BUSINESS NZ

PLANNING FORECAST

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BusinessNZ

NZ economy generally on track despite risks

Executive Summary

Descriptions such as ópatchy growthôand óuncertaintyôcharacterise the current debate on the state of the New Zealand economy. General discussions with industry groups produce a wide array of responses from those who are doing very well to those who really donõt see much light at the end of the tunnel. Perhaps more interestingly, even within the same industry, responses vary widely.

The availability of a range of data both from a quantitative and qualitative point of view helps individuals push a particular line in support of their case for where the economy is headed. In some respects it depends on whether the glass is seen as half full or half empty.

The danger of reading too much into the results of one-quarter and assuming that a particular quarter signals a change in fortunes is very real. To give a couple of examples, recent Household Labour Force Survey (HLFS) results give wild swings in measured unemployment rates, yet when one looks a little deeper at the data, employment rates have hardly moved. Similarly, doomsayers who state that world commodity prices are collapsing, fail to appreciate that while prices have certainly come off their peak, they are still significantly higher than at the same time last year. Similar comments can be made in respect to movements in business and confidence. It is for this reason that things need to be put in context and level heads need to prevail.

There certainly are risks as the economy rebalances away from domestic-led consumption towards the export sector. Exchange rates continue to fluctuate. Growth rates in China have dropped slightly while Australia is still sorting out who will run the country following a hung Parliament - both issues particularly important to New Zealand given that these two countries are our largest trading partners.

The US economy has tended to take two steps forward and one step back and given its crucial role in world affairs, until its economy gets back on track, international jitters will remain.

On the other hand, despite ongoing concerns about debt levels in some developed countries and difficulties with governments winding back expenditure programmes in light of public expectations, many emerging economies and parts of Asia, are booming with double digit growth. A number of European countries, including powerhouse Germany, are now showing strong growth profiles.

On the domestic front, the Governmentõs accounts are tracking pretty much to expectations, although Budget deficits are expected for a number of years to come. Of late, issues concerning the sustainability of NZ superannuation and questions of compulsion have been raised; given the view held by many that New Zealand has a savings problem. These issues require informed and rational debate rather than slogans.

HIGHLIGHTS

BusinessNZ’s Economic Conditions Index (ECI) sits at 10 for the September 2010 quarter, up 4 from the previous quarter and up 1 on a year ago.

‘Patchy growth’ and ‘uncertainty’ still characterise the debate on the state of the New Zealand economy but care should be taken not to read too much into negative data for one quarter. New Zealand is in no danger of falling into a W-shaped recovery.

While international markets are still volatile, underpinned by concern about sovereign debt levels, overall world growth prospects continue to improve.

International commodity prices, while slipping from their earlier heights, remain high.

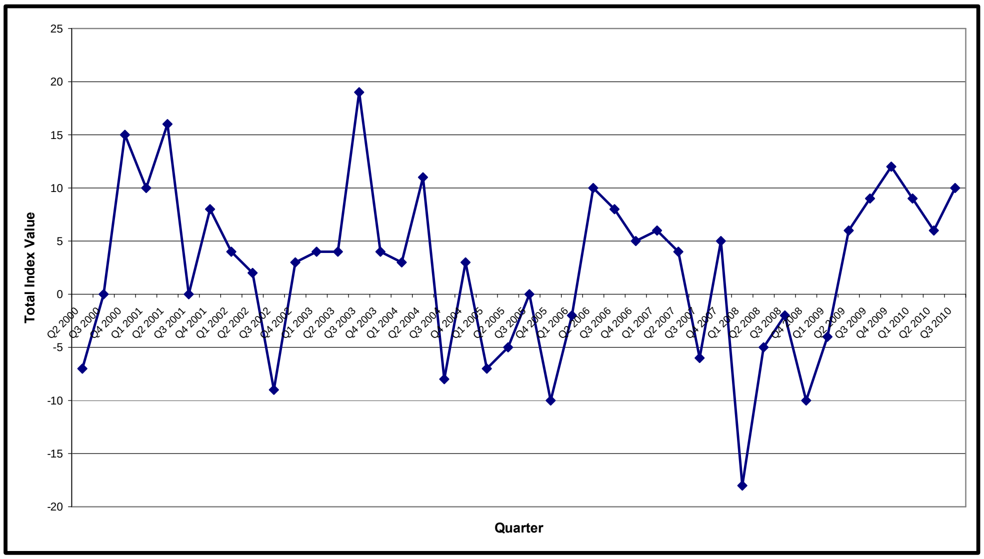
The Government’s accounts continue to track pretty much as expected, although big ticket expenditure items, particularly the funding of NZ Superannuation and other costs associated with an aging population (such as health care costs) will need to be addressed in the not too distant future. Informed and rational debate is required, not slogans.

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 10 for the September 2010 quarter, up 4 from the previous quarter and up 1 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:

<u>Economic growth/performance indicators</u> sit at 6 for the September 2010 quarter, the same as for the last quarter and up 4 on a year ago. Growth is now much more robust, driven in large part by improved international commodity prices over the last year and stronger volumes. On the other hand, significant risks to future growth prospects remain, notably the continuing uncertainty in international markets as countries try and rein in debt and control household and business expectations.

[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.

