BUSINESS NZ

PLANNING FORECAST

DECEMBER 2010

BusinessNZ

NZ economy – two steps forward, one step back

Executive Summary

Despite official data continuing to show an inconsistent pattern to NZ's economic fortunes, the country's growth prospects appear to be improving, although off a relatively low base.

Feedback from the many industry groups associated with BusinessNZ show that 'patchy growth' is still the order of the day, a conclusion emphasised by both the BNZ – BusinessNZ Performance of Manufacturing Index (PMI) and Performance of Services Index (PSI).

Recent adverse events in NZ will impact on growth prospects, but not necessarily negatively. The significant loss of new lambs over spring as a result of a particularly severe cold snap will reduce farmers' incomes. On the other hand, reduced supply will force up prices.

While international markets are still volatile, underpinned by concern about sovereign debt levels (the latest being the bailout of Ireland), overall, world growth prospects are solid. This is particularly true of the country's trading partners, a factor of considerable importance for NZ's future growth prospects.

International commodity prices remain high, and despite some concerns with the NZ/US cross rate, returns to NZ's major commodity producers are healthy.

The second report of the 2025 Taskforce "Focusing on Growth" (November 2010) provided a sobering picture of what is required if New Zealand is serious about trying to catch up with Australia by 2025. Notwithstanding the huge task ahead, many of the report's recommendations and suggestions are mainstream economics. The report noted that *"…for there to be any chance of achieving that goal [reaching Australia], an early and substantial start is critical".* It is therefore disappointing that government seems to have given the report little consideration and has largely rejected its proposals.

Similarly, Treasury and Reserve Bank comments on the need for government to show further expenditure restraint have also received little attention. Perhaps the decision by Standard and Poors to put NZ's foreign currency rating on negative outlook will prove the catalyst for addressing significant expenditure items.

HIGHLIGHTS

BusinessNZ's Economic Conditions Index (ECI) sits at 15 for the December 2010 quarter, up 20 from the previous quarter and up 3 on a year ago. A number of indicators have moved wildly around over the past few quarters and in this respect, the latest result, while very positive, should be taken with a healthy grain of salt.

While international markets are still volatile, underpinned by concern about sovereign debt levels, overall, world growth prospects are solid. This is particularly true for NZ's major trading partners, a factor of considerable importance for the country's future growth prospects.

International commodity prices remain high and despite some concerns with the NZ/US cross rate, returns to NZ's major commodity producers, are healthy.

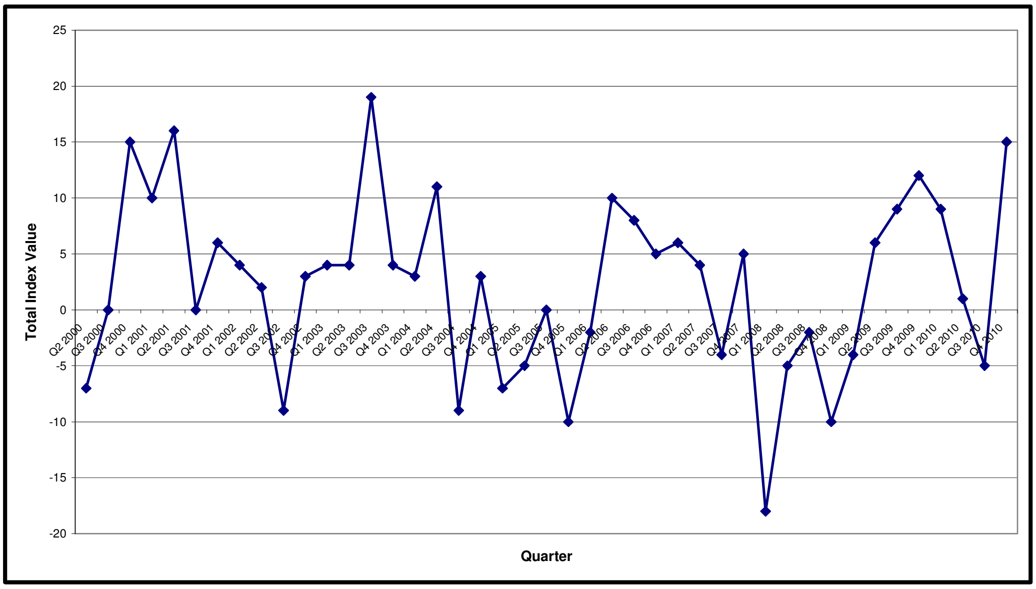
The Government's accounts continue to come under some pressure with a number of "one-off" bailouts, while Standard and Poor's decision to put NZ's foreign currency rating on negative outlook yet again stresses the need for the Government to get its expenditure under control, even if this means making some unpalatable decisions.

