BUSINESS NZ

PLANNING FORECAST

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BusinessNZ

NZ Economy – changing down a gear?

Executive Summary

Despite some key statistics showing economic growth is likely to have passed its peak, forward-looking indicators still give cause for relatively strong optimism in the NZ economy. Employment growth is relatively good while inflationary pressures have been remarkably benign to date, allowing the Reserve Bank to pause further interest rate rises until well into 2015.

The BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and the Performance of Services Index (PSI) show economic growth remaining at respectable levels of around 3 percent per annum.

Business and consumer confidence is still in positive territory, although declining from the unrealistically dizzy heights of earlier this year and the benefits of solid growth are increasingly reflected in the relatively strong employment growth. The Christchurch rebuild and Auckland housing are driving a very buoyant construction sector.

The general election is now over, giving a clear majority for a National-led government (with likely support agreements with the Maori Party, ACT and United Future) and providing some degree of comfort for investors, given that some of the minor parties contesting the election had, by NZ standards, particularly radical policies on foreign investment and the watering down of private property rights as key election policy planks. Already the NZ sharemarket has provided a strong post-election vote of confidence - particularly in the energy sector.

But there are still risks facing NZ that must be factored in to future thinking about the economy's direction.

- Global dairy prices have dropped significantly over the last 6 months, although they appear to have finally bottomed out of late. While there has been some reduction in the NZ dollar compared with our major trading partners, this has done little to offset reduced returns to NZ producers. With Fonterra announcing a further drop in the dairy payout, this will put pressure on regional economic growth in parts of NZ.

- Growth is certainly not spread evenly across the country as a number of research studies have recently shown. This conclusion is backed up by responses from BusinessNZ's Affiliated Industries Group (AIG) which indicate that growth across various sectors and regions is still mixed.

- International growth prospects remain patchy. Europe is still largely in the doldrums while the United States appears to be having a number of false starts. Most developed world economies are operating at well below capacity with unemployment numbers high by historical standards. On top of this, normalised monetary policies across both Europe and the US appear as yet to be still some way off.

- Private debt levels remain a concern, particularly with agricultural debt, largely dairy-focused, currently sitting at over $50 billion. Interest rate rises already appear to be having some impact on both business and consumer confidence, although this is not really unexpected.

- Strong net migration inflows would logically be expected to impact on inflationary pressures (particularly housing in Auckland). However the Reserve Bank in its recent monetary policy statement considered that while there are risks associated with the extent to which strong net migration will impact on housing and construction activity will spill over into broader inflation, the economy appears to have adjusted to the interest rate hikes earlier this year.

HIGHLIGHTS

The BusinessNZ Economic Conditions Index (ECI) sits at 10 for the September 2014 quarter, up 6 on the previous quarter and up 5 on a year ago.

Despite some key statistics showing that economic growth is likely to have passed its peak, forward-looking indicators still give cause for relatively strong optimism in the NZ economy.

Business and consumer confidence remains in positive territory, although declining from the unrealistically dizzy heights of earlier this year, while the benefits of solid growth are increasingly reflected in relatively strong employment growth. The Christchurch rebuild and Auckland housing are driving a very buoyant construction sector.

Growth is certainly not spread evenly across the country as a number of research studies have recently shown. This is backed up by responses from BusinessNZ's Affiliated Industries Group (AIG) which indicate that growth across various sectors and regions is still mixed.

Despite largely mediocre growth figures for major world economies, there is significant room for strong (non-inflationary) growth as capacity constraints are not the same as they were pre-GFC. This also means international interest rates will likely remain low for a significant period of time.