Monetary policy/pricing indicators sit at -6 for the September 2010 quarter, down 6 on the June 2010 quarter and down 7 on a year ago. This has largely been driven by increases in interest rates, a drop in commodity prices (admittedly from high peaks) and the potential for one-off price rises to impact on business and consumer pricing expectations.

Business/consumer confidence indicators sit at 5 for the September 2010 quarter, up 1 on the June 2010 quarter and down 4 on a year ago. Not too much should be read into the slide in both business and consumer confidence over recent months given that the extreme levels of confidence expressed in the previous year were really an overreaction to the truly adverse conditions experienced in the latter half of 2008 and in early 2009.

Labour market indicators sit at 5 for the September 2010 quarter, up 9 on the June 2010 quarter and up 8 on a year ago. With official labour market statistics fluctuating wildly over the last three quarters (particularly the HLFS); quarterly changes in respect to labour market indicators need to be approached with some degree of caution. However, forward looking indicators clearly show mild employment growth and the prospect of a slow reduction in unemployment.

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

1.1. Economic growth (GDP) – modest growth evident

Projections are for modest growth of around 3.0 percent for the years ending September 2011 and 2012 as outlined below. Given the contraction over 2008 and 2009, growth rates of 3.0 percent per annum out of a recession can be considered mediocre at best, since it will take at least another year simply to get the economy back to where it was before the recession started.

Forecasts: Real GDP % Growth

	Years Ending		
	Sep 10	Sep 11	Sep 12
Highest	2.2	3.9	3.8
Average	2.1	3.3	3.0
Lowest	2.0	2.6	2.3

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

On the positive side, world growth is expected to increase relatively strongly over the next few years which is good news for countries largely dependent on export trade such as New Zealand.

Fonterra recently reaffirmed its forecast payout range before retentions for the 2010/11 season of between $6.90 and $7.10. In reaffirming its current forecast payout, Fonterra executives stated that although there is still considerable volatility and uncertainty surrounding both international commodity prices and the future direction of the NZ dollar, a number of factors are signalling a potential improvement in prices later in the year.

The ANZ Commodity Price Index, while drifting slightly lower over the last couple of months from its peak in May 2010, still remains at high levels by historical standards. The index now stands at 270.0, up a huge 47.2 percent on a year ago. When converted into NZ$, the index was up 30.8 percent on a year ago. While some further slippage is likely over coming months, overall commodity prices should flatten out at levels well above those apparent at the same time last year.

ANZ Commodity Price Index

	World Price Index	Monthly % Change	Annual % Change	NZ$ Index	Monthly % Change	Annual % Change
July 2006	176.4	0.6	-1.9	160.0	0.9	9.3
July 2007	238.3	4.6	35.1	171.9	1.0	7.4
July 2008	259.0	1.8	8.7	196.7	2.8	14.4
July 2009	183.4	1.1	-29.2	156.9	0.2	-20.2
July 2010	270.0	-0.8	47.2	205.2	-2.8	30.8

Source: The ANZ Commodity Price Index NZ – May 2010

Despite a reasonably solid growth outlook, there are a number of big ticket items which must be addressed sooner rather than later if New Zealand really wants to lift its potential growth outlook to try and catch up on ground lost compared with our major trading partners.

These issues include:

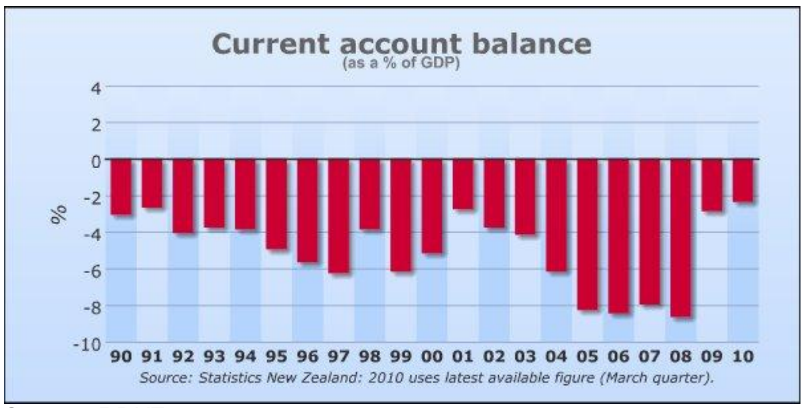
- International trading environment and openness to investment
- Regulation and compliance
- Productivity
- Tax and expenditure burdens
- Debt levels

International trading environment and openness to investment

It is often not widely understood how important world trade is to New Zealand and it is desirable to remind ourselves from time to time that world trade is the life-blood of the New Zealand economy.

New Zealand contributes around 0.2 percent (one fifth of one percent) to world GDP but is responsible for around 35 percent of the world trade in dairy products, has the largest share of international trade in sheep meat and is also a big player in the export of premium grade apples, mutton, beef and venison. In fact, Fonterra recently set a new export record, sending 2.1 million metric tonnes (MT) of product to international markets for the first time in its nine-year history.

Export tonnages were 60,000 MT higher than those achieved in 2008/09 and were a significant factor in New Zealandõs general run of trade surpluses for six of the last seven months, and the decline in the current account deficit to 2.4 percent.



Source: RBNZ

It has often been stated that New Zealandõs standard of living is relatively low by world standards because of the countryõs geographical situation, which hinders the transfer of human, physical and technological capital from abroad.

