BUSINESS NZ

PLANNING FORECAST

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BusinessNZ

NZ Economy – gaining traction

Executive Summary

A number of indicators, both quantitative and qualitative, provide increased evidence that the NZ economy is gaining traction.

While there is always a risk that this will just be another false start, the breadth of improvement in key economic indicators is heartening to say the least – including a measurable improvement in labour market outcomes.

Business and consumer confidence is continuing to improve with households starting to be open their wallets again as evidenced by greater levels of consumption of late.

Both the manufacturing and services sectors are showing solid growth according to the BNZ – BusinessNZ Performance of Manufacturing Index (PMI) and the Performance of Services Index (PSI).

There is also some positive news concerning the drought conditions which affected much of the country in late summer - early autumn. It is now considered their effects will be less severe than first thought as reasonably warm temperatures in late autumn and early winter have allowed for some replenishment of grass growth before winter truly sets in.

The housing market is showing strong growth, particularly in Auckland and Canterbury, with building activity starting to really crank up.

It's not all roses though. We have always said that as a small nation, dependent on exports, the strength of our major trading partners is crucial to how well New Zealand does. In this respect our two major trading partners, China and Australia, are looking quite different. While China's projected growth rate has dropped slightly to a still healthy 7.5 percent per annum, Australia's fortunes have taken a tumble over the last 18 months, starkly evidenced in comparison with the BNZ – BusinessNZ Performance of Manufacturing Index (PMI).

After being neck and neck for a relatively long period of time, the Australian PMI has drifted significantly lower of late and is in danger of falling off the radar. While New Zealanders might like to see the Australian Rugby team down and out, it is a different story in respect to the Australian economy. When the Australian economy does well, this often means that New Zealand's export receipts to Australia rise significantly as the Australian economy sucks in more imports.

The other worrying factor on the domestic scene is household debt. While there are a number of reasons for growth in household debt, the real concern is that debt is increasing at a time when servicing costs are relatively low and interest rates are at historic lows. The danger is that when interest rates rise, as they invariably will (although the exact timing of the rise can always be debated), households may get into strife. Although significant household debt reduction was achieved post-2009, it would appear that households have partially forgotten the lessons of the past. Rising house prices may provide a feel-good factor but it would be dangerous for households to consider that this represents a real increase in wealth. At the end of the day people have to live somewhere and the cost of housing will ultimately be passed on to households through higher rental costs.

HIGHLIGHTS

The BusinessNZ Economic Conditions Index (ECI) sits at 19 for the June 2013 quarter, up 9 on the previous quarter and up 27 on a year ago.

The global economic outlook is improving slowly with improving data coming out of the world's largest economy – the US.

NZ's largest trading partners are showing mixed reviews. China's growth is still relatively strong while Australia is struggling.

International commodity prices remain firm with expectations of improving returns for Fonterra suppliers for the 2013/14 season.

Domestically, business and consumer confidence continue to rise, with strong support from a number of key indicators.

Despite both an improving outlook domestically and internationally, a number of risks remain.

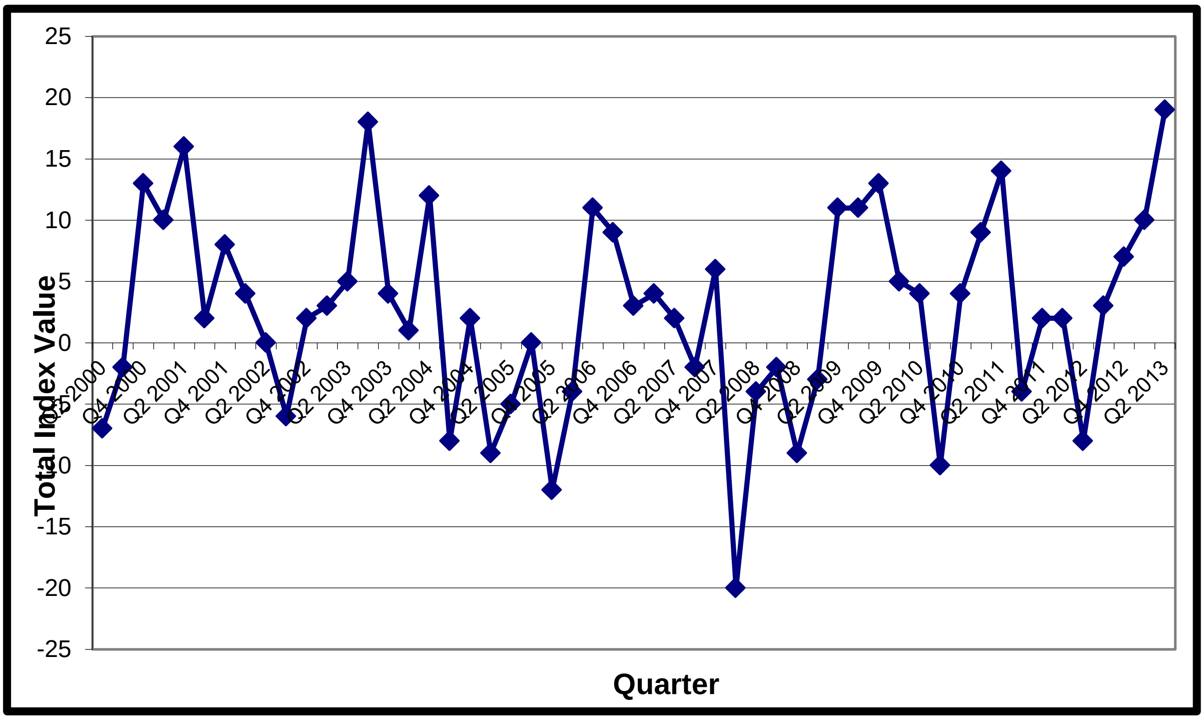
- **Household debt levels remain elevated after showing signs of improvement post-2008 leaving households exposed as interest rates rise.**
- **While some action has been taken to improve land supply, housing affordability remains a key concern.**

