BUSINESS NZ

PLANNING FORECAST

MARCH 2011

BusinessNZ

NZ economy – starting to get on the front foot then sideswiped.

NOTE: the forecasts cited in this publication were finalised before the recent major Christchurch Earthquake (22 February 2011) and therefore are likely to be revised, possibly significantly, over coming months as the full impact of the quake becomes clearer. In the meantime, a brief note on the potential impacts of the earthquake on the economy is contained in the boxed section over the page.

Executive Summary

Using a cricket analogy, there was increasing evidence of the economy getting on the front foot in 2011 after being crease bound for most of 2010. Then out of the blue the economy gets a nasty bouncer in the form of another huge earthquake in Christchurch, with significant loss of life and massive infrastructure damage.

Official statistics still provide a rather gloomy picture, but forward looking indicators did point to an upturn in 2011, although this will now be significantly dented by the recent events in Christchurch. The improved outlook for 2011 was largely on the back of a continuing improvement in export commodity prices rather than a pickup on the domestic scene. It represented a much-needed rebalancing away from domestic-fuelled consumption towards export-led growth.

With the usual lag between improving export returns and the improvement filtering through to the domestic economy, consumer confidence levels, reflected in a number of consumer opinion surveys and in a very subdued housing market and reduced retail sales and building activity, are still relatively low. On the other hand, confidence across the agricultural sector has generally of late improved significantly. This improvement has been largely a consequence of improved international commodity prices, plus another recent 2010/11 increase in the forecast milk payout to Fonterra's dairy farmers.

Inflationary pressures are resulting in a tightening of interest rates in China which will inevitably impact on demand. However, growth prospects are solid among New Zealand's major trading partners, including China and Australia (despite recent floods), with commodity prices still on the increase. China continues to suck up NZ commodities as if there were no tomorrow and trade between the two countries is up by a third since the Free Trade Agreement came into force a couple of years ago.

While improved commodity prices are obviously good news for commodity exporters, improved returns have been used to retire debt and get balance sheets back into some sort of order. Debt in the agricultural sector, for example, is still close to $50 billion so the usual spend-up and flow through to urban sectors is likely to be much more subdued than in previous recoveries.

Households, like businesses, have finally also woken up to the fact that at some stage debt needs to be serviced and paid back. So they too are tending to take a very cautious approach to major new expenditures.

HIGHLIGHTS

BusinessNZ's Economic Conditions Index (ECI) sits at 6 for the March 2011 quarter, up 6 from the previous quarter but down 3 on a year ago. Until recent events in Christchurch, there was increasing evidence of an upturn in economic conditions for 2011, driven largely by continued improvements in international commodity prices.

While the export sector is now in the midst of an upswing, largely in respect to rising commodity prices, the domestic households sector is still in the doldrums. Rising consumer costs, a stagnant housing sector and mediocre labour market results to date, all point to caution on the part of consumers. This is reflected in an emphasis on repaying debt and getting balance sheets in order.

While international markets are still volatile, underpinned by concern about sovereign debt levels and rising inflation in some markets, NZ's key export trading partners, notably China and Australia, continue to perform well, despite some recent hiccups – China in respect to inflationary pressures, and Australia in terms of floods.

Growth prospects for the remainder of this year will be significantly dented in light of the recent earthquake. Realistically, any upswing for the economy is really a 2012 issue not 2011 as many had been forecasting. As one economist put it, a key plank in the economic growth story [the rebuild of Christchurch] for this year has been kneecapped.

Christchurch Earthquake – Impact on Economy?

The likely medium-term impact of the quake on the wider economy is yet far from understood, although it is obvious that the rebuild programme, set to get underway in response to last September's major quake, will now be delayed for a number of months. A full damage assessment will be required and the longer-term prognosis for infrastructure build will need first to be considered. Short-term growth prospects will be significantly affected but the region's longer-term growth could be boosted through large capital injections and a second major round of insurance payouts. Confidence, however, will doubtless be severely tested over coming months.

Quite frankly, at this stage, estimates of the impact on economic growth and rebuild costs are more in the nature of guesstimates given that NZ has not, for a very long time, experienced such an horrific event combining a substantial loss of life and monumental property damage.

While the Canterbury region accounts for about 15 percent of total Gross Domestic Product (GDP) and a similar percentage of employment in NZ, the major damage was much more related to the CBD of Christchurch itself, although obvious infrastructure damage has been widespread. Some expectations are that around 50,000 people will be directly affected in respect to employment in the CBD, with already a number of companies making employees redundant as their businesses are no longer functioning. The Government's quick support package to those employers and employees adversely affected with cash grants to both full-time and part-time employees will help provide some breathing room to better assess longer term job prospects and whether businesses can relocate their staff to new premises. It is important that employees remain connected to the business if at all possible during these uncertain times.