The Organisation for Economic Cooperation and Development (OECD) in their Economic Survey of New Zealand stated that *"Greater international economic integration can reduce the "effective distance" between New Zealand and its economic partners…"* and therefore recommended that New Zealand ensures it is open to the rest of the world in terms of lowering the cost of moving people, goods and ideas between this country and the rest of the world.

While New Zealand has a relatively open policy in respect to foreign direct investment, there has been much debate recently over the possible sale of large tracts of dairy farms to overseas interests.

In the context of this debate, it is important to remember that key contributions from foreign investment include the transfer of capital, employment growth, technology transfer and innovation, enhanced competition and consumer choice, and more innovative management practices. Studies suggest that around one third of the New Zealand workforce is likely to be in employment created as a direct result of foreign direct investment. In other words, the New Zealand economy has been built on the back of foreign investment.

Often a lack of available capital in New Zealand (some would argue through a lack of domestic savings) means that foreign ownership provides a very useful source of capital when domestic investors do not have the capital base or the willingness to invest in large scale activities.

Some media comments have suggested that New Zealand should allow foreigners to invest in New Zealand land and assets only if the investing country does likewise (i.e. a reciprocal arrangement). However, this policy would make no sense. Why would a country limit potential purchasers, effectively restricting the sale price of domestic assets and making it difficult, if not impossible to maximize their value? Even if foreign ownership were confined to countries with open policies on land sales (putting aside potential WTO implications), limiting sales in that way would not be in our interest ï just as tariff removal linked to the speed of our trading partnersôtariff reductions would also make no sense.

New Zealand is not in a position to dictate how the rest of the world should ideally operate. Restricting foreign ownership might be a feel good factor for some New Zealanders but would come at considerable cost.

If New Zealanders wish to restrict land sales or the ability of foreign owners to invest in New Zealand then they clearly need to be aware of the consequences of doing so. They need to know of the potential implications for economic growth and ultimately for the standard of living to which most aspire.

Any restriction on the sale of assets needs to take into account the following crucial issues.

- Is it going to be of net benefit to New Zealand?
- What are the implications for future investment in New Zealand (i.e. will it create uncertainty or discourage further investment given that international capital and labour markets are open for business)?
- Does it impact on property rights (by restricting the potential sale price) and what sort of message does this send to businesses generally?
- What sort of compensation regime are taxpayers prepared to pay to disaffected property owners?

Regulation and compliance

It is important for New Zealandôs general regulatory framework to be world class, ensuring the country is seen as a place where investors can feel confident to invest, that property rights are protected and that there is little likelihood of ad hoc changes to regulations governing particular sectors.

The government is currently looking at a number of areas of regulatory reform, including improving the regulatory framework governing water allocation and quality issues. Given the importance of water to the New Zealand economy, it is essential to put in place a sound framework with clear rules so that investors have confidence to invest in infrastructure without fear of having property rights to water taken away without their consent.

The Government is to be congratulated on announcing the shape of the NZ Productivity Commission (current Bill before a parliamentary Select Committee), which should enhance the quality of regulatory decision-making through a better independent analysis of the major issues impacting on the competitiveness of the New Zealand economy.

On the other hand, the lack of real progress in introducing a Regulatory Responsibility Act is disappointing after all the efforts of the Regulatory Taskforce to produce an excellent report and to draft a Bill. Further delays are unacceptable if the Government is serious about addressing overall regulatory burdens.

Productivity

Why does productivity matter?

In short, productivity is a measure of how efficiently inputs are being used within the economy to produce outputs.

Growth in productivity means that a nation can produce more output for the same amount of input, i.e. increase its non-inflationary standard of living.

Recent productivity figures released by Statistics NZ continue the trend of relatively low productivity for both labour and capital. Putting aside measurement problems, and the fact that the measured sector accounts for only about 75 percent of the New Zealand economy, the latest results continue to present a relatively disappointing picture.

While there are many theories as to why New Zealandôs productivity is low, including economies of scale, distance from international markets etc, there is no one silver bullet that will turn our productivity performance around. Reforms are needed over a wide range of areas with the objective of creating a more efficient and competitive economy.

Tax and expenditure burdens

While the Government has made a number of useful tax reforms on the back of the report from the Tax Working Group, the reforms have mainly been targeted towards shifting the balance of tax from income to expenditure, rather than reducing government demands on the economy per se.

Numerous examples of low quality spending are still evident. The current student loan scheme is estimated to cost around $800 million per annum. In other words for every dollar the Government (read taxpayer) puts into students loans, it can expect to get back around 52 cents. Not a particularly healthy return!

While no doubt such expenditures may also have significant benefits, these need to be weighed against the extent to which there is genuine market failure (and if so, what is the most appropriate response) or whether such money would be better left in taxpayersô hands to spend and invest as they see fit. Or in further reducing debt levels. There are significant costs associated with such expenditures and there is no free lunch!

In similar vein, the other big issue of the day is savings rates and the possibility of compulsory savings for retirement. The Minister of Finance has just announced the terms of reference for the independent Savings Working Group which has a relatively wide brief but importantly also a range of exceptions (no-go areas), including not touching NZ Superannuation (which the Government has promised not to change) or reviewing the broad taxation of capital or land which the Government has also said will not be touched. Given all the above constraints, the Working Group will be operating very much within a straightjacket, unfortunate if the objective is to look at relevant issues impartially and produce the most logical recommendations for the future.