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 19 for the June 2013 quarter, up 9 on the previous quarter and an improvement of 27 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 4 for the June 2013 quarter**, up 2 on the last quarter and up 8 on a year ago. An improved international outlook with firm commodity prices bodes well for solid export growth.

<u>**Monetary policy/pricing indicators**</u> **sit at 2 for the June 2013 quarter**, up 4 on the last quarter and up 4 on a year ago. Inflationary pressures remain subdued although pressures are building on the back of strong growth in house prices as demand outstrips supply, particularly in Auckland, and to some extent Christchurch.

<u>**Business/consumer confidence indicators**</u> **sit at 7 for the June 2013 quarter**, up 2 on the previous quarter and up 9 on a year ago. A number of surveys of both business and consumer confidence show a consistent theme emerging of steady growth in confidence. Households are slowly reopening their wallets.

<u>**Labour market indicators**</u> **sit at 6 for the June 2013 quarter**, up 1 on the previous quarter and up 7 on a year ago. While measured employment is growing, perhaps more importantly, some forward looking surveys show firms are increasingly contemplating taking on new staff.

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

PART 2: THE NEW ZEALAND ECONOMY – WHERE ARE WE GOING?

1.1 Economic growth (GDP) – cranking up

Economic growth is forecast to average just over 3 per cent per annum out to March 2015, as outlined below.

These forecasts are slightly more optimistic than the recent Treasury Budget forecasts which had economic growth 'peaking' at 3 percent per annum in 2015 before dropping slightly in the out-years to reach 2.2 percent by 2017 – slightly less positive than forecasts by some private sector agencies.

Forecasts: Real GDP % Growth

	Years Ending		
	June 13	June 14	June 15
Highest	2.6	3.4	3.5
Average	2.6	3.1	3.2
Lowest	2.4	2.9	2.9

Source: ANZ, ASB, BNZ, and Westpac

There is a range of factors which will likely boost economic growth over coming years while as always, there are potential risks to be considered.

On the positive side:

- **Export prices continue to remain high with the ANZ Commodity Price Index in world prices terms 26.1 percent ahead of a year earlier. When converted in NZ dollars, there was a lesser rise, but still a healthy 17.3 percent up on a year ago.**

ANZ Commodity Price Index

	World Price Index	Annual % Change	NZ$ Index	Annual % Change
May 2009	180.9	-28.2	164.7	-11.2
May 2010	266.6	47.3	203.7	23.6
May 2011	315.3	18.3	216.8	6.5
May 2012	260.3	-17.5	182.4	-15.9
May 2013	328.2	26.1	214.0	17.3

Source: The ANZ Commodity Price Index – 5 June 2013

Given New Zealand's dependence on exports, the state of the country's major trading partners is fundamental. In this regard, prospects are looking up with a number of surveys showing improved global sentiment.

- **Fonterra has increased its projected payout to its dairy suppliers for the 2013/14 year to $7 per kg – a significant rise on the current year's payout.**

While there is always some risk associated with future payouts given exchange rate volatility and the like, with evident improvement in the US economy and projections that its massive quantitative easing is due to be reined in, it is likely that the US dollar will continue to gain traction over time. This necessarily means that returns when converted to NZ dollars could be even better than projected. Recent results for Fonterra's Global Dairy Trade Auction have decreased of late (although the latest result showed a small increase) but overall increases over the last 6 months have been nothing short of specular. If the $7 per kg holds, that is likely to add around $2 billion to the economy over the next 12-18 months.

