BUSINESS NZ

PLANNING FORECAST

SEPTEMBER 2013

BusinessNZ

NZ Economy – onwards and upwards

Executive Summary

Nearly all key indicators for the New Zealand economy are pointing in the right direction with a gradual acceleration in economic growth forecast.

According to the BNZ – BusinessNZ Performance of Manufacturing Index (PMI) and the Performance of Services Index (PSI), the manufacturing and services sectors continue to show solid growth.

The agricultural sector is now much more positive as evidenced by Federated Farmers mid-season Farm Confidence Survey and boosted further by Fonterra's decision to crank its forecast milk price payout to suppliers up to $8.30 per kg, up 50 cents on its previous forecast just last month.

International commodity prices remain firm and underpinning the latest rise in Fonterra's milk price payout, the GlobalDairy Trade (GDT) has shown prices remaining at high levels with significant volumes sold.

Construction is starting to crank up and new housing is to the fore in both Auckland and Christchurch, with the wider Christchurch rebuild just starting to get properly underway. It is almost impossible to get one's head around the concept of essentially a $40 billion rebuild job taking years – if not decades - to complete.

Business and consumer confidence remain at relatively high levels and households are starting to open their wallets again, evidenced by greater levels of consumption of late.

Improved confidence is reflected in a significant rise in recent inward net migration that will boost economic growth as the demand for housing and general services gains traction.

While there will always be risks associated with the international environment, data coming out of the major world economies, including the US and China, show improvement of late - good news for NZ exporters given the importance of protein to the growing Asian middle class.

And good news for Australia in light of its exposure to the state of the Chinese economy. Australian prospects may not now be as downbeat as was thought a few months ago. In fact recent economic data coming out of Australia points to a country on the improve.

While all the above is positive, it is important to ensure our feet remain on the ground. There are still risks, both domestically and internationally, that need to be understood.

On the international scene, the jury is still out on the underlying strength of the US economy and when quantitative easing will be reined in. How the major economies will develop their future monetary policy settings is an issue requiring careful thought.

Many major economies are still burdened by debt and fundamental regulatory reform is required in a number of countries. Unemployment remains a major issue for many developed economies.

On the domestic scene, the potential for inflation to rear its head should not be downplayed in light of strong housing demand currently pushing up prices, particularly in Auckland and Christchurch. On the other hand, interest rate increases will act to dampen demand.

HIGHLIGHTS

The BusinessNZ Economic Conditions Index (ECI) sits at 17 for the September 2013 quarter, up 3 on the previous quarter and up 14 on a year ago.

Business and consumer confidence remain at relatively high levels with confidence reflected in increased business investment and improved growth prospects in a range of sectors.

The construction sector is leading the charge with the rebuild of Christchurch, strong growth in Auckland's housing demand and the flow-on effects of building seismic strengthening all starting to consume considerable resources.

Improved confidence is reflected in higher levels of net inward migration which should provide another impetus for improved growth.

Household debt is a continuing issue. When interest rates rise, as they inevitably will, the cost of servicing high levels of debt will come home to roost, adversely affecting households. It will also likely impact on the NZ dollar to the detriment of exporters.

On the international scene, economic data coming out of the major world economies, including the US and China, show improvement of late - good news for NZ exporters given the importance of protein to the developing Asian middle class.

With the Chinese economy improving, Australia's prospects may not be as downbeat as was thought a few months ago. Recent economic data coming out of Australia point to a country on the improve.

Long-term interest rate rises are already starting to feed into the system while views are mixed on the relative merits (or otherwise) of the Reserve Bank's introduction of restrictions on loan-to-value ratios. Where such mechanisms are in use overseas, the evidence indicates mixed results; it is questionable whether mechanisms of this kind are the best way to address rising house costs when the major cause is land supply.

While the Reserve Bank has been careful to justify loan-to-value ratio restrictions as intended to ensure the ongoing strength of New Zealand's financial system, it is hard not to interpret this latest move as simply a stop-gap measure to delay raising the official cash rate (OCR).

On the housing front, it is pleasing that the Auckland Council has accepted a new plan which will establish special housing zones - a significant start to meeting Auckland's housing demand. The policy will provide some relief by helping to improve the artificially and unnecessarily constrained supply-side of the housing market.

In the regulatory space, there is concern from the property sector and wider business community about government decisions relating to seismic building risk upgrades. What the government has decided essentially represents a 'regulatory taking' at the expense of earth-quake prone building owners and the cost will ultimately flow through into higher tenancy costs.

Continuing with the regulatory theme, it is pleasing that the Government's decision, some years ago, to fund a NZ Productivity Commission (NZPC) is now bearing fruit. The general quality of the Commission's analysis is consistently high and certainly sets a benchmark of rigour to which central and local government (and their agencies) should aim to aspire when analysing issues for possible intervention. The need for greater consistency is a key factor and was clearly taken into account by the NZPC in its recent study of central and local government regulatory practice.