Superannuation and personal savings issues are fraught with difficulty and by and large the debate to date has been driven either by vested interests or slogans. Hopefully the Savings Working Group will provide the basis for a rational discussion of the issues involved.

There is no doubt that the future funding of superannuation is an issue likely to increase in importance as the population ages, along with the other costs associated with an aging population.

For the year ended June 2010, NZ Superannuation expenditure equated to over $8 billion per annum or around 13 percent of total Core Crown expenses. To put this expenditure in context, it was the third highest level of expenditure after Health ($12 billion) and Education ($11 billion). It is useful to examine the role of public versus private provision for retirement, along with appropriate funding mechanisms. However, it is important not to jump to conclusions by simply saying that if New Zealand does have a savings problem (which is debatable) then compulsory savings are the answer, without clearly defining the problem. Second, it is important that all areas relating to retirement provision are looked at rather than simply taking some things, such as the current NZ Superannuation Scheme, off the table.

Important questions the Savings Working Group will need to grapple with include:

- Clearly defining the so-called problem. Without a clear definition of the problem(s), the right solution will not be apparent. Is it a lack of savings for retirement income? Is NZ Superannuation provision at current levels unsustainable over the long-term? Is New Zealand Inc. too exposed to the whim of international investors? Is it that we have too much foreign debt? Depending on who you talk to, all the above are referred to at various times, rightly or wrongly.
- Would compulsion actually impact on net savings?
- If New Zealand does have a savings problem then is compulsory saving for retirement the answer or would a peel back of state provision encourage greater personal savings? Simply put ï why save when the Government (via taxpayers) provides!
- What would the impact be on individuals whose funds were diverted into compulsory superannuation as opposed to funding other investments such as education, business growth or simply investments where the returns might be better? What about the self-employed and the diversion of investment?

All these issues and more need to be thoroughly canvassed by the Working Group before any assumptions are made or solutions provided. Despite constraints imposed, the calibre of the Working Group gives cause for optimism.

Debt levels

New Zealand, like many other countries is burdened by high levels of debt, although much of this debt is owed by businesses and households rather than government. In this respect successive governments, through a range of policy approaches, have reduced debt considerably from the high levels evident in the mid-1980s. However, once again government debt is on the increase and in the future the pressure of an aging population will put significant stress on both health and superannuation costs.

High debt levels of debt can increase risk levels and therefore increase the cost of capital to all New Zealanders.

In March 2010 New Zealandõs overseas debt stood at $243.5 billion, or around 130 percent total GDP. Around 117 percent of this was owed by the corporate sector with around 13 percent owed by the New Zealand Government.

Household debt is also a concern. Household claims as a percentage of nominal disposable income increased from around 60 percent in 1991 to 106 percent by 2001 and currently sit at 154 percent, having dropped slightly from a peak of 159 percent in late 2008. In tandem with higher debt levels, debt serving costs have also increased, making households much more vulnerable to any increases in interest rates.

While debt is not bad per se, the big question which remains for government, businesses and households is: is that debt being used for productive purposes which will increase efficiencies over time?

1.2 Monetary Conditions – further tightening likely

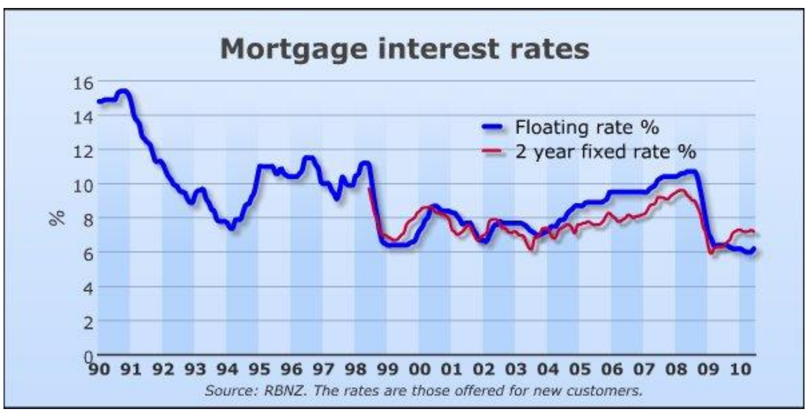
Interest rates – rises still on the cards but speed of further rises may moderate

Reasonably significant rises are likely with the 90 day bill rate forecast to increase to around 5 percent by September next year and to go slightly higher into 2012 (see table below).

While the Official Cash Rate (OCR) has increased to 3 percent, up a total of 50 percentage basis points on its earlier low, it is likely that further rises will occur. However, mixed data over the last few weeks may cause the Reserve Bank to reassess when it will lift rates further, although the fundamentals show the economy is in a modest growth phase.

Reserve Bank Governor Dr Alan Bollard, in announcing the rise in the OCR to 3.0 percent on 29 July 2010, stated that *"While the outlook for economic growth has softened somewhat, it is still appropriate to continue to reduce the extraordinary level of support implemented during the 2008/09 recession."*

The Reserve Bank is in a difficult position as it moves the OCR away from an expansionary approach towards a more neutral stance. Inflationary pressures are currently low (particularly from the tradables sector) but pressures (mainly one-offs) are building around the corner. The risk for the Reserve Bank is moving to fast or too slow.



Source: RBNZ

Notwithstanding the above, the Governor has issued a warning shot to businesses and households trying to take advantage of one-off increases in inflation later this year in respect to wage and other contract negotiations.