- **The rebuild of Christchurch, after significant delays, appears to be gathering momentum as outlined in a number of official and unofficial statistics.**

Beyond Christchurch there is also significant improvement in the housing market, particularly in Auckland as several years of pent up demand for housing are now being reflected in greater construction activity. Earthquake strengthening of buildings will also be an ongoing source of activity for a number of years to come.

- **Consumer confidence is cranking up, with consumers increasingly opening their wallets on the back of an improving housing market and an improved employment outlook**.

Unfortunately in many respects, but traditionally in NZ, an improving housing market has resulted in consumers increasing consumption expenditure in light of perceived evidence of increasing net wealth. This is reflected in an increase in electronic transactions and improving retail sales. A net growth in migration will also add to the upward pressures on housing demand.

- **Historically, low interest rates are encouraging greater investment but this could be considered a two-edged sword.**

On one hand, historically low interest rates are providing opportunities for individuals to enter the housing market and borrow substantial sums of money given the relatively low level of debt servicing costs. On the other hand, it is likely that at least a portion of these investors could get burnt as interest rates rise on the back of an improving economy. It would be a foolhardy to assume that interest rates will remain at 5 – 6 percent into the future, when on average, over time, they have been more likely to be close to double figures. Debt servicing costs should be factored in when making major purchases such as housing.

- **Proposed reductions in accident insurance (ACC) levies for 2014/15 and 2015/16 will lift disposable incomes.**

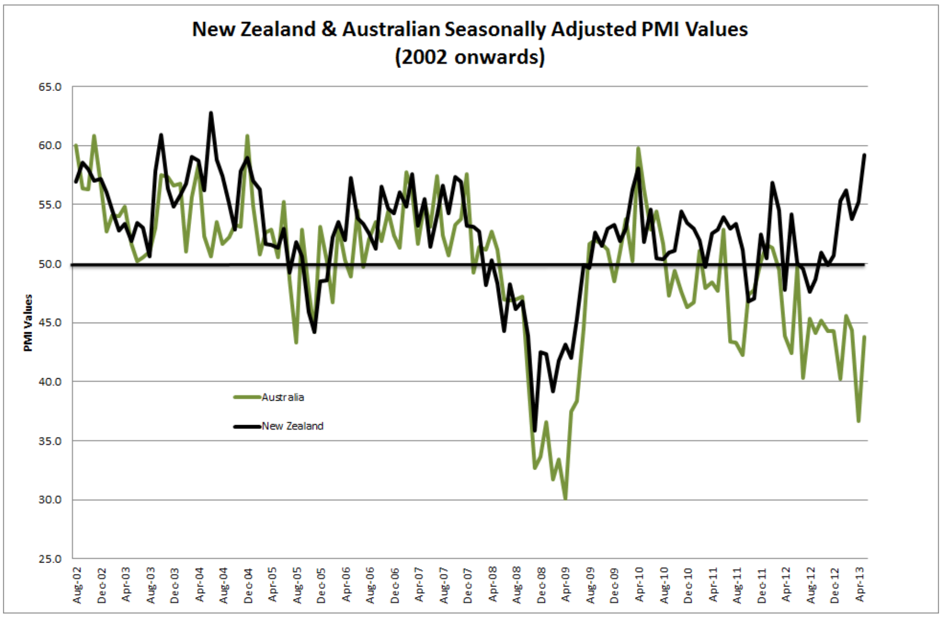
The Government is now satisfied that there is scope for significant reductions in accident insurance (ACC) levies in the near future, Allowance has been made for levy reductions of around $300 million in 2014/15 with reductions increasing to around $1 billion in 2015/16. This will have the desirable effect of increasing disposable income.

While both business and households will welcome reductions in ACC levies, the fact remains these reductions are simply possible as a result of the Government keeping levies artificially high over the past couple of years. This reinforces the fact that premiums should be set independently of Government to ensure that premiums reflect actual insurance principles rather than political considerations.

On the negative side:

- **Our two major trading partners, China and Australia are looking quite different, raising concerns about the state of the Australian economy.**

While China's projected growth rate has dropped slightly to a still healthy 7.5 percent per annum, Australia's fortunes have taken a tumble over the last 18 months starkly evidenced in comparison with the BNZ – BusinessNZ Performance of Manufacturing Index (PMI), as can be seen below. While the NZ PMI is close to 60, the Australian PMI is hovering below 45.