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 15 for the December 2010 quarter, up 20 from the previous quarter and up 3 on a year ago.[1] A number of indicators have moved wildly around over the past few quarters and in this respect, the latest result, while very positive, should be taken with a healthy grain of salt. Some largely unjustifiable swings raise question marks over the quality of some official statistics which have not necessarily reflected market reality over the last year.

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 2 for the December 2010 quarter, the same as for the last quarter and as a year ago. Growth is still relatively tentative but has been assisted by the continuing strength of international commodity prices. On the other hand, there are still significant risks to future growth prospects notably the continuing uncertainty in international markets as countries try to rein in debt. The number of adverse domestic events of recent months (e.g. the significant loss of lambs in parts of Southland due to a short, sharp burst of bad weather) may have implications for growth over the next year.

[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.

<u>Monetary policy/pricing indicators</u> sit at 1 for the December 2010 quarter, up 9 on the September 2010 quarter and down 2 on a year ago. This significant improvement from the previous quarter largely reflects a particularly bad September quarter which saw interest rate increases, a drop in commodity prices (when converted into NZ dollars) and a rising NZ dollar compared with the US dollar.

<u>Business/consumer confidence indicators</u> sit at 7 for the December 2010 quarter, up 11 on the September 2010 quarter and the same as a year ago. Again this latest significant rise in confidence should be taken with a grain of salt given the slide in both business and consumer confidence over the first three quarters of 2010.

<u>Labour market indicators</u> sit at 5 for the September 2010 quarter, the same as for the September quarter 2010 and up 5 on a year ago. With official labour market statistics fluctuating wildly over the last year (particularly the Household Labour Force Survey), quarterly changes in respect to labour market indicators need to be approached with some degree of caution. However, forward looking indicators (e.g. job ads) clearly show mild employment growth and the prospect of a slow reduction in unemployment. The latest official figures available also tend to suggest that the worst is well behind us with growth in full-time – rather than part-time – employment occurring, an important sign of a general upswing.

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

1.1. Economic growth (GDP) – modest growth forecast

Projections are for modest growth averaging around 3.2 percent for the years ending December 2011 and 2012 as outlined below.

Forecasts: Real GDP % Growth

	Years Ending		
	Dec 10	Dec 11	Dec 12
Highest	2.1	4.2	3.0
Average	2.0	3.7	2.7
Lowest	1.9	3.0	2.3

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

There are a number of factors with the ability to impact negatively and positively on growth prospects over the next few years. Some adverse events (e.g. the aftermath of the Christchurch earthquake) have the potential to add to growth over the medium term but do come at a cost both in terms of the reallocation of resources which would have been used elsewhere and in terms of the financial cost felt not only by local residents but by government and taxpayers as well.

A significantly reduced lambing percentage (as a result of adverse weather) has the potential to reduce growth prospects and will clearly impact on farmers' incomes while having obvious flow-on affects for the freezing industry. On the other hand, reduced international lamb supplies will put further upward pressure on prices, perhaps compensating somewhat for lower volumes.

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, NZ's major trading partners (notably Australia and China) are continuing to show solid growth, while over time, the prospect of entering into further bilateral free trade arrangements (e.g. with Russia,) will stand the country in good stead further down the track.

International commodity prices remain high, reinforced in respect both to Fonterra's international online auction and the company's projected payouts to its suppliers for the current 2010/11 year. While international commodity prices are still volatile and there is considerable uncertainty about the future direction of the NZ dollar, demand remains strong, underpinning a reasonably high payout when compared with Fonterra's long-run average payout.