"The coming increase in the rate of GST and other government-related price changes are likely to temporarily push annual CPI inflation above 3 percent. The Bank does not expect this price spike to have a lasting impact on inflation. However, the price and wage setting behaviour of firms and households will be monitored for evidence of any increase in inflation expectations." The Governor makes an important point that pricing behaviour should ideally reflect low underlying inflation not the upcoming temporary spike. Perhaps even more importantly, businesses and households need to seriously examine the factors on which they make pricing and contract decisions. In many respects, tying contracts into the rate of increase (or possibly decrease) in the CPI may not necessarily reflect supply and demand conditions in particular markets. It is unfortunate that warnings of this kind are often not heeded but clearly the Governor will not tolerate any increases in pricing behaviour which threaten to cause generalised inflation.

Forecasts: Interest Rates (90 day bills)

	As at end of		
	Sep 10	Sep 11	Sep 12
Highest	3.7	5.7	6.2
Average	3.7	5.2	5.7
Lowest	3.5	4.9	5.2

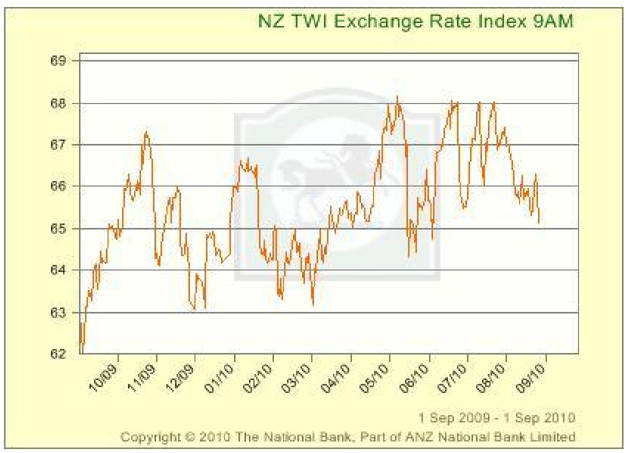
Source: ANZ, ASB, BNZ, National, and Westpac

The New Zealand dollar – uncertainty reigns

The forecasts below clearly show the uncertainty involved in projecting currency movements over the medium term, with bank forecasts for the NZ/US cross rate still fluctuating significantly over the next couple of years.

The NZ$ has come under some pressure of late given continued uncertainty in the EU and the rush back towards what are perceived to be safe havens rather than commodity-based currencies. However, the situation will likely change as confidence internationally improves and investors return to commodity-based currencies.

Only one thing is certain, and that is that no currency is totally immune from world economic events. In this respect, businesses must use available tools to try and manage that risk to their advantage but remembering that just as there are the risks attached to fixed or floating interest rate options, so too there are risks associated with hedging.



Source: National Bank of NZ

Forecasts: Exchange Rates

AUD (cents)			
	Sep 10	Sep 11	Sep 12
Highest	0.828	0.840	0.840
Average	0.814	0.819	0.821
Lowest	0.800	0.780	0.790

USD (cents)			
	Sep 10	Sep 11	Sep 12
Highest	0.720	0.740	0.700
Average	0.715	0.715	0.678
Lowest	0.700	0.690	0.630

TWI			
	Sep 10	Sep 11	Sep 12
Highest	70.2	72.9	70.7
Average	69.0	70.9	68.0
Lowest	68.1	68.1	63.4

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

Inflation - one-off impacts unlikely to result in generalised pressures

Forecasts outlined below show that inflation is widely tipped to well exceed the Reserve Bank's target of 1-3 percent for the year to September 2011.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Sep 10	Sep 11	Sep 12
Highest	1.7	5.3	3.3
Average	1.7	4.9	2.8
Lowest	1.6	4.4	2.3

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

While many still view inflation as a dead issue, currently (citing a number of factors such as modest capacity utilisation, relatively high levels of unemployment by recent historical standards, modest wage growth and stagnant retail sales), the potential for one-off inflationary pressures to impact on generalised inflation over the medium term should not be completely discounted.

As the economy picks up relatively strongly and capacity utilisation increases, as is increasingly evident, so too the pressure on resources will increase with an inevitable effect on prices.

Second, inflation, as measured by the CPI is forecast to be around 5 percent for the September year 2011 as a result of one-offs associated government policy in respect to ACC levies, the expansion of the Emissions Trading Scheme and rises in excise taxes on tobacco, for example, flowing through into prices to consumers.

While the Reserve Bank in terms of its mandate does not have to take into account these one-offs when setting monetary policy, the danger is that individuals and businesses will react to them.

Unless the Government has the fortitude to address issues which are driving up non-tradables inflation - such as ACC levy increases and local government rates - and to impose greater discipline and contestability in service provision, so-called one-offs this year could become part of the landscape for years to come.

On the other hand, the potential for a significant rise in debt servicing costs could erode away any increases in disposable income resulting from the personal income tax cuts which take effect from 1 October 2010, while uncertainty over house prices and increased outward migration could encourage consumers to tighten their belts and focus on repaying debt.

On balance, however, given the state of the domestic economy and a relatively subdued international outlook overall, there should be only a temporary (inflationary) blip towards the end of this year and early next, and inflation should be well back within the Reserve Bankֳs target band by 2011.