Some estimates of the impact of the September 4 2010 earthquake on GDP were put at between 0.2 and 0.5 percentage points. The 22 February earthquake has produced initial estimates suggesting an impact 3 times greater than the earlier quake's.

Total insurance losses have been put at $12 billion by JP Morgan Securities. By comparison, the September quake generated around $3.5 billion in claims.

In the short-term, after the initial rescue effort and potential public health issues have been dealt with, comes the significant question of relocating any businesses that can be relocated so they can begin to return to normal functioning. Clearly, a priority is getting infrastructure key to the operation of exports from the wider Canterbury region, up and running as soon as possible (e.g. the port of Lyttelton and the rail network). Initial reports suggest that although the port infrastructure has suffered damage, essential port operations are already back on stream and within the coming week, port operations are likely to be back to functioning at near full capacity. This is good news. It is also understood that Christchurch airport is now fully functional, having been cleared of major damage, and that road and rail networks are also operating.

Over the longer term, key questions about wider infrastructure (and the type of infrastructure) will have to be addressed and this will involve significant cost. For example, whether important infrastructure such as electricity and telephone communication should be provided via overhead wires (with inherent risk involved) or via underground cables, making recovery operations significantly more difficult and complex.

Initially, some estimates of total damage have been put at over $20 billion. Whatever the final figure, it will be large, raising the question of who will provide the funding and what the impact on funders will be? While some household funding will come from the Earthquake Commission and from insurance, many companies, in light of the last September's earthquake, will have seriously reassessed their risk and taken appropriate action to reduce potential losses. But reducing risk comes at a cost; taking out comprehensive insurance to cover lost earnings etc may have been beyond many smaller companies.

Given that the significant damage to local infrastructure (water and sewerage) is largely the responsibility of local government, the potential cost could be significant as it is understood many local governments self-insure because they have the power to tax (rate) local communities. With ratepayers likely to face a significantly increased burden, central government (via all taxpayers) may well be required to front up with the cash - with implications for the economy as a whole.

Since government accounts are still firmly in the red, further borrowing could see a risk margin placed on New Zealand, although much of the country's overseas debt is corporate rather than public; government may still therefore be considered a reasonable risk. Also, international investors may see the nature of the borrowing - to fund rebuild of infrastructure in the wake of an horrific earthquake - in a much better light than if its purpose were to fund present consumption. On the other hand, if New Zealand is considered a risky investment destination, because of the ongoing threat of natural disasters, progressively, international investors will take this into account. Whatever the case, government's objective of balancing the books within the next few years will be particularly challenging.

There has been some media talk of the Reserve Bank reducing the OCR by perhaps 50 basis points, down to 2.5 percent, as an earthquake response but this would have both pros and cons. On the one hand, the move could be seen as a positive and timely attempt to reduce the cost of capital and an important symbolic gesture. On the other, it might be thought of as less than satisfactory as the Canterbury region is not the sole driver of monetary policy. Before considering a reduction of this sort, account would first need to be taken of the implications for the rest of the economy. As the Planning Forecast later notes, there are already inflationary pressures in the economy, given that monetary policy is targeted at 18 months to 2 years down the track rather than to the present time. Furthermore, internationally, a drop in the OCR might be seen unfavourably as evidence of panic in the economy which with already high levels of international debt, would not be good news for borrowers. Finally, as the Forecast also notes, any changes in the OCR would likely have a rather mooted impact since the cost of capital over the longer-term is driven by international pressures. With international inflationary pressures mounting, the cost of capital is going up.

The other potential impact of a reduction in the OCR would be a significant drop in the value of the $NZ. While there has already been some reduction in dollar value, any sudden drop could pump up the price of fuel (already increasing in light of growing international demand) as well as of other imported material and goods. Should this happen, it could mean a sharp increase in interest rates further down the track.

Providing targeted assistance to the people and businesses of Canterbury (like the recent subsidised employment package) is likely to prove far more effective than ad hoc changes to monetary policy. Targeted assistance is a better way of dealing with what is a huge catastrophe but one highly focused on a particular region. Monetary policy changes would impact on all sectors and regions, while not necessarily delivering the help that Christchurch would find most useful.