Source: BusinessNZ

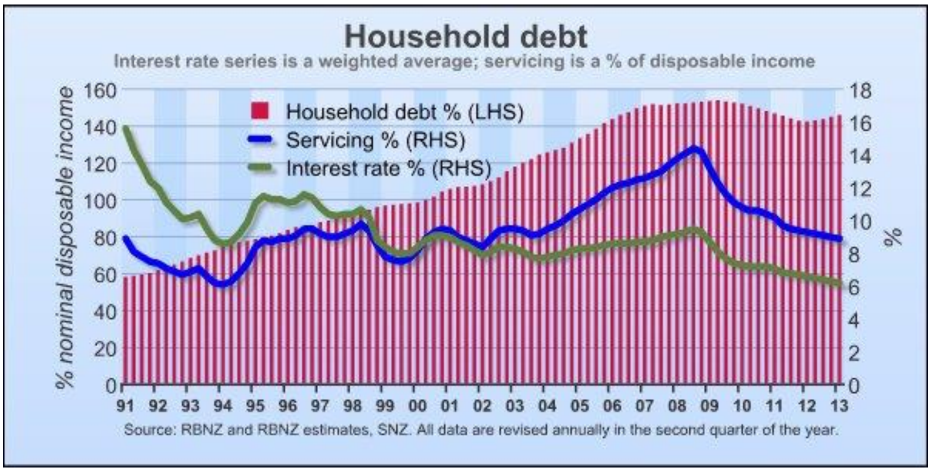
- **Future increases, and the speed of increase, in interest rates could be detrimental.**

Another big issue and another risk is the potential for rising house prices to put pressure on the Reserve Bank to raise interest rates in response to increases in the Consumers' Price Index (CPI). It is therefore important to expose the real reasons for house price rises to ensure any artificial constraints on supply (such as regimented regimes that restrict land supply) are removed.

Other factors will also be relevant in respect to inflationary pressures such as the future direction of the NZ dollar, particularly against the US dollar. While many exporters would welcome further reductions in the cross-rate, this would have a down-side in terms of making the costs of imported goods and services (including petroleum) more expensive.

- **Rising household debt.**

While there are a number of reasons for the growth in household, the real concern is that debt is increasing at a time when debt servicing costs are relatively low and interest rates are at historic lows. There is a danger that when interest rates rise, as they invariably will (although the exact timing of any rise can always be debated), households may get into strife if the economy falters. The increase in bank lending to customers with high-loan-value ratios is also part of this mix.



- **Ongoing impact of the drought**

Finally, the ongoing impact of the drought needs to be considered.

Reductions in stock numbers will have implications for production over the next year and possibly beyond as farmers rebuild capital stock numbers.

1.2 Monetary Conditions – changes to prudential supervision requirements

The Minister of Finance and the Reserve Bank Governor have signed a memorandum of understanding on measures aimed at further protecting the economy and financial system against boom and bust cycles.

The memorandum will require banks to:

- Hold additional capital on their balance sheets as a buffer during an economy-wide credit boom.
- Hold additional capital against loans in specific sectors if risks emerge in those sectors.
- Adjust their funding ratios to use more stable sources of funding to avoid short-term funding shortages.
- Apply quantitative restrictions on the share of high loan-to-value ratio loans in the housing sector.

There will be reasonable controls and threshold tests to determine when these tools will be used.

While BusinessNZ considers that most of the above tools can be seen as sensible, the last one (restrictions on loan to value ratios) is a little problematic and might impact adversely on first home buyers. Moreover, it might encourage would-be home buyers to source finance from less desirable institutions than banks given that at least initially, the tools would apply only to registered banks.

It must be emphasized that such measures are targeted at prudential supervision and financial security rather than being a substitute for monetary policy settings (i.e. interest rates) as a means of controlling inflation. Neither should they be considered a mechanism to rein in investment in specific markets, notably the housing market. Housing affordability is best addressed by dealing with the root causes of housing unaffordability which are principally, though not wholly, related to the question the supply of land available for new housing development.

There is perhaps the potential for some tension between the Reserve Bank (which is essentially responsible for ensuring the soundness of New Zealand's financial system), and the Government, which is obviously keen to see as many first home buyers enter the housing market as possible. Obviously, the Government doesn't want to see first-home buyers locked out of the market but adopting a system which is acceptable and workable to the four major stakeholders – the Reserve Bank, the Government, the registered banks and finally households – is unlikely to be an easy task. In order for any scheme to have credibility, it must be relatively simple and there must be clear understanding of when it will apply. Uncertainty will simply add to risk, and by definition raise the cost of capital, while potentially resulting in perverse and unintended outcomes – e.g. obtaining loans from less financially secure sources.

Interest rates – still on hold….for now.

The 90-day bill rate is forecast to increase slowly to reach 3.3 percent by June 2014 and 4.1 percent by June 2015, as evidenced by the forecasts below.

