (OCR)  
(d) 90-day Bank Bills  
(e) Variable first mortgage housing rates  
(f) Inflation (CPI)  
   (i) Tradable sector inflation  
   (ii) Non-tradable sector inflation
Sub Index: Business/Consumer Confidence Indicators

(a) New Zealand Institute of Research Quarterly Survey of Business Opinion (QSBO)
   (i) General business situation
   (ii) Businesses own activity
(b) Westpac McDermott Miller Consumer Confidence Index
(c) BNZ Capital - Business NZ Performance of Manufacturing Index (PMI)
(d) BNZ Capital - Business NZ Performance of Services Index (PSI)
(e) Retail sales
(f) Building permit issues dwellings
(g) Household debt
   (i) % of disposable income
   (ii) debt servicing as % of disposable income

Sub Index: Labour market indicators

(a) Net gain/loss from permanent and long-term migration
(b) Labour force participation rate
(c) Employment
(d) Unemployment rate
(e) Labour Cost Index – salary and wage rates
(f) Level of Job Advertising
(g) Job Ad rates
(h) Work stoppages (person days of work lost)

Data Sources: Business NZ, Statistics New Zealand, Reserve Bank of New Zealand, New Zealand Institute of Economic Research (NZIER), ANZ Bank, Westpac, Department of Labour (DOL).

APPENDIX 2: Glossary of terms
ANZ Commodity Price Index
Measures the price of a number of commodities. Two indexes are included. The first provides commodity prices in world price terms. The second provides commodity prices in NZ dollar terms.

Job Ad rates
Measures the percentage of job advertisements compared to the total number of jobs. A greater number of jobs advertised compared to the total number of employed indicates a higher Job Ad rate (%).

Level of Job Advertising
Measures the level of job advertising (seasonally-adjusted) from both newspapers and the internet.

Building consents issued (dwellings)
Consents issued by local authorities for the building of residential dwellings.

Business NZ’s Performance of Manufacturing Index (PMI)
A monthly index which measures five significant components of manufacturing activity.

Consumer Price Index (CPI)
Measures the change in prices of goods and services relating to households.

Current Account
The current account balance is the difference between the payments NZ receives from overseas and the payments NZ makes. It includes the balance of merchandise trade, services and investment income.

Deflation
A general decline in the price of goods and services.

Disposable income
Total after tax income.

Employment (HLFS)
The proportion of the labour force employed.

Export prices
Domestic currency export prices.

Gross Domestic Product (GDP)
The total market value of goods and services produced in NZ after deducting the cost of goods and services used in the process of production over a given time period.

Household debt
Measures the claims on households. Normally measured either as claims as a percentage of nominal disposable income or as debt servicing (interest) costs as a percentage of nominal disposable income.

Import prices
Domestic currency import prices.

**Labour Cost Index (salary and wage rates)**
The salary and wage rates component of the Labour Cost Index (LCI) measures movements in base salary and ordinary time and overtime wage rates. The LCI has fixed industry and occupational weights and measures changes in salary and wage rates for a fixed quantity and quality of labour input.

**Labour force participation rate**
The percentage of the working age population in the labour force.

**Net gain/loss from permanent and long-term migration**
Measures the net difference between overseas migrants who arrive in New Zealand intending to stay for a period of 12 months (or permanently), plus New Zealand residents returning after an absence of 12 months or more, minus New Zealand residents departing for an intended period of 12 months or more (or permanently), and including overseas visitors departing New Zealand after a stay of 12 months or more.

**NZ Institute of Economic Research’s Quarterly Survey of Business Opinion (QSBO)**
A survey of business opinion reflecting the business outlook for the economy as a whole and for firms actual and intended business activity.

**NZ’s Overseas Debt**
Measures corporate and official debt owed overseas. It is a gross figure which includes liabilities only and does not take account of overseas assets held by New Zealanders.

**Nominal Income**
Income without taking account of inflation or other factors which may impact on purchasing power.

**Non-tradables sector inflation**
Inflation for goods and services traded domestically (i.e. goods and services not subject to fluctuations in exchange rates).

**Official Cash Rate (OCR)**
The interest rate the Reserve Bank sets in conducting monetary policy. Commercial banks can borrow cash overnight from the Reserve Bank at an interest rate of 25 basis points above the OCR, and deposit cash at 25 basis points below the OCR.

**Producers Price Index (PPI)**
The PPI outputs index measures changes in prices received by producers. The PPI inputs index measures changes in costs of production excluding labour and depreciation costs.

**Real Income**
Income after taking account of inflation or other factors impacting on the purchasing power of money.
Retail trade
Retail trade statistics measure the sales from a wide range of businesses that provide household and personal goods and services. Retailers include supermarkets, bookshops, restaurants, hotel, motels, repairers of household equipment and motor vehicles.

Seasonal adjustment
Adjusting a time series to measure and remove the regular seasonal components (e.g. the effect of Christmas on retail sales).

Tradables sector inflation
Inflation for goods and services that can be traded on international markets (i.e. those goods and services subject to fluctuations in exchange rates).

Unemployment rate (HLFS)
The proportion of the labour force not in work, but actively seeking employment.

Variable first mortgage housing rate
Measures the floating cost of borrowing money secured by housing assets as opposed to the fixed rate which measures the cost of borrowing for a specified period of time and does not fluctuate during the length of time the mortgage is on a fixed rate (typically 1-5 years).

Westpac McDermott Miller Consumer Confidence Index
Measures consumer responses to a number of questions which reflect consumer confidence levels.

Work Stoppages (person days of work lost)
Number of person days of work lost as a result of a strike or lockout.

90-day bill rate
Defined as the interest yield on 90-day bank bills. Rates are closely related to movements in the Official Cash Rate (OCR).