Unfortunately, after a second major earthquake within six months, the cost of insurance premiums, not only in Christchurch but further afield, will likely be cranked up. This will also be true of Earthquake Commission levies as the Commission seeks to rebuild reserves. The cost of reinsurance will inevitably rise as a consequence. Ironically, such increases may discourage many people from buying insurance even though the risk of further major natural disasters cannot be ruled out. The sad reality is that for those most needing insurance, the cost may become prohibitive, potentially leaving them to face financial ruin should a further disaster occur. That effectively transfers the uninsured risk to government and ultimately, to other taxpayers.

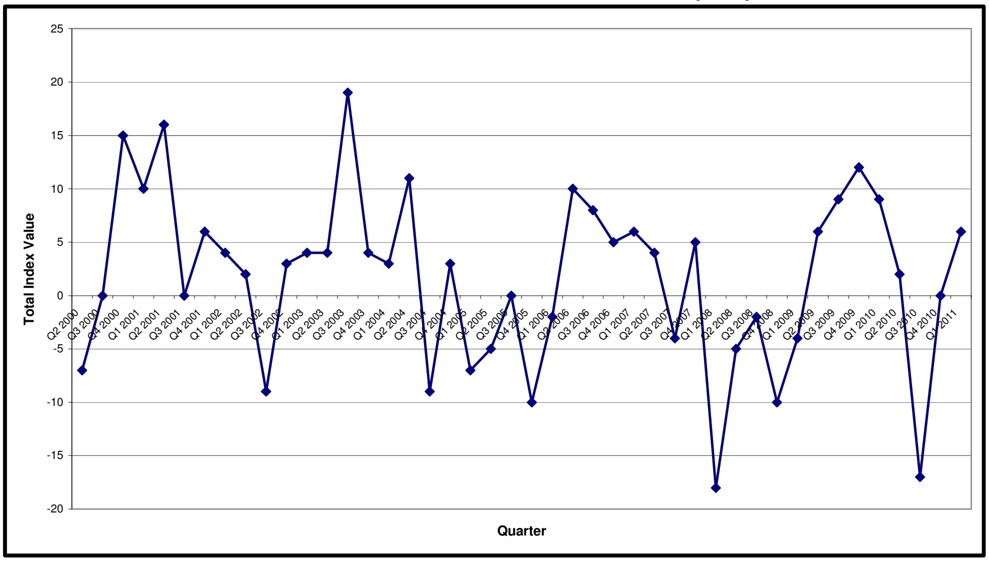
As the Prime Minister recently stated, despite the devastation, the country will get through this. The Government's balance sheet is in reasonable shape and so far, international credit rating agencies have not seen fit to downgrade New Zealand's international credit rating. It is a time for cool heads and sound policy decision-making rather than reactions that have not been well thought through. Introducing special taxes or levies to fund the rebuild needs careful consideration. In spite of recent events, there is still much to be positive about the New Zealand economy's future prospects. The broader outlook is still positive, only the timing of the upturn has been delayed.

Part 1: The New Zealand economy – where are we now?

BusinessNZ Economic Conditions Index (ECI)

The overall BusinessNZ Economic Conditions Index (a measure of the major economic indicators) sits at 6 for the March 2011 quarter, up 6 from the previous quarter but down 2 on a year ago.[1]

Overall Economic Conditions Index (ECI)



Source: BusinessNZ

Data in the ECI is broken into four key sub-groups:

- Economic growth/performance indicators
- Monetary policy/pricing indicators
- Business/consumer confidence indicators
- Labour market indicators

In terms of the ECI sub-groups:

Economic growth/performance indicators sit at 6 for the March 2011 quarter, the same as for the December 2010 quarter and the same as a year ago. Improved international commodity prices are feeding through into the best terms of trade for 35 years.

Monetary policy/pricing indicators sit at 1 for the March 2010 quarter, up 2 on the December 2010 quarter and up 2 on a year ago. Significantly improved commodity prices are having a positive effect.

Business/consumer confidence indicators sit at 4 for the March 2011 quarter, up 5 on the December 2010 quarter and up 1 on a year ago. While business confidence has tended to recover much of the ground lost in early

[1] The ECI tracks 33 indicators on a quarterly basis. The overall index value for any particular quarter represents the net balance of the 33 indicators (generally the number increasing minus the number decreasing) thus providing an overall measure of performance. In general, increases in an indicator are seen as positive (e.g. growth in GDP or employment) and declines as negative. However, this is not always the case. For example, declines in unemployment are seen as positive and increases as negative.