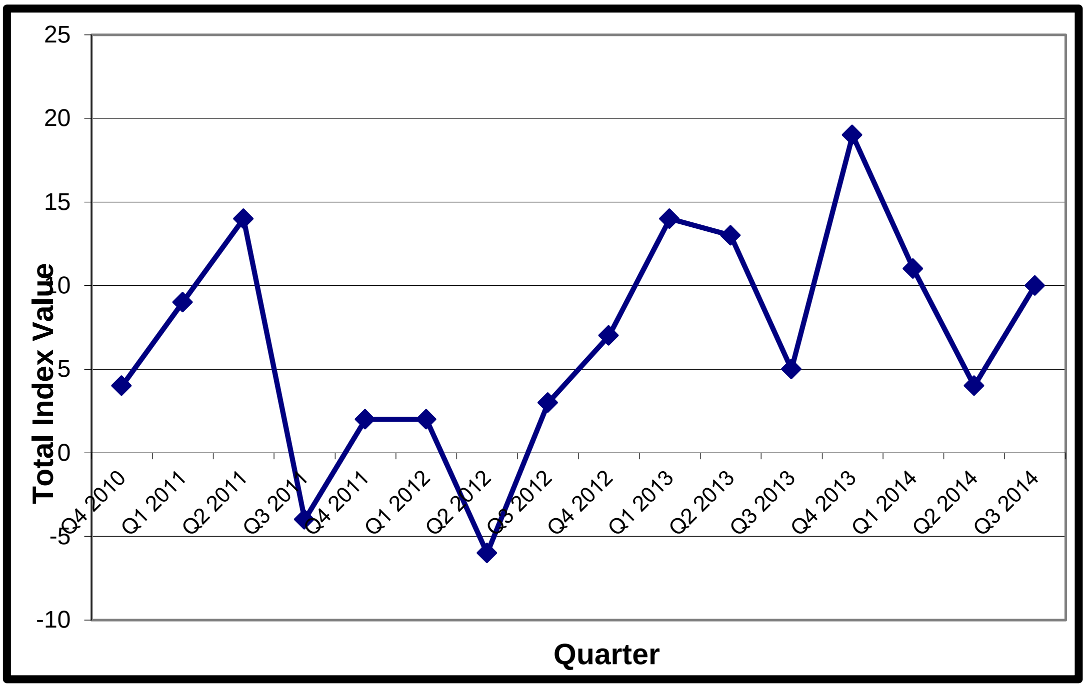
Private debt levels remain a concern in NZ, particularly with agricultural debt, largely dairy-focused, currently sitting at over $50 billion. The Reserve Bank will be keeping a close eye on lending to this sector to ensure there is minimal chance of NZ's financial stability being compromised.

PART 1: THE NEW ZEALAND ECONOMY – WHERE ARE WE NOW?

BusinessNZ Economic Conditions Index (ECI)

The overall BusinessNZ Economic Conditions Index (a measure of the major economic indicators) sits at 10 for the September 2014 quarter, up 6 on the previous quarter and up 5 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

Of the ECI sub-groups:

Economic growth/performance indicators sit at 2 for the September 2014 quarter, the same as for the last quarter and the same as a year ago. Despite significant reductions in international commodity prices over the second quarter of 2014, prices more recently appear to have stabilised, although a stubbornly high $NZ dollar is impacting adversely on returns to NZ producers.

Monetary policy/pricing indicators sit at -4 for the September 2014 quarter, up 2 on the last quarter and the same as a year ago. Interest rate rises (while now on hold), a continued elevated exchange rate and moderating commodity prices are putting downward pressure on inflationary expectations. Offsetting this effect is strong net inward migration and strong growth in the housing and construction sector generally, while the manufacturing and services sector continue to show solid growth as evidenced by the BNZ-BusinessNZ PMI and PSI.

Business/consumer confidence indicators sit at 7 for the September 2014 quarter, up 8 on the previous quarter and up 4 on a year ago. Business and consumer confidence took a hit mid-year on the back of higher interest rates, significant declines in commodity prices and significant uncertainty about the outcome of the general election.

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[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.

Labour market indicators sit at 5 for the September 2014 quarter, the same as the previous quarter and up 1 on a year ago. The labour market is now experiencing relatively strong employment growth while unemployment should continue to dip, despite increasing numbers of people entering (or re-entering) the labour market as conditions improve.