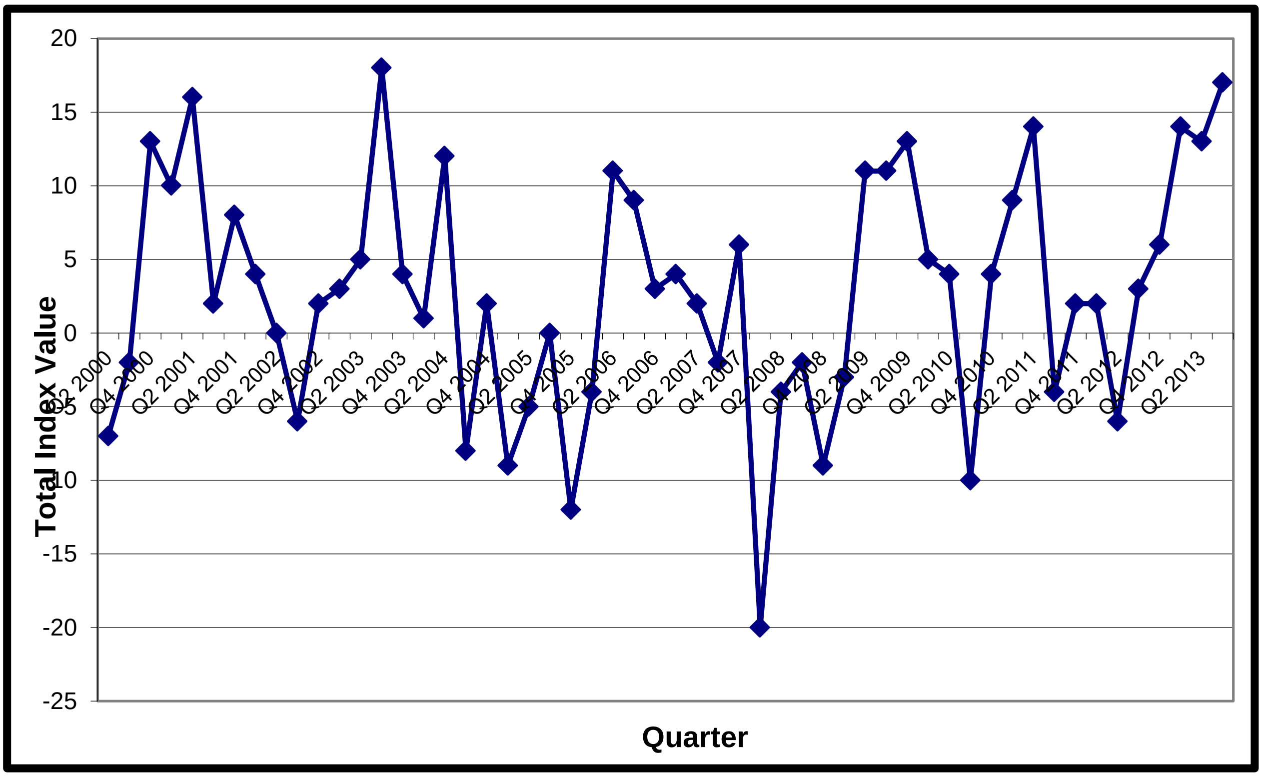
Finally, household debt continues to be an issue. When interest rates rise, as they inevitably will, the cost of servicing high levels of debt will come home to roost, adversely affecting households. It will also likely impact on the NZ dollar, to the detriment of exporters.

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 17 for the September 2013 quarter, up 3 on the previous quarter and an improvement of 14 on a year ago.[1]

Overall Economic Conditions Index (ECI)



Source: BusinessNZ

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

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

In terms of the ECI sub-groups:

Economic growth/performance indicators sit at 4 for the September 2013 quarter, up 2 on the last quarter and down 2 on a year ago. After a mid-year blip, the result of the drought earlier this year, an improved international outlook with firm commodity prices bodes well for solid export growth.

Monetary policy/pricing indicators sit at 2 for the September 2013 quarter, down 1 on the last quarter and up 2 on a year ago. Inflationary pressures are building on the back of the relatively strong growth in house prices on which the recent Reserve Bank decision to introduce curbs on high loan-to-value ratios is unlikely to have a major impact. Long-term interest rates have already risen substantially, a rise which will eventually flow through to the cost of mortgage finance.

[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.

Business/consumer confidence indicators sit at 5 for the September 2013 quarter, up 1 on the previous quarter and up 8 on a year ago. Both business and consumer confidence surveys show activity continuing to crank up over a number of sectors. Business investment is on the rise while households are starting to reopen their wallets, as evidenced by a number of indicators, including vehicle sales.

Labour market indicators sit at 6 for the September 2013 quarter, up 2 on the previous quarter and up 7 on a year ago. While official statistics still provide a mixed picture of labour market activity, forward-looking surveys and business activity statistics generally provide a much more positive picture.

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

1.1 Economic growth (GDP) – accelerating

Economic growth is forecast to average around 3 per cent per annum out to September 2015, as outlined below.

While GDP growth took a dip in the June quarter of this year, this was almost totally related to the earlier drought which affected manufacturing and the processing of agricultural production. The impact of the drought is likely to be less than earlier predicted given relatively good growing conditions over much of the country in early spring - despite recent storms.