2010 with agricultural producers at the forefront, consumer confidence is still in the doldrums. Clearly consumers are busily repaying debt with wallets firmly tucked away. This is reflected in household debt levels leveling out and showing positive signs of reduction, while key indicators of domestic activity e.g. retail spending, electronic sales and building activity remain depressed.

Labour market indicators sit at -5 for the March 2011 quarter, a deterioration of 1 on the December quarter 2010 and down 6 on a year ago. Official indicators of labour force activity, notably the Household Labour Force Survey (HLFS), have fluctuated significantly over the past year or so which makes picking any obvious trends (either positive or negative) difficult. While forward-looking indicators (e.g. job ads) and the BNZ-BusinessNZ Performance of Manufacturing Index (PMI) showed evidence of tentative employment growth, the recent Christchurch earthquake will have put paid to that over the short-term.

Part 2: The New Zealand economy – where are we going?

1.1. Economic growth (GDP) – growth forecasts will be cut for 2011

Initial projections were for modest growth averaging around 3.8 percent for the year ending March 2011 and drifting lower to around 2.6 percent 2012 as outlined below. However, as previously noted, these forecasts are likely to be substantially revised in light of recent events in Christchurch. Growth prospects for this year will probably now be halved and the upturn pushed back to 2012.

Forecasts: Real GDP % Growth

	Years Ending		
	Mar 11	Mar 12	Mar 13
Highest	1.5	4.0	3.4
Average	1.4	3.8	2.6
Lowest	1.3	3.2	1.8

Source: ANZ, ASB, BNZ, National, and Westpac

The medium term impact of the second major earthquake in Christchurch on the wider economy is not yet properly understood, apart from the obvious fact that the rebuild programme set to get underway in response to the September quake will be delayed by a number of months pending a full assessment of the damage and longer-term prognosis for infrastructure. The expected 2011 boost from the rebuild's start is now increasingly likely to be a boost in 2012. A key factor will be the latest quake's impact on longer-term business investment intentions in the Canterbury region. Short-term growth prospects will be substantially dented.

Despite the above, one of the big drivers of an improved outlook for the export sector is the continuing growth in world commodity prices, now starting to feed back into higher returns to major commodity producers.

International commodity prices continue to go from strength to strength, reflected both in Fonterra's international online auction and the company's recent increase in the forecast payout to its suppliers for the current 2010/11 year. Some estimates see the projected payout as giving the economy a shot in the arm of around half a billion dollars.

The ANZ Commodity Price Index now stands at 321.8, up 2.7 percent from the previous month and 25.9 percent from a year ago. Even when converted into $NZ, returns have still improved considerably, with the index up a healthy 15.3 percent on a year ago. Perhaps of greater importance is the fact that commodity prices are generally up across the board and not restricted to one particular sub-sector.

ANZ Commodity Price Index

	World Price Index	Monthly % Change	Annual % Change	NZ$ Index	Monthly % Change	Annual % Change
Feb 2007	195.4	1.4	13.1	159.0	1.7	11.6
Feb 2008	248.0	1.1	26.9	177.1	-2.2	11.4
Feb 2009	172.0	-4.6	-30.7	179.9	1.9	1.6
Feb 2010	255.5	3.7	48.6	199.2	7.4	10.7
Feb 2011	321.8	2.7	25.9	229.7	2.9	15.3

Source: The ANZ Commodity Price Index – February 2011

While increased commodity prices are, in general, good news for NZ exporters, there are potential downsides which need to be acknowledged.

First, higher prices flow through into the cost of many inputs, including fuel, and can lead to higher generalised prices and inflation.

Second, higher prices for commodities for which NZ is a major international player in terms of traded goods e.g. dairy and lamb, could well encourage competitors to re-enter the market (particularly on the margins) and drive prices down or result in greater production with which NZ producers will have to compete in the future. It is likely that a gradual increase in prices would be in NZ producers' longer-term interests rather than the potential for boom or bust prices.

Third, many New Zealanders do not seem to accept or understand that the price of commodities on the domestic market will, to a greater or lesser extent, be driven by international commodity prices. Rapid price rises can cause domestic angst making consumers feel grumpy, particularly as domestic prices have increased significantly for some commodities over the last year or so. Thankfully, the Government has seen fit to state categorically that domestic milk supplies will not be subsidised. The effect of rapid commodity price rises is not necessarily all milk and honey!

World growth, although mixed, is expected to continue to improve over the next few years, good news for largely export-dependent countries such as New Zealand. Perhaps more importantly, the country's major trading partners (notably Australia and China) are continuing to show solid growth, recent blips notwithstanding.