The ANZ Commodity Price Index, after taking a breather mid-year, has improved to reach an all-time high (November 2010). The index now stands at 296.2, up 4.5 percent from the previous month and 23.7 percent from a year ago but when converted into NZ$$, shows an increase of only up 1.4 percent on the previous month. This is a reflection of the general strengthening in the NZ dollar, particularly against the US dollar over that period but, even so, the index was still up a healthy 15.7 percent on a year ago. With the domestic economy subdued (particularly housing and retail), NZ is heavily dependent on continuing strong commodity prices to boost export returns and hence overall growth in the economy.

ANZ Commodity Price Index

	World Price Index	Monthly % Change	Annual % Change	NZ$ Index	Monthly % Change	Annual % Change
Nov 2006	183.1	2.2	5.4	154.0	1.3	10.7
Nov 2007	248.8	0.7	35.8	186.1	0.8	20.8
Nov 2008	203.3	-7.4	-18.3	196.3	-1.4	5.5
Nov 2009	239.4	11.0	17.8	180.6	12.3	-8.0
Nov 2010	296.2	4.5	23.7	209.0	1.4	15.7

Source: The ANZ Commodity Price Index NZ – October 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 growth potential and catch up on ground lost compared with our major trading partners.

The second report of the 2025 Taskforce “Focusing on Growth” (November 2010) provided a sobering picture of what is required if New Zealand is serious about trying to catch up with Australia by 2025. Notwithstanding the huge task, many of the recommendations and suggestions for reform contained within that report are mainstream economics. The report noted that *“…for there to be any chance of achieving that goal [reaching Australia], an early and substantial start is critical”.* It is therefore disappointing that government seems to have given the report little consideration and has largely rejected its proposals.

Similarly, Treasury and Reserve Bank comments on the need for government to show further expenditure restraint have also received little attention. Perhaps the decision by Standard and Poors to put NZ’s foreign currency rating on negative outlook will prove the catalyst for addressing significant expenditure items. Addressing large expenditure items requires a degree of political commitment.

Three significant areas deserving of a thorough review are outlined below. A fourth, welfare reform, is currently being looked at by the Welfare Working Group. The group’s latest contribution to the debate is the discussion paper *“Reducing Long-term Benefit Dependency – the Options”.* Concerns over aspects of the Working for Families package could also be considered in this context, together with the potential to create poverty traps and the impact of high effective marginal tax rates on the incentive to earn more income. Social assistance programmes such as Working for Families (WFF) currently apply to about 300,000 New Zealand households, equating to a total cost of around $2.2 billion for 2010.

Three significant areas of Government expenditure which should be addressed with some urgency include:

1. Reform of NZ Superannuation
2. Reducing the fiscal cost of KiwiSaver
3. Reform of the “interest-free” student loans scheme

Reform of NZ Superannuation

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).

There are clearly a number of options available in respect to future superannuation provision.

The general thrust should be towards tightening the criteria for age-related benefits and could be in the form of the following (or possible combinations):

- extending out the age of eligibility (either in line with increases in life expectancy or on an ad hoc basis to keep costs manageable).
- having (possibly) a tiered approach to superannuation depending on when a person opts to take it (as advocated recently by Dr Don Brash). e.g. the later someone “opts in” the higher the level of payment for the rest of their life.
- stepping the level of benefit depending on age e.g. 50 percent of average income at 65 years of age, 70 percent of average income at 75 years of age.
- reducing the amount paid (currently two-thirds of the average wage) over time either through freezing benefits or indexing them to the Consumers’ Price Index (CPI) rather than wages.
- means testing benefits either through asset(s) and/or income testing.

While all the above approaches have pros and cons, deciding what changes should be made will be influenced by both economic and political considerations. Progressively increasing the age of eligibility would appear to be an obvious change. With individuals generally living longer, on average, and with medical advances offering an improved quality of life, it is reasonable to expect that the age of entitlement could be increased to close to 70. Many other countries are already increasing their age of pension coverage - Australia to 67 over 14 years, for example. The age in Britain is now 68 and in the US, 67.