Forecasts: Real GDP % Growth

	Years Ending		
	Sept 13	Sept 14	Sept 15
Highest	2.9	3.2	3.4
Average	2.7	3.0	2.8
Lowest	2.5	2.8	2.2

Source: ANZ, ASB, BNZ, and Westpac

Factors positive for the future of the economy are outlined below:

- **The major players in the international economy, including China and the US, are showing signs of improving growth prospects.**

In the case of China, growth rates, while dropping from their previous dizzy heights, are still projected to remain at around 7.5 percent per annum. This is good news for NZ agricultural producers given increasing demand from the middle class for protein. It is also good news for the Australian economy which has tended to face a severe upwind as the Chinese economy has slowed over the past couple of years. In light of Australia's exposure to the state of the Chinese economy, the country's prospects may not now be as downbeat as was thought a few months ago. In fact, recent Australian economic data points to a country on the improve. In the case of the US, things are a little more complex, but there is increasing evidence of improving economic data, despite continued quantitative easing.

- **International commodity prices (particularly associated with agricultural production) continue to remain high.**

The ANZ Commodity Price Index in world price terms is 26.0 per cent ahead of a year earlier. When converted into NZ dollars, there is a 28.8 per cent increase on a year ago – partially reflected in a slightly lower NZ dollar.

ANZ Commodity Price Index

	World Price Index	Annual % Change	NZ$ Index	Annual % Change
Aug 2009	189.8	-23.5	154.9	-22.0
Aug 2010	254.8	34.2	192.9	24.5
Aug 2011	302.0	18.5	198.1	2.7
Aug 2012	254.2	-15.8	169.7	-14.4
Aug 2013	320.2	26.0	218.6	28.8

Source: The ANZ Commodity Price Index – 3 September 2013

International commodity prices remain firm with the GlobalDairy Trade (GDT) showing prices still at high levels and significant volumes sold, underpinning the latest rise in Fonterra's milk price payout for the current 2013/14 season to $8.30 per kg.

- **The rebuild of Christchurch, after significant delays, is gathering momentum.**

In respect to the magnitude of the Christchurch rebuild, it is important to look at both the official and unofficial statistics. Often official statistics tend to understate the amount of construction activity required with a prominent Canterbury business leader recently stating 'you have seen nothing yet'.

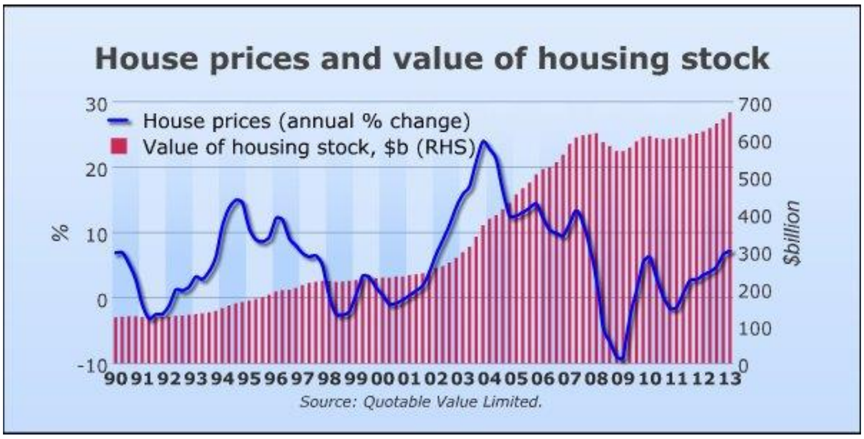
Beyond Christchurch there is also significant improvement in the housing market, particularly in Auckland, as several years of pent up demand for housing are being reflected now in greater construction activity. Earthquake strengthening of buildings will also be an ongoing source of activity for a number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

An increased housing demand raises the significant issue of the capacity of the construction sector to deliver and the potential for cost blow-outs to occur due to pent up demand for action. This is an issue which needs to be carefully worked through to ensure optimal use of scarce resources.

- **The services sector is starting to show improvement.**

The seasonally adjusted BNZ - BusinessNZ Performance of Services Index (PSI) for August stood at 53.2. This was down 5.0 points from July but a still showing a healthy level of expansion.

Consumers are also increasingly opening their wallets on the back of an improving housing market and an improved employment outlook.



Healthy growth in net inward migration will add to demand pressures and boost growth potential. On the other hand, greater stress on limited resources could add to inflationary pressures.

- **The Auckland Council has accepted a new housing plan which will establish special housing zones, in order to make a significant start on meeting new housing demand in Auckland.**

This policy will provide some relief by improving the artificially and unnecessarily constrained supply-side of the housing market.

- **Proposed reductions in accident insurance (ACC) levies for 2014/15 will provide a small lift in disposable incomes for many households.**

ACC consultation documents show employer, employee and motor vehicle levies are set for reductions of 15 – 17 per cent for the 2015/15 levy year, on average resulting in substantial cost reductions for both businesses and households.

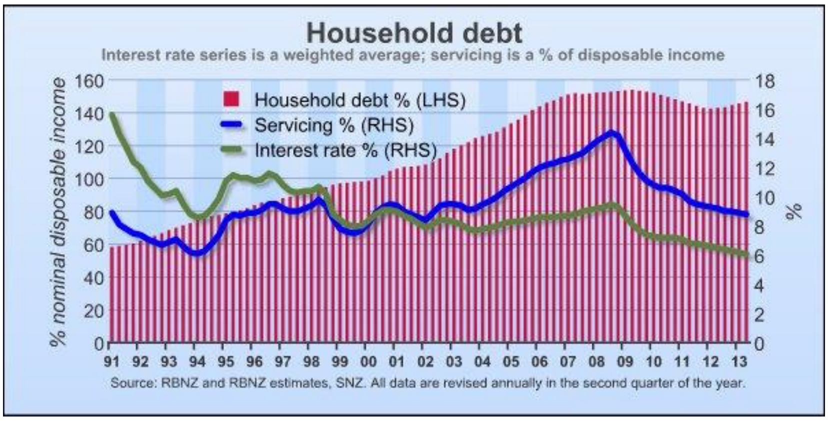
While businesses and households will welcome the ACC levy reductions, the fact remains that levy setting is subject to a significant degree of political interference as evidenced by varying yearly levy outcomes, spanning a number of different governments. This reinforces the fact that ACC premiums should be set independently of government to ensure premiums reflect actual insurance principles and not political considerations.