Trade with China is now booming and total trade between New Zealand and China has increased by more than a third, from $8.5 billion to $11.1 billion, since the Free Trade Agreement came into force a couple of years ago. New Zealand's exports to China, now worth $4.5 billion, have almost doubled in the past two years, with growth in all major export sectors. This has been a key factor in sheltering the country from the major effects of the global recession.

Despite China continuing to suck in New Zealand commodities, potential risks to the Chinese economy, particularly inflationary pressures, are continuing to build. China has again moved to tighten bank lending by raising required reserves to a record 19.5 percent. This is the fifth increase since October 2010 and will mean less cash floating around the economy to push up prices. China is also raising interest rates in an attempt to contain inflation within its target of 4 percent for 2011.

Australia is still performing well, although recent natural disasters, floods and storms have wreaked havoc and significant infrastructure and housing will require repairing. And agricultural production will be down, impacting on fruit, vegetables and potentially animal prices for the remainder of this year. It is hard to get a gauge on the impact of the recent storms on the Australian economy but in the short-term at least, it will be negative, with obvious implications for New Zealand given Australia is our largest trading partner.

There are some other events and situations which will impact favourably on growth for this year and potentially beyond. Potential flow-on effects from the Rugby World Cup (September/October) are huge, not only in respect to retail, hospitality and tourism, but also in relation to longer-term contacts and business links extending well beyond the actual World Cup event itself.

High debt levels are still a risk to the New Zealand economy. The cost of capital would increase should banks face a credit downgrade and interest rates rise. That would dampen already fragile household demand. Moody's have announced a review of Australia/New Zealand bank credit ratings, with negative implications. While households are belatedly paying off debt, government is busily borrowing to fund expenditure programmes, some justified and some not. While debt levels are being addressed, they nevertheless pose a risk to both businesses and the Government itself, given high levels of exposure to international debt markets.

Finally, on a positive note, it is very pleasing that the Government has recently had the courage to pursue the reintroduction of a Regulatory Responsibility Act. It is fundamental that sound monetary and fiscal policy objectives should be supported by sound regulatory polices if New Zealand is to foot it on the international stage.

1.2 Monetary Conditions – on hold?

Interest rates – slow rise still likely

The 90 day bill rate is forecast to increase slowly and reach 5 percent by March 2013 (see table below) although again, these forecasts are likely to be revised downwards.

While the Official Cash Rate (OCR) has remained at 3 percent for some time, although up a total of 50 percentage basis points on its earlier low, further small incremental shifts - rather than anything major – were expected. It has been suggested that the Reserve Bank might reduce the OCR in light of the recent Christchurch earthquake but such a move would likely have little real effect. It seems more likely that external factors, not the OCR, have the greatest effect on interest rates.

Standard and Poors' decision to put New Zealand's foreign currency rating on negative outlook, the result of continuing high external debt levels and Moody's decision to review Australia/New Zealand bank credit ratings may well see interest rates rise (particularly if a downgrade occurs) given the country's reliance on foreign capital.

As Standard and Poors points out, New Zealand's household liabilities are over 150 percent of disposable income – 50 percent higher than 10 years ago, making the NZ economy vulnerable to any significant change in international investor sentiment.

Second, inflationary pressures internationally are once again building on the back of high commodity prices.

These international inflationary pressures will eventually flow through to the domestic scene, as already evidenced by consumer complaints, particularly about the increased cost of dairy products.

Third, while the increase in GST from 1 October 2010 was a one-off hit on headline inflation, ripple effects will be felt for the next quarter or so as retailers and suppliers take time to adjust prices.

Fourth, as banks are already paying around 5.5 percent for much of their term deposit funding, they are unlikely to cut rates to households and businesses even if the Reserve Bank moves to drop rates (even substantially). On top of this, businesses most in need capital injections may well be facing significant risks which banks may well not be prepared to subsidise. In sum, therefore, any drop in the OCR would probably have little effect on the interest rates faced by businesses and consumers.

Finally, while households are failing to spend - evidenced by huge retailer discounting to move stock and households retiring debt for the first time in years - increased returns to agricultural producers should sooner or later flow through to the wider economy, if not this year in light of the focus on debt reduction, then, if prices hold up, certainly next year. It is the nature of monetary policy that expected outcomes 18 months to 2 years down the track have to be considered; there should not be undue emphasis on historical numbers.