However, many of the other approaches have significant drawbacks e.g. – the impact freezing benefits would have on those dependent on NZ Superannuation as a sole source of retirement income. Different levels of benefit depending on age can raise issues of ethnicity (given differing life expectancies), while the pitfalls of income and asset testing are generally well known.

Reducing the fiscal cost of KiwiSaver

Clearly it is useful to examine the role of public versus private provision for retirement, along with appropriate funding mechanisms.

The current subsidies provided to those who join KiwiSaver are considerable, and in many cases a persuasive reason for signing up. As well as the $1,000 initial contribution, government then provides up to a maximum of $1,042 per year, depending on the contribution level of the individual member.

In terms of long-term cost, we do not believe the initial $1,000 subsidy represents a significant fiscal issue for government. It is a one-off cost, which in nominal terms has cost government close to $1.5 billion from 2007 to June 2010. However, the yearly government contribution is an area which we believe does need revision. Simply put, the greater the enrolment number, the greater the annual cost of the government subsidy, given around 81% of KiwiSaver members are in the labour force. Current numbers would mean the annual cost to Government could reach as high as $1.2 billion, or 2.1% of total revenue collected by IRD.

BusinessNZ's submission to the Savings Working Group included a key recommendation that: "*Any changes to KiwiSaver subsidies should involve at a minimum the removal of the yearly government contribution of up to $1,042 per year per member.*"

Reform of the "interest-free" student loans scheme

The student loan scheme has become anything but a loan. As the Treasury has pointed out, in 2009/10 government lent $1.5 billion in student loans, but the expected cost to government is $728 million. Therefore, nearly half the value of the loan is written off when it is drawn down.

While BusinessNZ strongly supports the concept of student loans, serious consideration should be given to charging appropriate (possibly even market) interest rates on the loans in view of the significant cost involved. The opportunity cost to government and taxpayers of such money being written off, demands a much more rigorous approach both to interest payments and the monitoring of loan repayments.

1.2 Monetary Conditions – delay in tightening

Interest rates – timing of further rises still debatable

The 90 day bill rate is forecast to increase to around 5 percent by December next year and then level out after that (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, further rises are likely to 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.

A recent fly in the ointment is the decision by Standard and Poors to put NZ's foreign currency rating on negative outlook as a result of the country's continuing high external debt levels (particularly in respect to the corporate/household sectors).

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

In short, high debt means greater risk, hence higher interest rates and reduced credit levels. Interest rate movements (mainly rises) may well be outside of the ability of the Reserve Bank to influence. Certainly government can do its bit and take some of the pressure off interest rates by returning its accounts to surplus as soon as possible. A number of candidates for expenditure cuts were briefly mentioned above in order for this to eventuate.

Forecasts: Interest Rates (90 day bills)

	As at end of		
	Dec 10	Dec 11	Dec 12
Highest	3.4	5.2	5.5
Average	3.2	4.9	5.2
Lowest	3.2	4.7	4.7

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

The New Zealand dollar – anyone's guess

The forecasts below clearly show the uncertainty involved in projecting currency movements over the medium term.

The NZ$ has come under some pressure of late, particularly given Standard and Poors decision to put the country's foreign current rating on negative watch. On the other hand, the NZ/US cross has given cause for concern to exporters, not because of the inherent strength of the NZ dollar, but due to the US weakness consequent on printing more money. Continued uncertainty in the EU and moves towards further bailout packages have seen something of a rush back to what are perceived to be safe havens rather than to commodity-based currencies. However, the situation will likely change as confidence internationally improves and investors seek higher returns.

Source: National Bank of NZ

Only one thing is certain, and that is that no currency is totally immune from world economic events. Further bumpiness for the NZ dollar, along with other currencies, is likely to be the order of the day for some time to come.