On the other side of the coin, there are some potential headwinds which may dampen growth.

These include:

- **Future increases, and the speed of increases, in interest rates which could be detrimental to business and more particularly, household, confidence.**

After dealing to the debt beast following the fall-out associated with the 2008 Global Financial Crisis (GFC), households seem keen to get back on the debt wagon again. The difficulty this time round is that interest rates are coming off a very low base and substantial interest rate rises could result in many households getting into strife as debt servicing costs rocket up.



- **International issues could play either a negative or a positive part in NZ's recovery.**

As mentioned above, commodity prices are currently a positive for NZ but NZ is dependent on our key export markets continuing to improve. Other factors will also be relevant, such as the future direction of the NZ dollar, particularly against the US dollar, since it is not immediately obvious when the US Federal Reserve will pull back on quantitative easing (essentially printing money). This all means there will be some volatility in the NZ dollar which exporters will need to manage.

- **While successive governments have, in general, abided by sound monetary and fiscal policies as epitomised by the Reserve Bank Act and the Fiscal Responsibility Act (now part of the Public Finance Act), the same cannot be said for regulatory policies in general.**

In this respect it is pleasing that the Government's decision to fund a NZ Productivity Commission (NZPC) some years ago is now bearing fruit with the quality of the Commission's analysis generally of a consistently high standard. The Commission's analysis certainly sets a benchmark of rigour to which central and local government (and their agencies) should aim to aspire when analysing issues for possible intervention, or otherwise. The need for greater consistency is a key factor of which the NZPC clearly took account in its recent study of central and local government regulatory practice.

The introduction of a Regulatory Responsibility Act is still fundamental to encouraging sound regulatory decision-making, despite the Government and some government agencies raising all sorts of red herrings as to why one should not be introduced and even introducing a very watered down version that will make little difference to the quality of regulation. When the opposition to such an Act is examined, it can be seen as largely reflecting political self-interest; politicians are looking to minimise accountability for regulatory decisions.

The broader investment climate will be important for businesses in making decisions to invest in new plant and equipment. In essence investors are loath to invest if there is a risk that the rules of engagement will change, either through ad hoc government decision-making, or more broadly, through flawed policy-making. While it is impossible to control what happens internationally, it is important for NZ to control and influence, to the extent possible, those things that can controlled, by promoting good regulatory decision-making and regulatory certainty to the extent that this can be achieved.

1.2 Monetary Conditions – tightening on a number of fronts

Monetary conditions are tightening on a number of fronts despite the fact that the Reserve Bank has not increased the Official Cash Rate (OCR) – yet.

Long-term interest rates are on the rise while the Reserve Bank's recent decision to curb high loan-to-value-ratio loans will have an impact on the cost of capital for those least able to afford to enter the housing market.

The Reserve Bank has settled on a 'speed limit' approach to proposed restrictions on high loan-to-value ratio mortgage lending, effectively reducing the volume of low-equity lending banks can offer in a given period rather than banning it outright.

A 'speed limit' approach is arguably much more flexible and realistic than the earlier proposal to ban high loan-to-value mortgages altogether. However, it also tends to work against the Government's stated intention of encouraging more low income earners into their own houses since for low income earners it is more than likely to increase the cost of capital.

Evidence from overseas, where such mechanisms are in use, indicates mixed results; it is questionable whether loan-to-value ratio restrictions are the best way to address rising housing costs when the major cause is land supply.

While the Reserve Bank has been careful to justify loan-to-value ratio restrictions as intended to ensure the ongoing strength of NZ's financial system, it is hard not to interpret this latest move as simply a stop-gap measure to delay raising the official cash rate (OCR).

Interest rates – on the rise

The 90-day bill rate is forecast to increase slowly to reach 3.5 per cent by September 2014 and 4.4 per cent by June 2015, as evidenced by the forecasts below. Meanwhile, long-term interest rates have already risen substantially so it is only a matter of time before these start flowing through to the cost of fixed-rate mortgages.

Forecasts: Interest Rates (90 day bills)

	As at end of		
	Sept 13	Sept 14	Sept 15
Highest	2.7	3.3	4.0
Average	2.7	3.5	4.4
Lowest	2.7	3.3	4.0