Forecasts: Interest Rates (90 day bills)

	As at end of		
	June 13	June 14	June 15
Highest	2.8	3.6	4.7
Average	2.7	3.3	4.1
Lowest	2.7	3.2	3.8

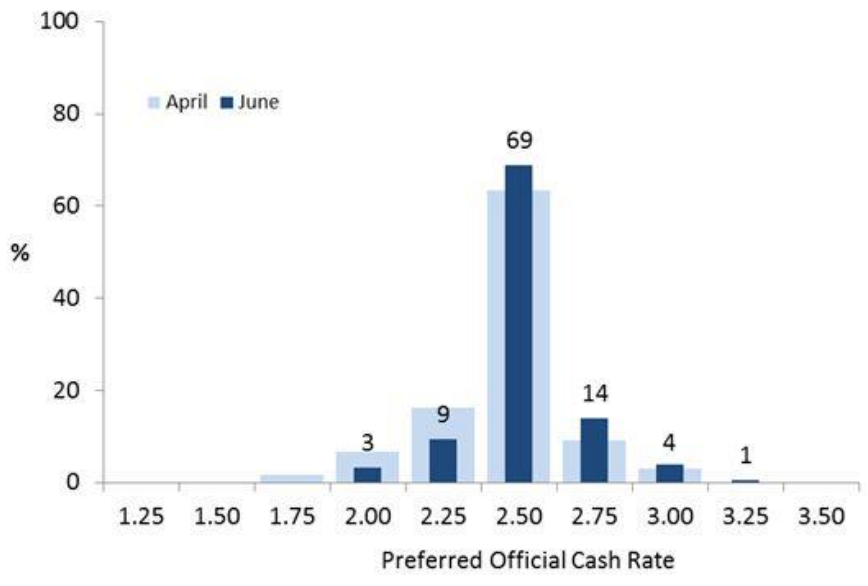
Source: ANZ, ASB, BNZ, and Westpac

With inflationary pressures (and expectations) at historic lows, the likelihood of any interest rate rises for this year look slim. However, the Reserve Bank Governor has a number of conflicting issues which he must manage in determining when to raise interest rates. First there is continuing strength the housing market. Second, the future direction of the NZ dollar is uncertain (largely as a result of overseas influences e.g. on-again off-again quantitative easing in the US). Third, as mentioned above, the impact, if any, of moves by the Reserve Bank to effectively tighten up credit availability on the cost of funds to banks, which will ultimately be passed on to consumers. It is not an easy time for the Governor.

The New Zealand Institute of Economic Research's (NZIER) Shadow Monetary Policy Board (whose task it is to recommend interest rate settings ahead of each decision by the Governor of the Reserve Bank) found the majority of its members still supports no change to the OCR.

"House prices in Auckland continue to surge higher risking a costly correction further ahead. So for the first time in eighteen months raising rates has more support than cutting interest rates."

NZIER *Shadow Board* continues to favour an OCR of 2.50%



Source: NZIER

69 percent of Shadow Board members "votes" were for the OCR to stay as is (i.e. at 2.5 percent), 19 percent supported an increase, and 12 percent supported a reduction in the OCR.

The New Zealand dollar – a guessing game.

Forecasts below show the NZ dollar generally remaining at elevated levels for at least the next year - particularly against the $Australian, before starting to fall away by June 2015.

Forecasts: Exchange Rates

AUD (cents)			
	June 13	June 14	June 15
Highest	0.853	0.889	0.870
Average	0.840	0.976	0.855
Lowest	0.820	0.863	0.847

USD (cents)			
	June 13	June 14	June 15
Highest	0.830	0.840	0.800
Average	0.818	0.808	0.755
Lowest	0.800	0.770	0.720

TWI			
	June 13	June 14	June 15
Highest	78.5	80.6	76.8
Average	76.8	78.0	74.2
Lowest	75.2	72.3	70.3

Source: ANZ, ASB, BNZ, and Westpac

The major economies' ad hoc monetary policy interventions have, over recent years, made forecasting the direction of exchange rates even more difficult than it has been in the past.

Recent better news coming out of the US, and suggestions that quantitative easing may come to an end within the next year, have resulted in the US dollar gaining some ground against other currencies, including the $NZ. On the other hand, given concerns with the performance of the Australian economy, the Aussie dollar has faltered of late, with the NZ dollar gaining traction. This all makes for an interesting mix when forecasting the TWI with currencies moving about so much.

While the Reserve Bank and others still have legitimate concerns about the international value of the $NZ, one has to question the impact of the Reserve Bank stating publicly that it sold a net $NZ250 million or so in April, given that the trade in NZ dollars equates to about $27 billion daily! Its a bit like trying to use a pea-shooter to stop a rampaging herd of elephants. However, the Reserve Bank clearly understands that such interventions are likely to have minimal effect but could possibly - and this is highly debatable - take a little off the peak and potentially the troughs of the NZ dollar business cycle.

Given the Reserve Bank has only around $12 billion in reserves, even dumping the lot on the market may not have any medium-term effect, but simply transfer the risk of getting it wrong to taxpayers.