1.3 Business and consumer confidence – still positive despite recent slippage

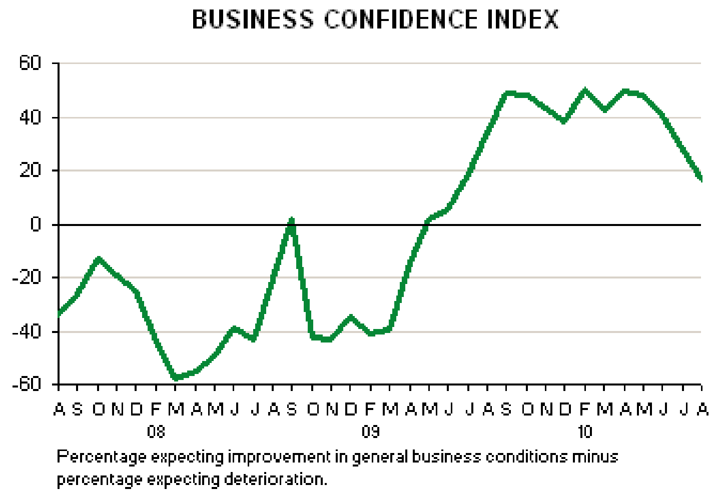
Business confidence – on the right side of the ledger

Both business and consumer confidence have slipped of late but still remain positive.

When one looks at the long-run average of many business and consumer surveys, in general confidence is still relatively high by historical standards. Drops in confidence of late, significant as they are, can be overstated when analysing where both business and households are at.

The National Bankֳs Business Outlook (August 2010) shows that confidence, while slipping further, continues to remain in positive territory with a net 16 percent of respondents expecting better times ahead. Perhaps the more crucial element which needs to be monitored is firmsֲ own expectations which are still well on the positive side of the ledger.

National Bank Business Confidence Index

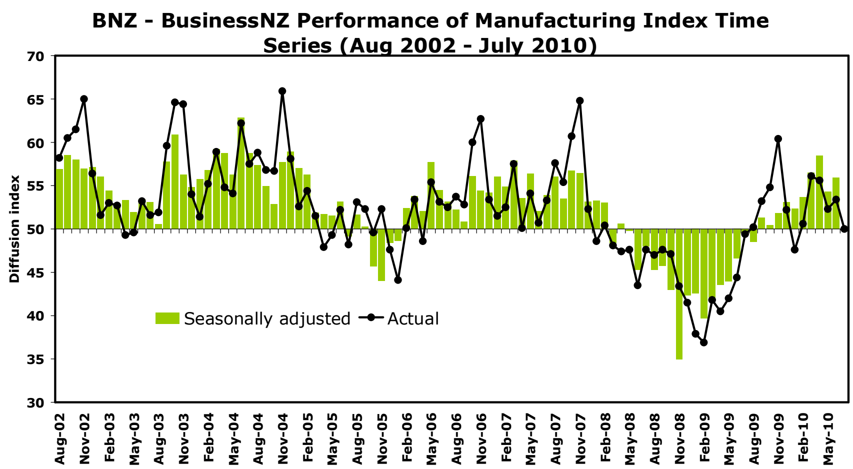


Source: National Bank of NZ

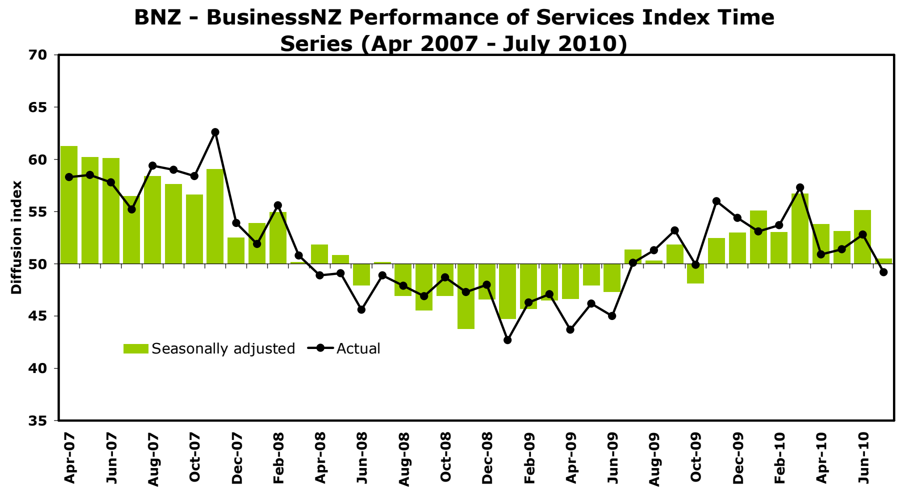
A net 26 percent of respondents expect better times ahead for their own business, down 6 points from last month. On a positive note, a net 31 percent of businesses expect to be exporting more over the year ahead which is further evidence of a rebalancing in the economy from consumption led growth to the export sector.

The slippage in business confidence of late is being reflected in reduced growth in both the manufacturing and the services sectors. While not too much should be read into the results of one month, the latest BNZ-BusinessNZ Performance of Manufacturing (PMI) and Services (PSI) Indexes show that both manufacturing and services performance have stalled after 8-9 months of positive results - as can be seen from the graphs below. A reading above 50 indicates that activity is expanding; below 50 indicates that it is contracting.

The drop in both the PMI and PSI show that the New Zealand recovery is not out of the woods yet, with comments outlining patchiness regarding new orders, as well as activity/sales.