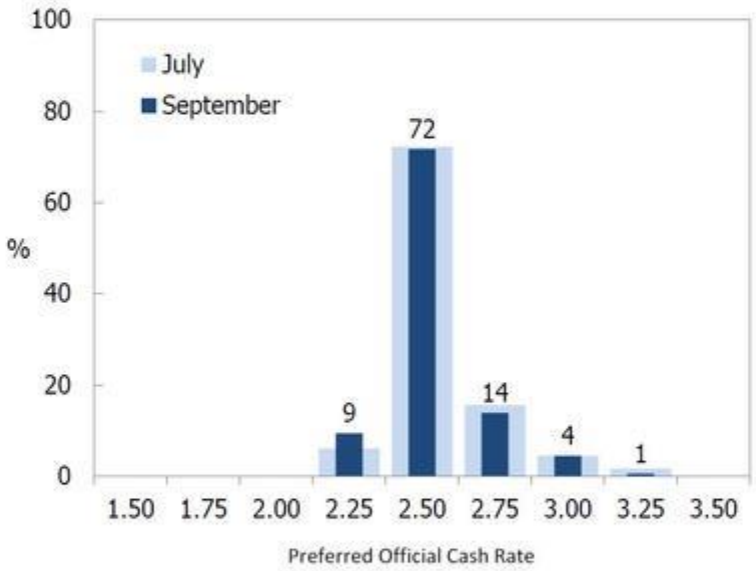
Source: ANZ, ASB, BNZ, and Westpac

The Reserve Bank is moving from a rather neutral stance on interest rates to suggesting that rises will be inevitable next year. The danger is that individuals have become used to very low interest rates and assume the party will go on forever. There is potential for many households to get burnt by not signing up to reasonable longer-term fixed rate mortgages while they can. Interest rates could rise quite fast and quite substantially over the next year or so.

Despite these risks, the New Zealand Institute of Economic Research's (NZIER) Shadow Monetary Policy Board (which has the task of recommending interest rate settings ahead of each decision by the Governor of the Reserve Bank) found that most of its members continue to support no change to the OCR.

"Inflation is low. Auckland's housing market is still at elevated levels, which presents risks. Views are mixed on the likely effectiveness of the Reserve Bank's restrictions on loan-to-value ratios."

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



Source: NZIER

72 per cent of Shadow Board members' 'votes' were for the OCR to stay as it is (i.e. at 2.5 percent), 19 per cent supported an increase, and 9 per cent supported a reduction in the OCR.

The New Zealand dollar – volatile

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

Forecasts: Exchange Rates

AUD (cents)			
	Sept 13	Sept 14	Sept 15
Highest	0.898	0.914	0.890
Average	0.877	0.892	0.875
Lowest	0.849	0.872	0.864

USD (cents)			
	Sept 13	Sept 14	Sept 15
Highest	0.800	0.780	0.750
Average	0.793	0.758	0.730
Lowest	0.790	0.740	0.700

TWI			
	Sept 13	Sept 14	Sept 15
Highest	76.3	75.3	73.6
Average	75.8	74.5	72.3
Lowest	74.9	72.5	70.6

Source: ANZ, ASB, BNZ, and Westpac

Recent mixed news coming out of the US, and the ongoing saga of when the Federal Reserve will taper off its quantitative easing have both tended to impact on the volatility of the $NZ. Over the longer term as the US economy gains traction and quantitative easing is peeled back, the $US should gain strength, obviously affecting commodity currencies such the $NZ, as forecast in the table above.

Inflation - building pressure

Forecasts outlined below show inflation likely to rise from its current low of less than 1 per cent to 2 per cent by June 2014 and to 2.7 per cent by 2015.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Sept 13	Sept 14	Sept 15
Highest	1.3	2.3	2.9
Average	1.2	2.0	2.7
Lowest	1.2	1.7	2.5

Source: ANZ, ASB, BNZ, and Westpac

After a significantly subdued period, the risk of inflation rising again is just around the corner.

Inflation risks include:

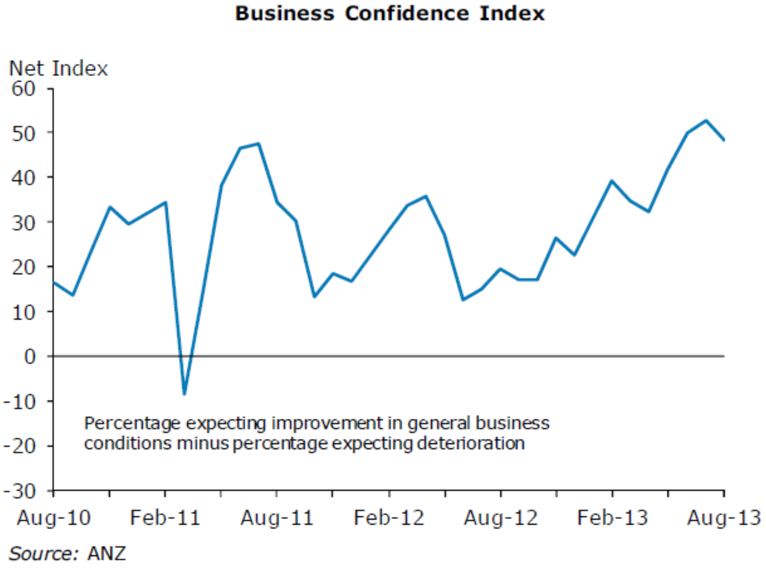
- Elevated demand for housing, particularly in Auckland, driving house prices significantly higher (despite moves to improve the supply side of the market by opening up more land for early development and efforts by the Reserve Bank to reduce demand through soon-to-be imposed restrictions on high loan-to-value-ratios)
- Relatively strong demand for NZ commodities, which will underpin domestic prices for staple products e.g. meat and dairy products
- 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
- Increased net inward migration adding to demand pressures
- An improving labour market outlook putting increased pressure on wage rates (although salary and wage movements to date have been relatively subdued).