Forecasts: Exchange Rates

AUD (cents)			
	Dec 10	Dec 11	Dec 12
Highest	0.763	0.810	0.823
Average	0.758	0.779	0.796
Lowest	0.750	0.740	0.740

USD (cents)			
	Dec 10	Dec 11	Dec 12
Highest	0.760	0.780	0.710
Average	0.743	0.735	0.678
Lowest	0.720	0.710	0.650

TWI			
	Dec 10	Dec 11	Dec 12
Highest	67.4	71.1	69.4
Average	66.2	66.9	64.3
Lowest	64.1	63.5	61.3

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

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

Forecasts outlined below show that inflation is likely to be within the Reserve Bank's target of 1-3 percent for the year to December 2011.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Dec 10	Dec 11	Dec 12
Highest	4.3	3.0	3.2
Average	4.2	2.6	2.7
Lowest	3.9	1.9	2.4

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

Despite some upward pressure on prices over the September 2010 quarter with further pressures likely over the December quarter (mainly as a result of the one-off increases in GST), inflation is likely to be well contained, nervousness earlier this year notwithstanding. Most inflation rise projections have been revised down of late.

Modest capacity utilisation, relatively high levels of unemployment by recent historical standards, modest wage growth and stagnant retail sales will likely offset any potential for "one-off" price increases to impact on generalised inflation over the medium term.

Clearly, in light of modest growth in the economy and rather stagnant retail and housing sectors, the pressure on the Reserve Bank to move to increase interest rates on the basis of potential inflationary threats is weakening by the day.

The above comments do not mean government should cease trying to help make the non-tradables sector more competitive. Unless government is able to address the factors that are driving up non-tradables inflation - such as ACC levy increases and local government rates - and impose greater discipline and contestability in service provision, the risk of the non-tradables sector fuelling consumer and business expectations of more generalised inflation will persist.

Notwithstanding some reduction of late, continuing high levels of household debt and associated servicing costs will see consumers still taking a cautious approach to new expenditures. In this respect, increases in disposable income resulting from the personal income tax cuts which took effect from 1 October 2010 are more likely to be used – as many felt was possible - to retire debt rather than boost consumption. Retailers in particular, are heavily discounting products in order to try and move stocks but to date, sales levels remain flat despite these efforts.

1.3 Business and consumer confidence – starting to improve again after slippage earlier this year

Business confidence – improving after earlier slippage

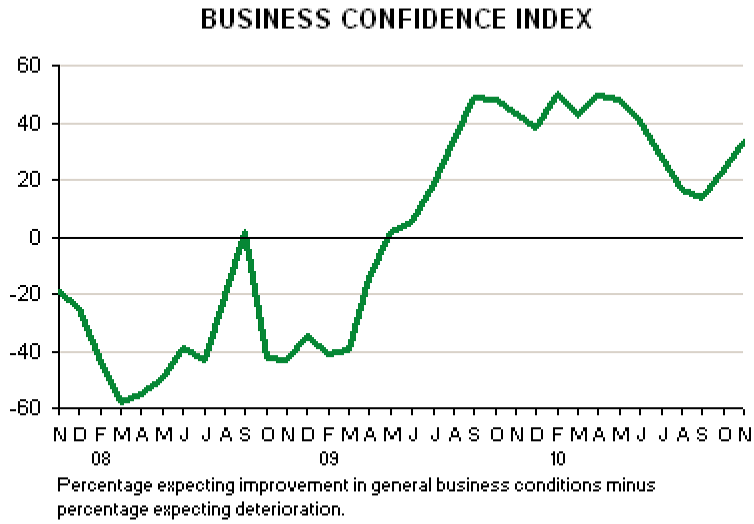
Both business and consumer confidence have improved slightly of late having slipped significantly earlier this year.

In examining both business and consumer confidence levels over recent years, it is important that not too much is read into one month's, or even one quarter's, results. The extremely high levels of confidence last year really reflected the fact that having dived severely in late 2008, the only way was up. As a consequence, confidence surveys can be affected by positive or negative "one-off" events, something it is useful to understand when analysing where both businesses and households are really at. Obviously a focus on the actual outcomes of individual business activity can provide a more telling picture than how businesses perceive "general" economic conditions. Perceptions of this kind often have significant emotional elements attached to them.

Current levels of confidence, therefore, largely reflect where the overall economy is at - showing modest levels of growth.

The National Bank's Business Outlook (November 2010) indicates that confidence continues to improve. Perhaps the more crucial element to be monitored is firms' own expectations and these are still well on the positive side of the ledger.