Source: BusinessNZ



Source: BusinessNZ

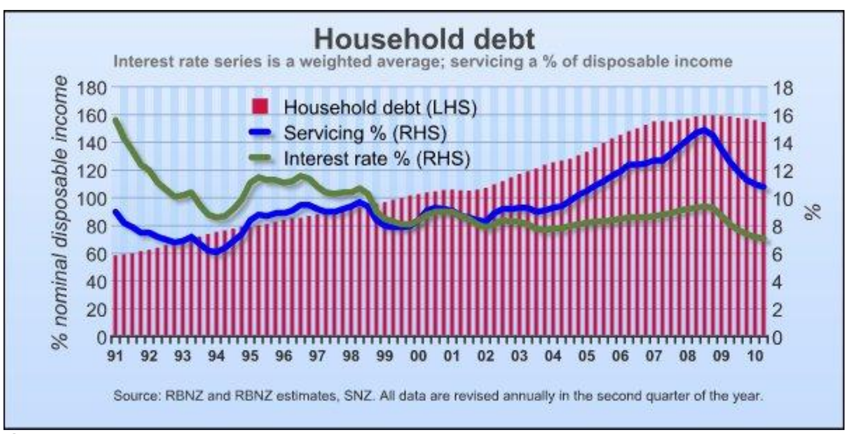
Consumer confidence – generally positive although risks remain

Consumer confidence remains in positive territory as measured by a number of surveys. However, in line with business confidence surveys, some slippage has been evident over recent months.

While it could have been assumed that the Budget, with a focus on 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, particularly in respect to headline unemployment, despite BusinessNZ and a number of other commentators having their own concerns about the quality of the information given recent wild swings in quarterly results.

Second, the march towards increased interest rates is on and despite limited achievements from households to lower debt over the last year or so, debt levels still remain at unacceptable levels, leaving households and businesses vulnerable to any significant interest rate hikes.



Source: RBNZ

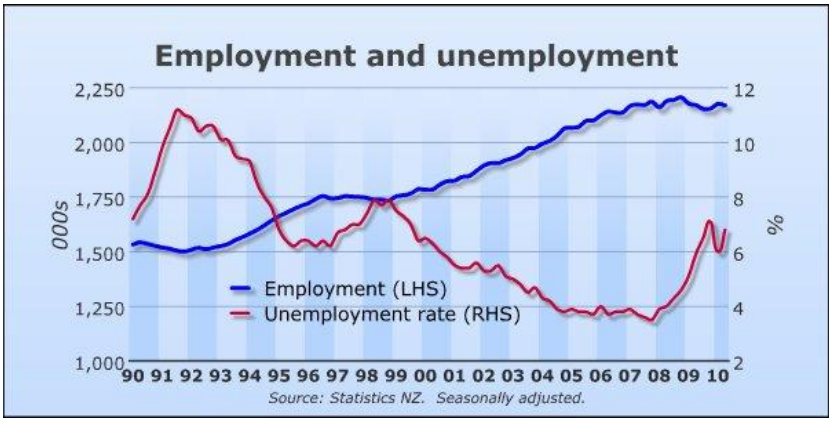
Confidence in housing has drifted away for a number of reasons, including less inward migration, and possibly the changes to the taxation of investment housing (depreciation of buildings). Electronic sales are flat and building consents are continuing to trend lower.

Consumers are taking a relatively cautious approach to major expenditure decisions and this is being reflected in heavy discounting by retailers trying to move stock. While stock *is* being moved, it is at significantly discounted prices so profit margins are under serious stress.

1.4 Labour markets – who to believe?

Employment – moderate growth forecast

The December quarter 2009 HLFS gave what appeared on the surface to be an overly pessimistic view of the labour market, particularly when looking only at the headline unemployment rate of 7.1 percent.



Source: RBNZ

The March quarter 2010 showed a quite dramatic reversal, with the unemployment rate diving to 6 percent and relatively strong employment growth (an overly optimistic result).

The June quarter 2010 then reversed all this with an equally pessimistic result - unemployment up to 6.8 percent (19,000) and a slight reduction in employment.

Looking at the headline rates can be confusing. In this respect, it is important to dig a little deeper to see what is happening to some of the key indicators of labour market strength which have stood the test of time.

First, some good advice is to largely ignore quarterly results and go with a trend series. Second, examining key forward looking indicators such as surveys of job ads and job vacancies, as well as part-time and full-time positions available, provides evidence of tentative employment growth, although perhaps not as optimistic as earlier business employment surveys would have had us believe.

To be fair, many labour market indicators are mixed at present which would tend to suggest that unemployment is likely to fall relatively slowly as indicated in the forecasts below. While growth in export sector jobs is increasingly evident, it is likely that the domestic retail sector will remain flat for some time with further redundancies possible. Businesses are still largely adopting a wait and see attitude before taking on new staff.