Inflation - pressures will build

Forecasts outlined below show inflation is forecast to rise from its current low base to reach 1.7 percent by June 2014 and 2.6 percent by 2015.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	June 13	June 14	June 15
Highest	0.8	1.8	2.8
Average	0.8	1.7	2.6
Lowest	0.7	1.6	2.3

Source: ANZ, ASB, BNZ, and Westpac

After a long period where inflation has been relatively benign, over the medium term most of the inflation risk would appear to be on the upside.

There are a number of potential candidates for boosting inflationary pressures.

- Elevated demand for housing, particularly in Auckland, driving housing prices significantly higher.
- Increased net inward migration adding to demand pressures.
- An improving labour market outlook putting increased pressures on wage rates (although salary and wage movements to date have been relatively subdued).
- Increased capacity constraints - not yet a major problem but with pressure on construction resourcing increasingly an issue in Christchurch (earthquake rebuild) together with housing development pressure in Auckland.
- The future direction of the $NZ, particularly against the US in light of decisions from the US Federal Reserve, likely putting

downward pressure on the $NZ, with obvious implications for the cost of imported goods, such as petroleum.
- Earthquake strengthening costs for buildings probably leading to increased costs for premium rental accommodation as many organisations become more selective about the buildings they are prepared to rent.
- The ongoing repricing of risk associated with the Christchurch earthquakes continuing to flow through to insurance premiums for NZ buildings across the country.

All of the above factors combined are likely to put substantial upward pressure on inflation. On the other hand, there is little in the way of mitigating factors to lower inflationary pressures.

1.3 Business and consumer confidence – tracking higher

Business confidence – positive

Business confidence has continued to improve as evidenced by a number of surveys.

The ANZ Business Outlook shows that for the month of May 2013, a net 42 percent of respondents expected business conditions to improve over the year ahead, up 10 points on the previous month. Perhaps not surprisingly, construction is leading the way, while earlier concerns about the impact of the drought on the agricultural sector have proved to be less problematic than earlier feared.

Source: ANZ

Of particular importance, firms' own activity expectations are strong with a net 34 per cent expecting more activity over the coming year.

Most of the survey's key components showed positive movement, with export intentions, which continue to languish (a net 17 percent expect a rise - the historic average is around 32) the only fly in the ointment. To some degree this likely reflects the impact of a relatively high dollar, which is affecting some exporters, particularly those largely exposed to the vagaries of international commodity markets.

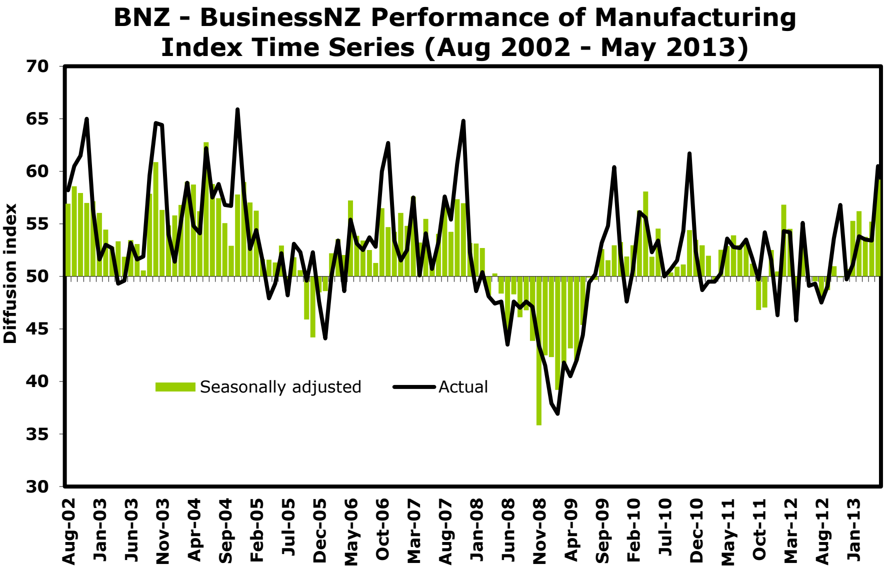
In terms of the highlights:

- A net 10 percent of firms expect to lift employment
- A net 17 percent expect to increase investment
- Residential intentions remain relatively high at a net 33 percent
- Pricing measures remain benign with inflationary expectations still relatively low.

In sum, this all adds up to a relatively positive outlook with survey data showing an improving economy now increasingly being confirmed by official statistics.

Other surveys also show the economy on the up, as confirmed by the continuation of strong expansion in the BNZ-BusinessNZ Performance of Manufacturing Index (PMI).

The BNZ-BusinessNZ seasonally adjusted PMI for May stood at 59.2, 4.0 points up from April and the highest monthly result since June 2004. Compared with previous May results, the 2013 value was the highest since the survey began in 2002.