National Bank Business Confidence Index



Source: National Bank of NZ

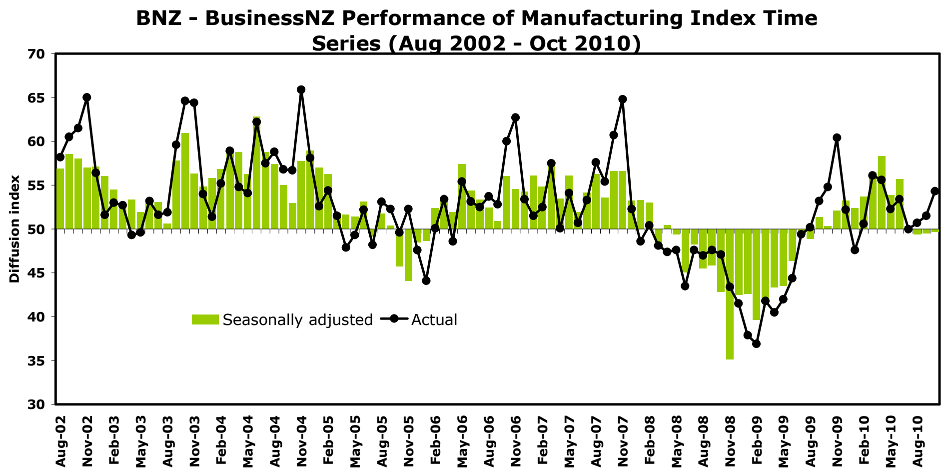
A net 33 percent of respondents expect better times ahead, up 9 points from the previous month. Business confidence has improved across all sub-components. Firms' perceptions of their own business activity also continue to improve with a net 35 percent expecting better times over the year ahead, up 4 points on business expectations for the previous month.

The key components of investment and employment are now showing further signs of lifting. A net 7 percent of businesses expect to be investing more (up 3 points) while a net 12 percent expect to be hiring staff over the coming year (up 4 points). Inflationary pressures appear to be well and truly under control.

An improvement in business confidence of late is being reflected in rather tentative signs of improvement in growth in both the manufacturing and the services sectors. The latest BNZ-BusinessNZ Performance of Manufacturing (PMI) and Services (PSI) Indexes show that both manufacturing and services performance are still flat - as can be seen from the graphs below - but responses to those surveys suggest a slightly improved outlook.

The PMI for the month of October 2010 was 49.7 while the PSI was sitting at 52.0. A reading above 50 indicates that activity is expanding; below 50 indicates that it is contracting.

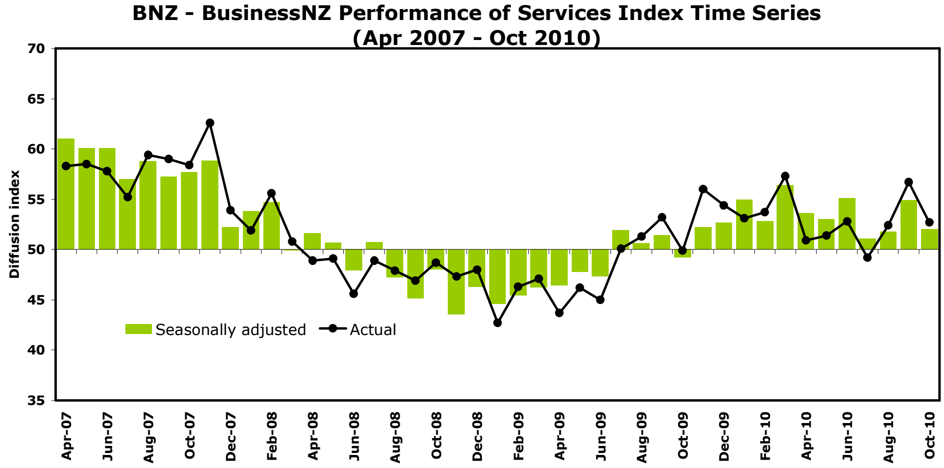
In respect to the PMI, three of the five seasonally adjusted main diffusion indices (which combined make up the overall PMI), *Employment, New orders* and *Deliveries,* all edged into positive territory while *Production* and *Finished stocks* remained negative. Positive responses in relation to new orders, and negative responses for finished stock, bode well for future expansion in the manufacturing sector.