Forecasts: Unemployment % (HLFS)

	Quarter		
	Sep 10	Sep 11	Sep 12
Highest	6.2	5.7	5.1
Average	6.0	5.2	4.9
Lowest	5.7	4.5	4.4

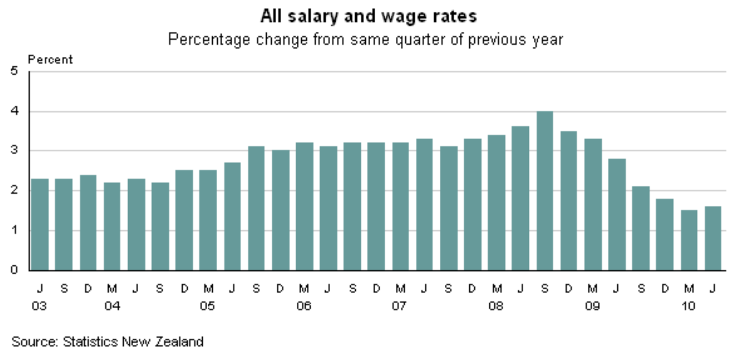
Source: ANZ, ASB, BNZ, National, and Westpac

The BNZ-BusinessNZ PMI (July 2010) indicates that employment activity (52.3), has continued to steadily improve from the very negative results experienced at the same time in 2009 (44.5). The BNZ-BusinessNZ PSI (July 2010) also remains in positive territory (51.2) compared to 48.5 at the same time last year. These results would tend to suggest steady, but not spectacular, employment growth will be the order of the day, with associated declines in unemployment.

The Department of Labour's Job Ad Series shows that both the number of internet job ads and newspaper job ad numbers bottomed out in the June quarter of 2009 (at around 70,000) and have generally increased slowly since. However, these improvements need to be put in perspective in that current job ads (around 87,000 for the June 2010 quarter) are still well below those seen during the peak of mid-2007 (around 200,000 for the June 2007 quarter). Nevertheless, improvements in job ads are a clear leading indicator of potential employment growth for the remainder of this year and beyond. These forward looking indicators clearly point to a slow rise in employment rather than a major surge.

Labour costs – modest increases likely

Wage and salary rises have continued to trend down over the last two years given the general easing in labour market pressures.



The latest official figures available show that salary and wage rates (including overtime) as recorded by the Labour Cost Index (LCI) increased by 1.6 percent from the June 2009 quarter to the June 2010 quarter, up slightly on the 1.5 percent from the March quarter 2009 to the March quarter 2010. By comparison, the Quarterly Employment Survey shows that average total hourly earnings increased 2.1 percent in the year to the June 2010 quarter.

Forecasts below indicate that labour costs are expected to increase modestly to around 2.5 percent for the years ending September 2011 and 2012. This is very much in line with the long-run average for the LCI.

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

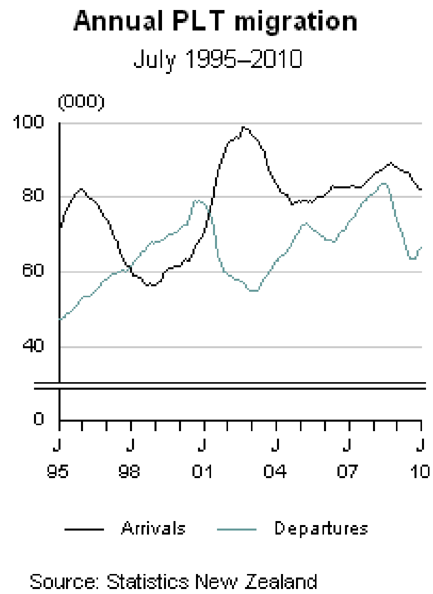
	Years ending		
	Sep 10	Sep 11	Sep 12
Highest	2.0	3.4	3.4
Average	1.7	2.4	2.7
Lowest	1.5	1.8	2.3

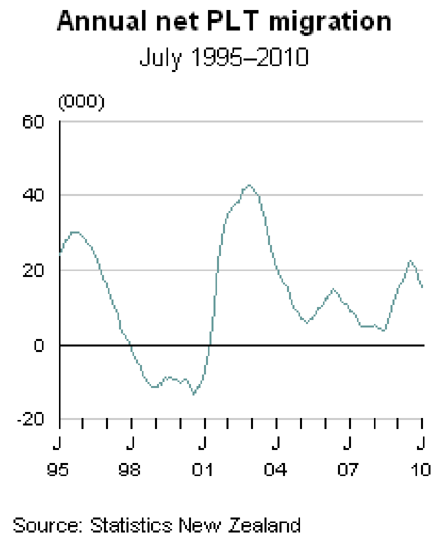
Source: ANZ, ASB, BNZ, National, and Westpac

Net migration gains – downward trend evident?

Net permanent and long-term (PLT) migration was 15,200 in the July 2010 year, compared with 14,500 in the April 2009 year. Annual net migration has decreased from a high of 22,600 in the January 2010 year.

The net PLT gain of 15,200 in the July 2010 year was higher than the annual average of 11,900 for the December year 1990-2009.





In the July 2010 year, the net outflow of migrants from the United Kingdom was 6,800, down from 9,300 the previous year. Net inflows were also recorded from India (5,600) and China (3,500). The net PLT outflow to Australia was 16,500 in the July 2010 year (32,300 departures and 15,800 arrivals); well down from 26,900 in the July 2009 year.

Given the recent hung Parliament in Australia and some uncertainty over policy direction until a new government is sworn in, it is possible that New Zealanders will become rather more cautious about making the semi-permanent trip across the Tasman than they have been to date. On the other hand, the Australian economy continues to boom and despite uncertainty over mineral taxes, nothing is likely to get in the way of further economic growth for the medium term as the country's mineral wealth continues to be sought after by major growth economies, including China.