1.3 Business and consumer confidence – holding well

Business confidence – solid

Business confidence has continued to remain firmly in positive territory as evidenced by a number of surveys.

The ANZ Business Outlook shows that for the month of August 2013, a net 48 per cent of respondents expected business conditions to improve over the year ahead, down marginally (4 points) on the previous month but still at a very healthy rate. Not surprisingly, construction is leading the charge, while confidence across the other sectors is well above historic averages, reinforcing the view that the recovery is now widespread and not confined to one or two sub-sectors of the economy.



A net 43 per cent expect more activity over the coming year for their own business, a crucial finding given that the way businesses view their own business is reflected in their level of investment and propensity to take on new employees.

Most of the survey's key components generally remain at elevated levels.

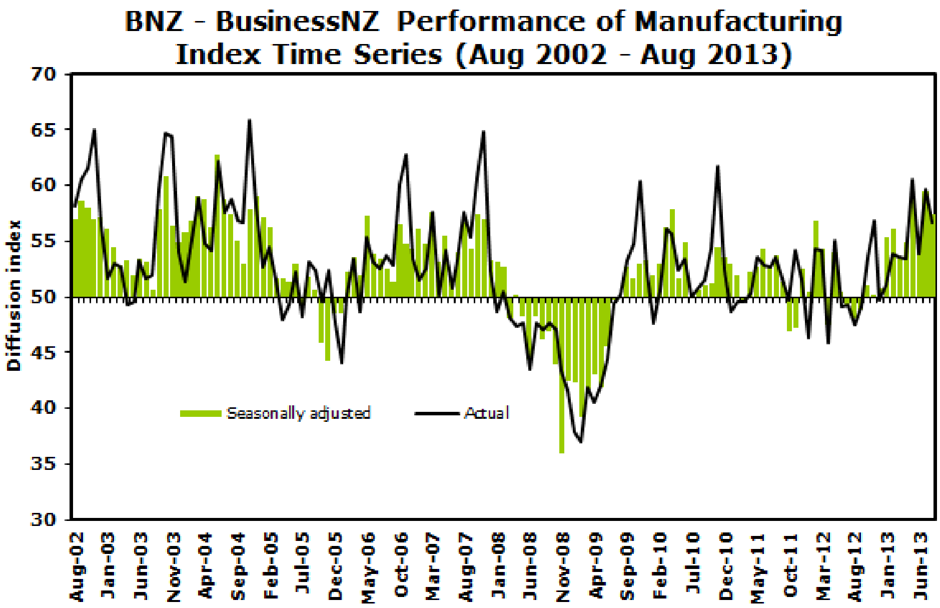
Response highlights:

- A net 24 per cent expect higher export volumes for the year ahead
- A net 18 per cent expect to lift employment
- A net 17 per cent expect to increase investment
- A net 52 per cent expect increased commercial construction investment
- A net 25 per cent expect to increase profits.

Meanwhile pricing intentions remain relatively stable.

While we have been careful in the past to resist the temptation to be carried away by survey results, the extent of the positive news across the broader sectors would suggest this up-turn is for real, not another false start.

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) over the first 8 months of 2013.



Source: BusinessNZ

The seasonally adjusted PMI for August stood at 57.5, 2.0 points lower than in July but indicative of another month of very healthy growth in the manufacturing sector. Compared with previous August results, the 2013 value was the highest since the survey began in 2002. Overall, the most recent four months of 2013 have averaged a strong 57.8.

A PMI reading above 50 points indicates manufacturing activity is expanding; below 50 indicates it is contracting.

With healthy levels of activity continuing in the manufacturing sector, all five seasonally adjusted main diffusion indices were again in expansion for August, as they have been for the last four months. *New orders* (60.9) led the way for August with another post-60 result. *Production* (58.3) experienced a slight dip in expansion levels during August, while *deliveries of raw materials* (55.9) reverted back to similar levels of activity during June. *Finished stocks* (54.1) experienced its fourth consecutive monthly increase in activity, while *employment* (54.1) continued to show an increase in activity levels.

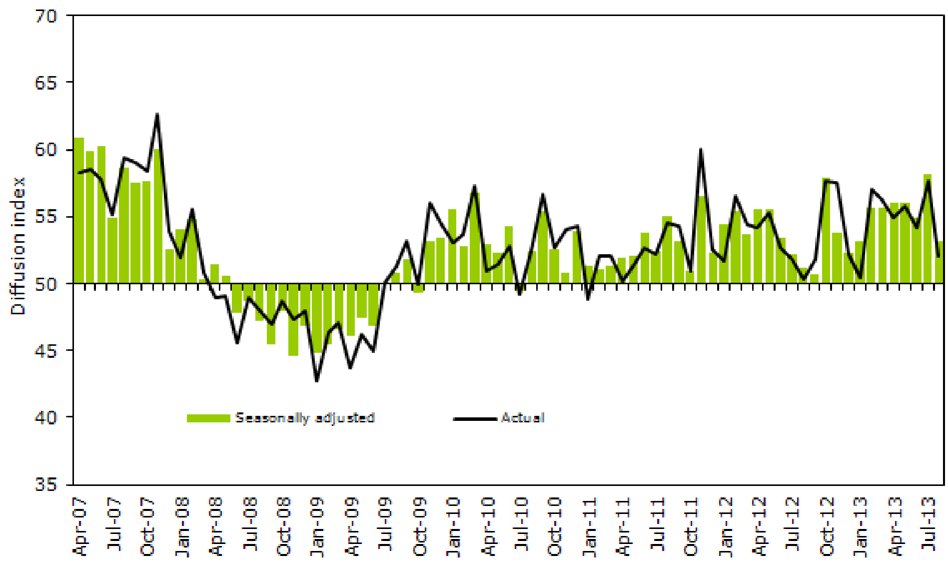
Expansion was experienced in all parts of the country in August. The *Central* region (61.9) led the way for the first time since March, with a strong pick up in new orders and production. The *Northern* region (53.8) eased somewhat after robust growth during the previous three months. In the South Island, the *Canterbury/Westland* region (56.7) remained in health expansion mode, while the *Otago-Southland* region (58.8) produced its highest result since May 2013.