Source: BusinessNZ

The seasonally adjusted PSI for October 2010 (52.0) was down 2.9 points from September and a return to the level of activity experience in August.

Despite the reduction in expansion, four of the five sub-indices were again in expansion mode during October. The only negative was *Employment* (49.8) which was flat in October, down 3.6 points from the previous month. This may well reflect further job shedding in key employment areas of the service sector e.g. retailing.



Source: BusinessNZ

Consumer confidence – mixed but still positive

Consumer confidence remains in positive territory as measured by a number of surveys. However, in line with business confidence surveys, it is still relatively tentative with consumers cautious about major decisions and an emphasis on retiring debt.

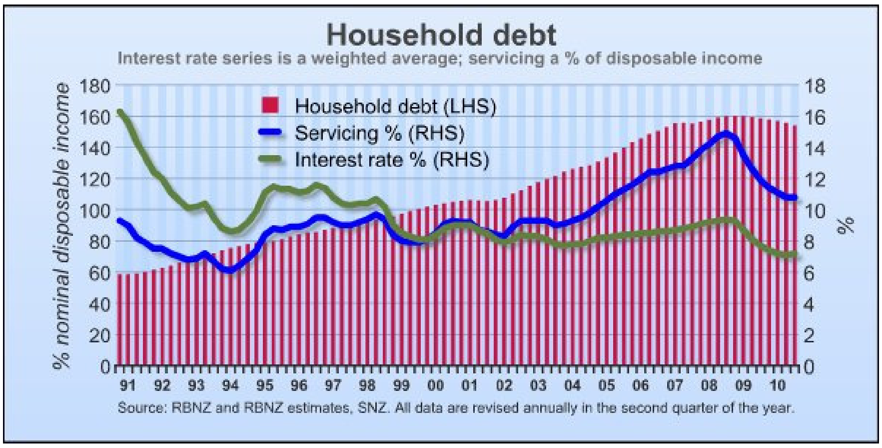
The ANZ-Roy Morgan survey shows that confidence rose just 1 point to 114.5 in November, with the index hovering around the 115 market for the past five months.

While it could 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 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 remained 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 NZ, 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.



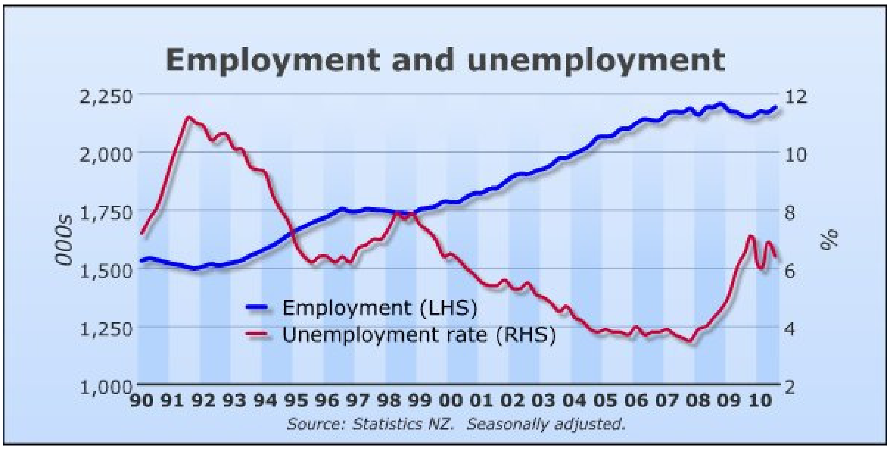
Source: RBNZ

Other indicators of consumer confidence e.g. electronic sales and building activity continue to remain flat.

1.4 Labour markets – improvement evident despite wobbles

Employment – moderate growth forecast

The graph below, tracking both employment and the unemployment rate, has attracted some media attention of late in light of the seismic like wobbles apparent when the unemployment rate over the past year is examined.