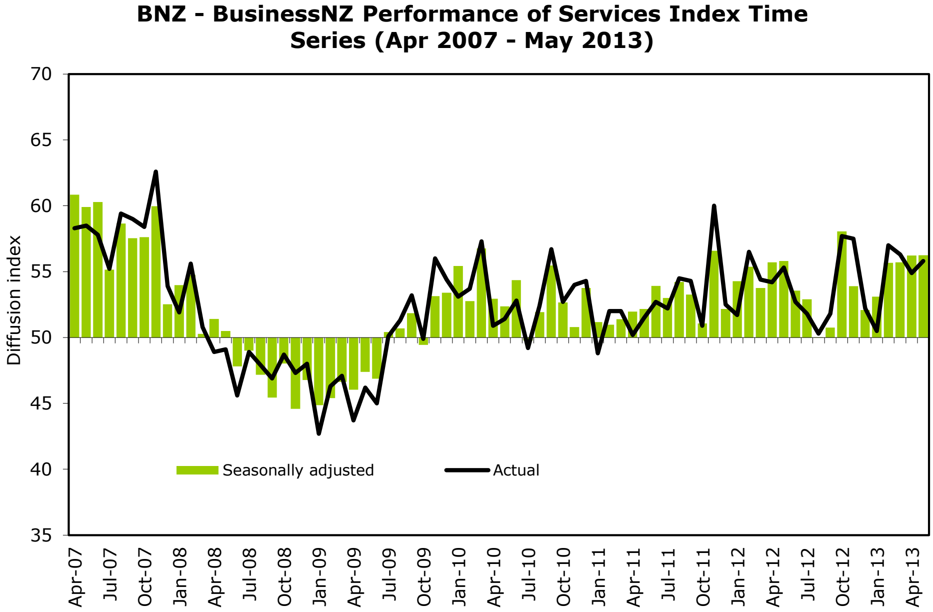
Source: BusinessNZ

Given the strong national result, all five seasonally adjusted main diffusion indices were in expansion for May. *New orders* (63.1) again led the way with its highest result since July 2004. This was followed by *production* (60.5), which was at a similar level to February this year. *Employment* (55.3) rose 7.8 points to record its strongest result since November 2007, while *deliveries* (54.6) and *finished stocks* (51.8) were also in expansion.

Expansion was experienced in all parts of the country in May. With increasing economic activity in the Canterbury region, the *Canterbury* (67.0) result was the highest since November 2007. The *Northern* region (60.5) also showed a strong upswing in activity, rising 7.9 points to its highest level since November 2010. The *Otago/Southland* region (60.7) bounced back from recent declines to record strong expansion, while the Central region (55.4) experienced a slight dip in its level of expansion for May.

Manufacturing by industry sub-groups was mostly in strong expansion during May. *Machinery & equipment manufacturing* (67.4) again led the charge for May, followed by *petroleum, coal, chemical & associated product manufacturing* (62.1). *Food, beverages & tobacco* (61.4) and *metal product manufacturing* (61.3) were at almost identical levels of expansion.

The seasonally adjusted BNZ - BusinessNZ Performance of Service Index (PSI) for May stood at 56.2, the same as the April result. Given both the March and February results stood at 55.7, this represents a very stable and healthy level of activity for the sector. Compared with previous May results, the 2013 value was the highest recorded since the May 2007 value.



Source: *BusinessNZ*

All five main sub-indices were in expansion during May. While *new orders/business* (59.5) *and activity/sales* (56.9) both exhibited a lower level of expansion from the previous month, *employment* (53.6) increased to its highest level of expansion since April 2012.

Stock/inventories (53.7) went back into expansion after two consecutive months in contraction, while *supplier deliveries* (56.1) increased to its highest rate since June 2007.

Activity was again positive in three of the four regions during May. In the North Island, the *Northern* region (58.6) increased 3.2 points to its highest level of activity since November 2012. However, the *Central* region (53.2) fell back 5.2 points from April, but remained in expansion. In contrast, the *Canterbury/Westland* region (47.3) remained in contraction, while the *Otago/Southland* region (51.9) lifted 1.1 points from the previous month.

Despite the continued healthy levels of expansion at the national level, service sector results by sub-sector continued to be mixed. *Wholesale trade* (63.1) picked up from a sharp drop in April, while *property & business services* (54.2) moved in the opposite direction. *Health & community services* (52.8) moved back into expansion after consecutive months in contraction.

Other sectors also reflect improving growth prospects. After taking a hit with the drought, farmers, in general, have recovered reasonably well since the return of rain was also associated with relatively warm weather, allowing for some pasture growth before winter set in. Confidence in dairying was also given a shot in the arm with a significant increase in the projected milk payout for the 2013/14 season.