The seasonally adjusted BNZ - BusinessNZ Performance of Services Index (PSI) for August stood at 53.2. This was down 5.0 points from July and the lowest level of activity since January this year. Compared with previous August results, the 2013 value was higher than 2012 but lower than 2011.

Despite the dip in the level of expansion, none of the five main sub-indices was in decline during August and this has been the case for the last four months. New *orders/business* (55.2) and *activity/sales* (55.2) tied for the highest level of activity for August, while s*tocks/inventories* (53.6) and *supplier deliveries* (53.4) produced similar levels of activity. *Employment* (50.0) gave up its gain from July to return to the position of no change, where it had found itself in June.

There was a clear difference in activity levels between the North and South Islands. In the North Island, the *Northern* region (55.5) led the way, despite falling 7.1 points from July. Conversely, the *Central* region (53.5) improved 3.0 points, with its highest value since April 2013. In the South Island, the *Canterbury/Westland* region (42.1) fell back further from July, while the *Otago/Southland* region (36.5) experienced a significant August drop due to low activity and little new business.

BNZ - BusinessNZ Performance of Services Index Time Series (Apr 2007 - Aug 2013)



Source: *BusinessNZ*

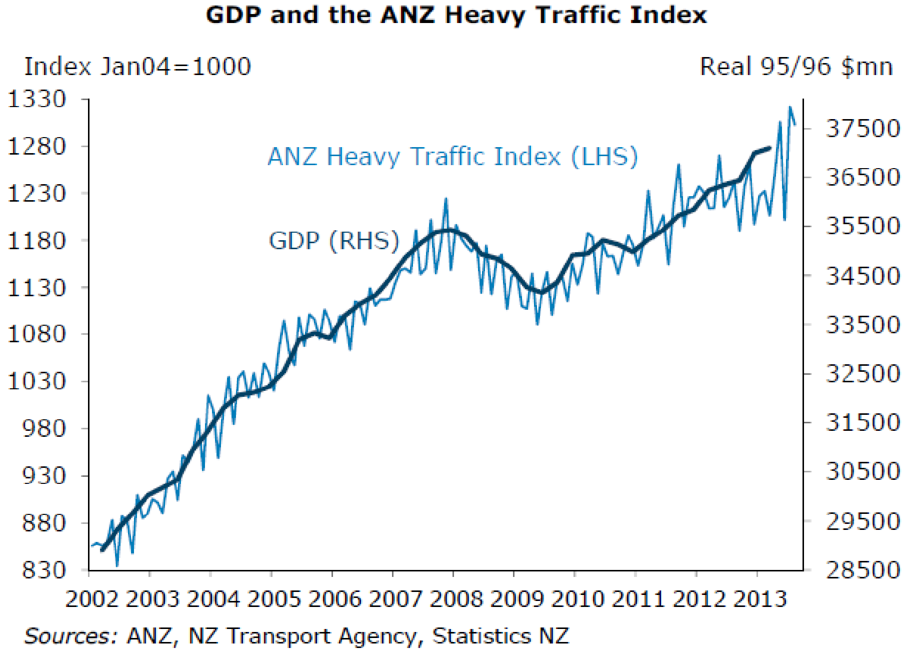
Service sector results by sub-sector were mostly positive during August. *Property & business services* (59.2) showed a strong upward swing while the *wholesale sector* (52.2) came back down to earth after a significant July expansion. The *retail sector* (58.5) improved slightly to show strong growth, while the *health & community services* (51.4) fell back to display slight expansion.

Other sectors also reflect improving growth prospects.

The agricultural sector is now much more positive, as evidenced by Federated Farmers' mid-season Farm Confidence Survey – boosted further by Fonterra's decision to crank up to $8.30 per kg (50 cents higher than its previous forecast last month), its forecast milk price payout to its suppliers.

International commodity prices remain firm with the GlobalDairy Trade (GDT) showing prices still at high levels with significant volumes sold, underpinning the latest rise in Fonterra's milk price payout.

The ANZ Bank Truckometer, which measures heavy traffic movements, has generally shown solid growth of late. Historically, there has been a relatively close relationship between this index and future GDP growth (see below), so this is yet another sign of an economy on the move – upwards.



Consumer confidence – holding its own

Consumer confidence remains firmly in positive territory despite marginal slippages of late.

The latest Westpac McDermott Miller Consumer Confidence Index for the September quarter sits at 115.4, down marginally on the June quarter, but still at a healthy level. A reading above 100 indicates more optimists than pessimists.