Source: RBNZ

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 given that previous results have trended higher or lower reflecting the economic situation at the time.

Some useful practical advice is largely to ignore quarterly results and go with a trend series. Quarterly results can be misleading when it comes to the real strength of the labour market. An examination of key forward looking indicators, such as job ad and job vacancy surveys, part time and full-time positions available and official "joblessness" statistics (everybody who is available for work or actively seeking work) provides evidence of an improving labour market. Forecasts below show that unemployment is expected to drift lower over time from 6.4 percent currently to around 5.4 percent by the end of 2011 and level out in 2012.

Household Labour Force Survey: September 2010 quarter

Seasonally adjusted	September 2010 quarter	Quarterly change	Annual change
Unemployment rate	6.4%	-0.5	-0.1
Unemployed	150,000	-6.1%	+0.3%
Employed	2,193,000	+1.0%	+1.8%
Not in the labour force	1,089,000	-0.5%	+0.6%
Labour force participation rate	68.3%	+0.2	+0.3

Source: Statistics NZ

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.

Forecasts: Unemployment % (HLFS)

	Quarter		
	Dec 10	Dec 11	Dec 12
Highest	6.6	6.0	5.6
Average	6.4	5.4	5.3
Lowest	6.3	5.0	4.9

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

The BNZ-BusinessNZ PMI (October 2010) indicates that employment activity (51.5), has continued to improve steadily from the negative results experienced at the same time in 2009 (47.1). The BNZ-BusinessNZ PSI (October 2010) has been in positive employment territory since December 2009 but dipped in October, effectively showing no growth for the month (49.8).

Despite projections of steady employment growth, there are still significant pockets of labour market concern, particularly the high levels of unemployment among the young and unskilled members of society.

Some recent legislative decisions may assist in providing greater opportunities for young and “first-timers” to enter the labour market, namely the decision to extend the 90-day trial period to all businesses (previously only available to small businesses with fewer than 20 employees). This is positive. On the other hand, minimum wage rates, and particularly the absence of a youth minimum wage, may well be restricting the ability of many vulnerable people to enter the labour market.

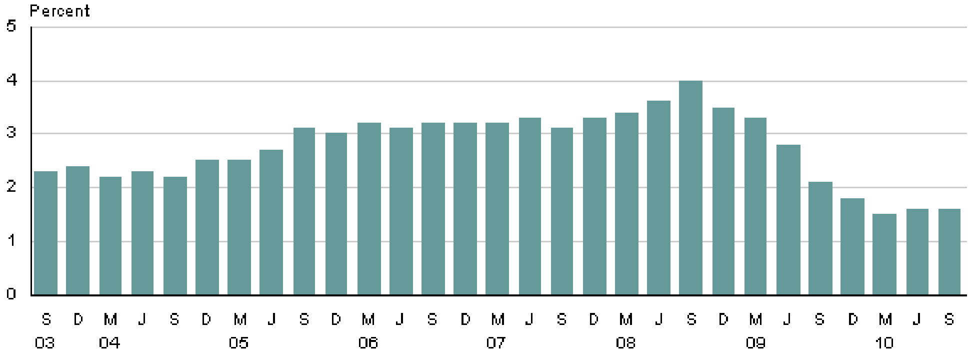
Labour costs – modest increases likely as employment growth pick up

Wage and salary rises have generally remained relatively low over the past year, given the general easing in labour market pressures to date.

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 September 2009 quarter to the September 2010 quarter, the same rise as from the June quarter 2009 to the June quarter 2010.

All salary and wage rates

Percentage change from same quarter of previous year



Source: Statistics New Zealand

Notwithstanding relatively subdued rises in salary and wage rates over recent quarters, households will be benefitting from increased take-home pay as a result of the cuts to personal income tax which took effect from 1 October 2010. Consequently, from a household point of view, net income is probably a much more reliable measure than gross income changes per se.

Forecasts below indicate that labour costs are expected to increase modestly to around 2.3 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		
	Dec 10	Dec 11	Dec 12
Highest	1.8	2.3	2.4
Average	1.8	2.3	2.4
Lowest	1.7	2.2	2.3

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