Forecasts: Interest Rates (90 day bills)

	As at end of		
	Mar 11	Mar 12	Mar 13
Highest	3.3	4.7	5.3
Average	3.2	4.3	5.0
Lowest	3.2	4.0	4.7

Source: ANZ, ASB, BNZ, National, and Westpac

The New Zealand dollar – bobbling about

The forecasts below clearly show the uncertainty involved in projecting currency movements over the medium term. Given the strong relationship between commodity prices and exchange rates for currencies such as the $NZ, the dollar might perhaps be expected to appreciate somewhat against the country's major trading partners. On the other hand, the more recent impact of the Christchurch earthquake on the dollar is arguably yet to be fully felt. Clearly the risk is for a further drop over coming weeks with the dollar likely will bobble about in light of conflicting pressures.

Forecasts: Exchange Rates

	AUD (cents)		
	Mar 11	Mar 12	Mar 13
Highest	0.763	0.810	0.820
Average	0.756	0.786	0.803
Lowest	0.750	0.750	0.770

	USD (cents)		
	Mar 11	Mar 12	Mar 13
Highest	0.770	0.780	0.730
Average	0.763	0.738	0.685
Lowest	0.750	0.700	0.640

	TWI		
	Mar 11	Mar 12	Mar 13
Highest	69.0	72.0	69.0
Average	68.0	67.8	64.9
Lowest	67.0	64.5	60.9

Source: ANZ, ASB, BNZ, National, and Westpac

Inflation - some risk of upward pressure

Forecasts outlined below show that inflation is likely to be within the Reserve Bank's target of 1-3 percent for the year to March 2012 and 2013.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Mar 11	Mar 12	Mar 13
Highest	4.8	3.1	2.9
Average	4.6	2.6	2.7
Lowest	4.5	1.7	2.4

Source: ANZ, ASB, BNZ, National, and Westpac

Despite widely expected upward pressure on the CPI for the December 2010 quarter (up 2.3 percent for the quarter and up 4.0 percent on an annualised basis), inflation will probably be contained, although there are potential risks as outlined earlier.

A number of factors will continue to act to contain inflationary pressures, modest capacity utilisation, relatively high levels of unemployment by recent historical standards, modest wage growth and stagnant retail sales, are all likely to offset the potential for one-off price increases to impact on generalised inflation over the medium term. Net migration levels continue to slow, also taking further pressure off resources, housing in particular.

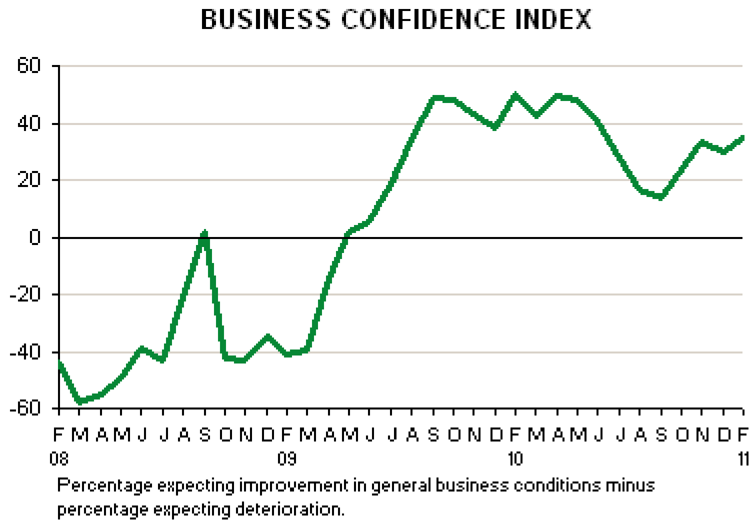
Against the above, high international commodity prices are forcing up the cost of fruit, vegetables and dairy related products increasing inflationary pressures, these commodities being a major component of the CPI. And fuel prices are drifting higher, also affecting the mix. Should the impact of the recent Christchurch earthquake be to drive the dollar lower that too, would exacerbate inflationary pressures.

1.3 Business and consumer confidence – mixed bag

Business confidence – steady improvement noted

The National Bank's Business Outlook (February 2011) indicates that confidence continues to improve. Perhaps the more crucial element to monitor is firms' own expectations which are still well on the positive side of the ledger. However the fly in the ointment is the fact that the survey was completed before the most recent earthquake. The big question is what impact will the latest earthquake have on business confidence, not only in respect to Christchurch, but the wider business community?

National Bank Business Confidence Index



Source: National Bank of NZ

For the record, a net 35 percent of respondents expect better times ahead, up 5 points from the previous month. Firms' perceptions of their own business activity also continue to improve with a net 37 percent expecting better times over the year ahead, up 2 points on business expectations for the previous month.