Other surveys also show that consumer confidence is sound, with a number of indicators such as electronic sales and motor vehicle sales on the rise. Services sector expenditure (e.g. spending on entertainment and eating out) is slowly rising with consumers reporting an improvement in their discretionary spending. These are all generally good leading indicators of improving consumer confidence and ultimately of improved prospects for economic growth.

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, something which could come back to bite them when interest rates rise.

1.4 Labour market – firming up

Employment – on the rise

Employment growth is on the rise with associated reductions in unemployment forecast as outlined below. The unemployment rate is expected to reach 5.1 per cent by September 2015 (see below).

Forecasts: Unemployment % (HLFS)

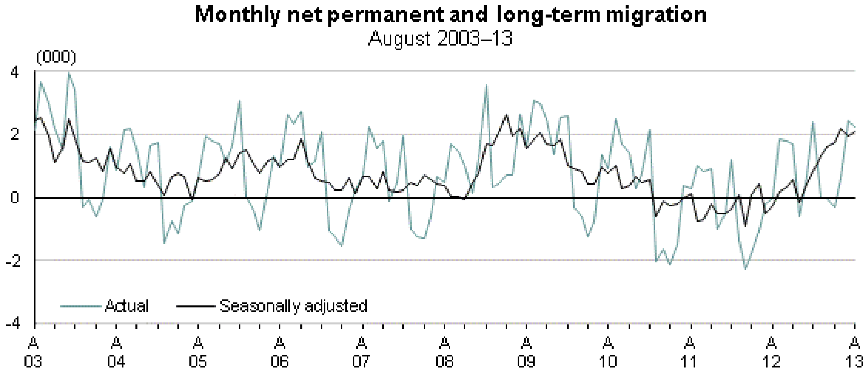
	Quarter		
	Sept 13	**Sept 14**	**Sept 15**
Highest	**6.3**	**5.8**	**5.6**
Average	**6.2**	**5.5**	**5.1**
Lowest	**6.0**	**5.1**	**4.6**

Source: ANZ, ASB, BNZ, and Westpac

While the Household Labour Force Survey (HLFS) has tended to bounce around quite significantly over the last few quarters without any necessarily clear direction, there is increased evidence of improving employment prospects.

There are a number of reasons why employment prospects are improving. These include, but are not limited to:

- A general rise in construction activity (rebuild of Christchurch, seismic building upgrades (across the country) and housing construction (largely in Auckland)
- Reasonably solid business and consumer confidence which is translating into an increased demand for goods and services
- Higher international commodity prices, particularly in relation to agricultural output (dairy in particular), which will drive further investment
- A significant rise in net permanent and long-term inward migration (see below) which will drive further demand.



Source: Statistics New Zealand

Both the BNZ-BusinessNZ Performance of Manufacturing (PMI) and Performance of Services (PSI) indices show confidence increasing with businesses increasingly taking on new staff and the employment sub-index sitting at 54.1 for the month of August (its second highest level since November 2007). The PSI meanwhile sat at 50.0 for August, although recent months have shown some expansion.

Finally, the ANZ NZ Jobs Ads series show job advertising in August holding on to a decent proportion of its July 4.0 per cent lift, the sum of newspaper and internet ads falling 1.4 per cent (on a seasonally-adjusted basis). The index is now 1.9 per cent higher than a year ago. Given that labour market outcomes generally lag behind improved economic performance, the rise in job ads over recent months bodes well for future economic and employment growth.

Notwithstanding the above, regional variations still persist. Internet ads rose in Canterbury, on top of a strong rise in July, but eased in Auckland and Wellington.

Labour costs – stable

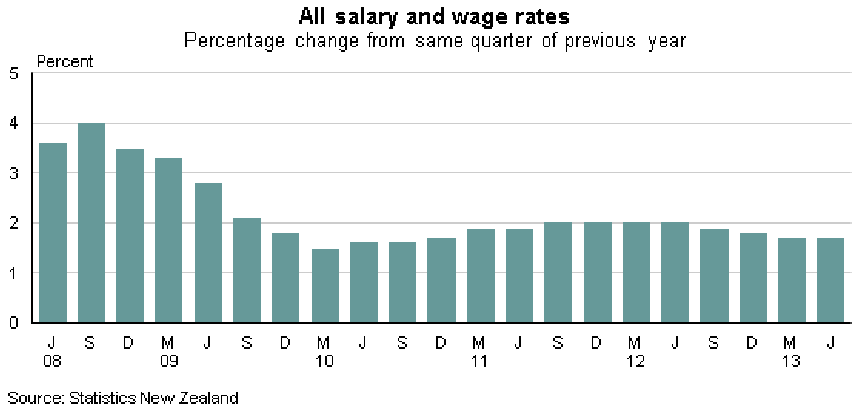
Forecasts below indicate that labour costs are expected to increase only slowly to around 2.4 per cent for the year ending September 2015. This is very much in line with the long-run average for the Labour Cost Index and is up slightly on recent annual increases which have averaged around 1.8 per cent. Forecasts largely reflect the pick-up expected in labour market outcomes predicted over the medium term.

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

	Years ending		
	Sept 13	Sept 14	Sept 15
Highest	1.7	2.6	2.6
Average	1.7	2.1	2.4
Lowest	1.6	1.8	2.2

Source: ANZ, ASB, BNZ, and Westpac

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