The ANZ Bank Truckometer, which measures Heavy Traffic movements, has turned upwards quite significantly of late. Historically, there has been a relatively close relationship between this index and GDP growth, so this is yet another sign of an economy on the move – upwards.

Consumer confidence – highest level in 3 years

Consumer confidence remains firmly in positive territory.

The latest Westpac McDermott Miller Consumer Confidence Index for the June quarter of 2013 sits at 116.6, up from 110.8 in March and the highest level since June 2010 when it hit 119.3. A reading above 100 indicates more optimists than pessimists.

There is likely to be a range of reasons why consumers have shifted from savings mode to spending mode. Higher house prices tend to encourage consumers to feel more confident, while an improving employment outlook is also positive. Inflationary pressures are also low and an elevated NZ dollar against the US dollar (until very recently) has also encouraged consumers to start buying up large.

One risk is that households are perhaps taking advantage of historically low interest rates to expand consumption and so are adding to household debt levels.

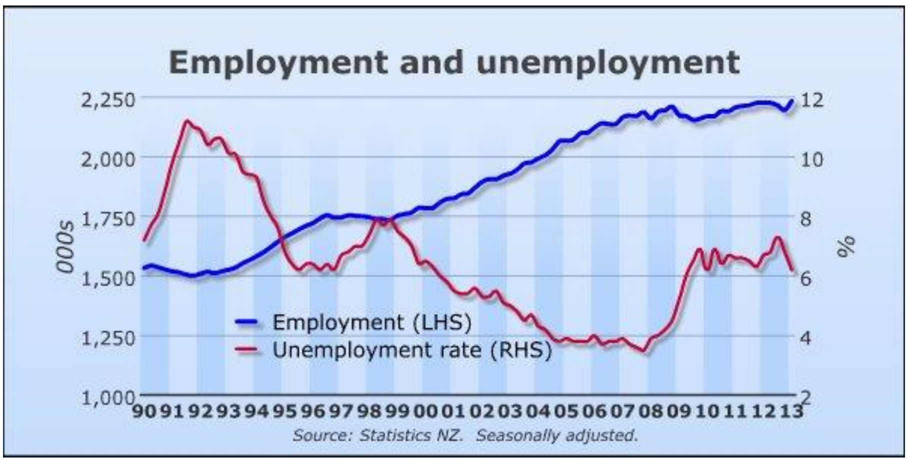
While households took the axe to debt post the 2008 global financial crisis, there is evidence that debt levels are starting to rise again, scary stuff as interest rates have clearly bottomed out. Interest rates will inevitably rise over the next couple of years and consequently some households are likely to find themselves burdened with increased interest (debt servicing) payments.

1.4 Labour market – firming up

Employment – prospects improving

Unemployment is expected to continue to reduce over the next 2 years to reach 5.3 per cent by June 2015 (see below).

While the Household Labour Force Survey (HLFS) results for the March quarter 2013 were very impressive (in terms of employment growth) we have cautioned against reading too much into the results for one quarter given that the HLFS has tended to bounce around quite significantly over the last few years.



Notwithstanding these cautions, a number of other surveys, including the latest BNZ-BusinessNZ Performance of Manufacturing Index (PMI) and the BNZ-BusinessNZ Performance of Services Index (PSI) surveys (for the month of May 2013) indicate that employment in both the manufacturing and services sectors is showing improvement after being more or less static for much of 2012. According to the PMI, *Employment* (55.3) rose 7.8 points from the previous month to record its strongest result since November 2007, while the PSI showed *Employment* (53.6) at its highest level of expansion since April 2012.

Forecasts: Unemployment % (HLFS)

	Quarter		
	June 13	June 14	June 15
Highest	6.5	5.9	5.6
Average	6.3	5.7	5.3
Lowest	6.1	5.5	4.7

Source: ANZ, ASB, BNZ, and Westpac

Labour costs – stable

Forecasts below indicate that labour costs are expected to increase only slowly to around 2.3 per cent for the year ending June 2015. This is very much in line with the long-run average for the Labour Cost Index and is up slightly on recent annual increases which have averaged around 1.8 per cent. Forecasts largely reflect the pick-up expected in labour market outcomes predicted over the medium term.

Private sector salary and wage rates (including overtime) increased 1.7 per cent in the year to the March 2013 quarter. Public sector salary and wage rates (including overtime) increased only 1.5 per cent in the year to the March 2013 quarter.

While there will likely be some upward wage pressure in particular sectors (e.g. construction), the general state of the labour market means wage pressures overall are still subdued. But they can be expected to increase over time as conditions improve.

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

	Years ending		
	June 13	June 14	June 15
Highest	1.8	2.6	2.6
Average	1.8	2.0	2.3
Lowest	1.6	1.3	2.1

Source: ANZ, ASB, BNZ, and Westpac