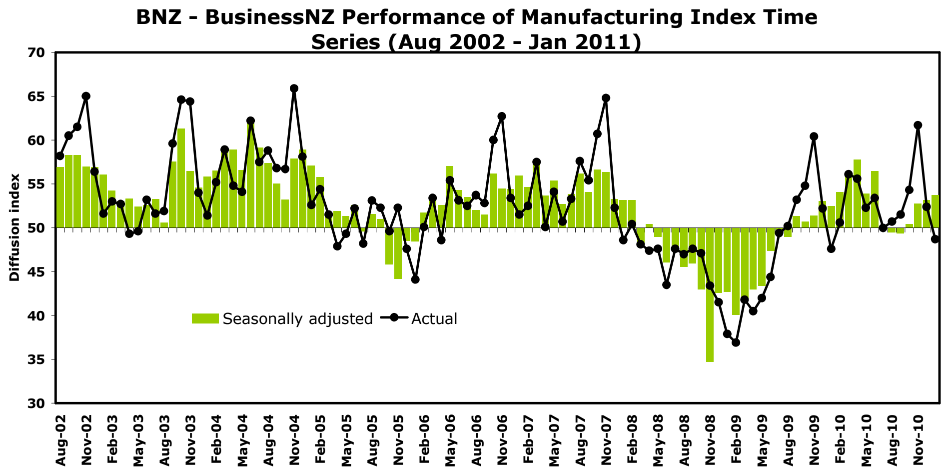
A key driver in improved business sentiment is the significant rise in confidence experienced in the agriculture sector, with confidence having lifted from -6 to 33 in the space of a month.

Other surveys of business confidence also reflect improving conditions, with Federated Farmers Farm Confidence Survey (January 2011) showing renewed optimism in the agriculture sector. This bodes well for significant increased investment in this sector. While still concerned about cost-pressures on their bottom line, improved commodity prices are being reflected in greater profitability, giving farmers the ability to repay debt built up over recent years.

An improvement in business confidence is being reflected in a more consistent improvement in the manufacturing sector. The latest BNZ-BusinessNZ Performance of Manufacturing Index (PMI) shows manufacturing activity continuing to pick up after being in the doldrums for the winter of 2010.

The PMI (seasonally-adjusted) for the month of January 2011 was 53.7, up slightly from 53.2 in December 2010. A reading above 50 indicates that activity is expanding; below 50 indicates that it is contracting. All five indices (which combined make up the overall PMI) - production (52.8), employment (52.8), new orders (56.6), finished stocks (50.7) and deliveries (52.4) - were all in expansion for the third consecutive month.

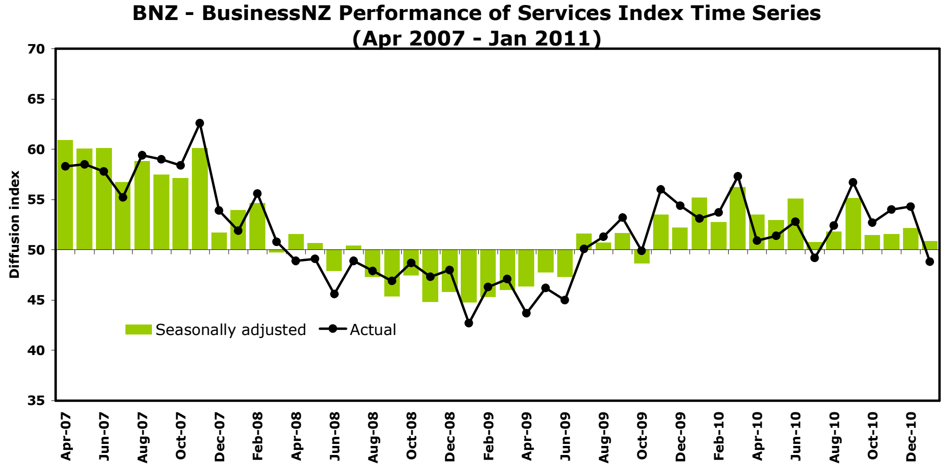
The continuing expansion of new orders over the last 5 months is an encouraging indicator that expansion will continue, even if it is slow and steady. Globally, the JP Morgan Manufacturing PMI, of which New Zealand is a part, also started the year on a good note, with the January value at a nine month high.



Source: BusinessNZ

Unlike the PMI, in general, the same level of optimism is not currently reflected in the services sector.

The seasonally adjusted BNZ-BusinessNZ Performance of Services Index (PSI) for January 2011 (50.8) was down 1.3 points from December 2010. Four of the five indices remained in positive territory, although employment deteriorated further (47.8), down 1.5 on the previous month. However, new orders continue to remain healthy at 54.8.



Source: BusinessNZ

Consumer confidence – gloomy

Unlike the rebound in business confidence, consumer confidence continues to languish as evidenced by a number of recent surveys.

The ANZ-Roy Morgan survey shows that confidence dropped 9 points in February 2011 to 108.2 with sizeable declines in consumers' perceptions of current and future conditions. While seasonal influences arguably account for a significant part of the drop, the index has been on a declining trend since early 2010.

While it might have been assumed that the personal income tax cuts from 1 October would have boosted confidence somewhat and assisted in improving disposable incomes, a range of factors may be acting to dampen consumer confidence.

Employment and unemployment data still give some cause for concern, although BusinessNZ and a number of other commentators have had their own concerns about the quality of information collected given recent wild swings in quarterly results. However, increasingly, indicators point to a slow, but nevertheless positive growth in employment and hence to a reduction in unemployment over the next couple of years.

Second, the high levels of household debt, although these have recently shown some signs of being addressed, are a continuing cause for concern. Any credit down-grade has the potential to flow through to the cost of capital for all New Zealanders.

Third, confidence in housing has drifted away with house sales extremely low by historical standards, even though house prices have stayed reasonably static. This may well reflect the sticky nature of the housing market and land sales in general, which in the absence of forced sales (e.g. mortgagee sales) will take some time to adjust. Perhaps for households, the saving grace is that New Zealand, unlike some other countries, does not have an oversupply of housing which would force prices lower. People are clearly trying to reduce debt, sit tight and wait for the recovery.

All the above factors, in part reflect the relatively low level of expansion evident from the BNZ-BusinessNZ PSI. The export sector in general is showing clear signs of improvement while the household sector continues to remain under the pump. A big question will be how fast improved returns to exporters flow through into the regional economy and ultimately to the urban sector?

1.4 Labour markets – bouncing along

Employment – stagnant

Quarterly results from Statistics NZ's Household Labour Force Survey (HLFS) have fluctuated wildly over the past year, an effect that is hard to explain since previous results have trended higher or lower reflecting the economic situation at the time.

The recent Christchurch earthquake will cause further blips in labour market outcomes over the next couple of quarters, although forward looking indicators point to gradual employment growth later this year. As stated earlier, it is crucial that businesses and their employees affected by the quake are closely connected while contingencies are put in place to allow of relocation, if possible.

Household Labour Force Survey: December 2010 quarter

Seasonally adjusted	December 2010 quarter	Quarterly change	Annual change
Unemployment rate	6.8%	+0.4	-0.2
Unemployed	158,000	+5.1%	-2.5%
Employed	2,182,000	-0.5%	+1.3%
Not in the labour force	1,107,000	+1.6%	+1.9%
Labour force participation rate	67.9%	-0.4	-0.2

Source: Statistics NZ

Notwithstanding all the above, the huge rate of unemployment amongst the young and unskilled, and amongst Maori and Pacific groupings is very concerning and demands that Government revisit both the demand and supply side of the labour market, examining any regulatory blockages to improved participant rates. Unless addressed, continuing high rates of unemployment amongst such groups, spell both economic and social disaster further down the track.

Forecasts: Unemployment % (HLFS)

	Quarter		
	Mar 11	Mar 12	Mar 13
Highest	6.7	5.8	5.9
Average	6.6	5.8	5.5
Lowest	6.3	5.7	5.1

Source: ANZ, ASB, BNZ, National, and Westpac

Labour costs – subdued

With the general easing in labour market pressures to date, wage and salary rises have generally been relatively low over the past year. Latest official figures available show that salary and wage rates (including overtime), as recorded by the Labour Cost Index (LCI), increased by 1.8 percent from the December 2009 quarter to the December 2010 quarter. Forecasts below indicate that labour costs are expected to increase modestly to around 2.3 percent for the year ending March 2012. This is very much in line with the long-run average for the LCI.

Forecasts: Labour cost index percentage change (wages & salaries)

	Years ending		
	Mar 11	Mar 12	Mar 13
Highest	2.0	2.5	2.8
Average	1.9	2.3	2.5
Lowest	1.7	2.0	2.0

Source: ANZ, ASB, BNZ, National, and Westpac