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

1.1 Economic growth (GDP) – down a gear

Some indications are that economic growth has peaked but growth forecasts out to September 2016 show it as still projected to average around 3 percent per annum (see below), a healthy growth rate compared with many of our major trading partners.

Forecasts: Real GDP % Growth

	Years Ending		
	Sept 14	Sept 15	Sept 16
Highest	3.7	3.6	2.8
Average	3.6	3.2	2.6
Lowest	3.6	2.9	2.3

Source: ANZ, ASB, BNZ, and Westpac

Gross Domestic Product (GDP) expanded 0.7 percent in the three months ended June 30th, slightly ahead of the 0.6 percent expected in a Reuter's survey of economists and slowing from the 1 percent in the first quarter of 2014. The annual rate of growth accelerated to 3.5 percent in the June quarter from 3.3 percent in the March quarter.

Strong growth in the services sector (fastest growth for seven-and-a-half years) offset shrinking activity in the primary sector as global commodity prices plummeted, particularly dairy prices. Construction sector activity is booming with annual growth at 12 percent.

While there have been a number of dents in the economic outlook over recent months (e.g. lower export prices and higher interest rates), overall confidence remains relatively relatively buoyant with growth much more widespread than simply the rebuild of Christchurch and Auckland housing, although the building sector is indeed booming.

The New Zealand Institute of Economic Research (NZIER) latest Consensus Forecast outlines growth moderating from 3.3% in the March 2015 year to 2.9 percent and 2.2 percent in the following two years.

The Consensus Forecast shows that economic growth will be broad-based across household spending, investment (including the Canterbury rebuild) and exports. The labour market will strengthen with fewer unemployed and moderate wage growth.

On inflation, the Consensus Forecast states that while this will accelerate over coming years, it will remain comfortably contained within the Reserve Bank's target band of 1-3 percent until early 2018.

The general election is now over with a clear majority for the National-led government (with likely support agreements from the Maori Party, ACT and United Future). This will provide some degree of comfort for investors, given some minor parties contesting the election had, by NZ standards, particularly radical policies on foreign investment and the watering down of private property rights as key election policy planks.

The National-led Government's clear majority will allow progress on issues such as Resource Management Act (RMA) reform that were simply bogged down in the last Parliament because of a lack of numbers.

Forward-looking indicators still indicate relatively strong optimism in the NZ economy.

The BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and the Performance of Services Index (PSI) show economic growth remaining at respectable levels of around 3 percent per annum.

Business and consumer confidence is still in positive territory, although declining from the unrealistically dizzy heights of earlier this year. The benefits of solid growth are increasingly reflected in relatively strong employment growth.

The Treasury released the pre-election economic and fiscal update (PREFU) on 19th August. There were no significant changes from those provided for in the May Budget with the Government still predicted to make a small surplus of $297 million in the year to June 2015 – one of the previous Government's key priorities.

While from an economic point of view the difference between a small surplus (and small deficit) is of marginal importance, the Government took a cautious approach to ACC premium reductions in order arguably to achieve a surplus next year. This year's ACC levy rate decisions have simply added to BusinessNZ's frustration over a number of years that ACC premiums are not set independently of government; political considerations rather than sound insurance principles tend to drive premium changes. If anything, premium levy setting seems, over recent years, to have become more, rather than less, politicised.

Putting government's approach to premium-setting aside, long-term projections outlined in the PREFU are reasonably sound with growing (but still moderate) surpluses on the back of an economy forecast to deliver around 3% growth per annum (on average) over the next 4 years. The other key determinants of growth all continue to trend in the right direction, despite continuing reductions in commodity prices of late, notably dairy.

Notwithstanding the above, there is little room for increased expenditure without seriously jeopardising retiring debt given that the (National-led) Government appears unwilling to address big ticket expenditure issues such as growth in NZ Superannuation and associated health expenditure reform and middle class capture such as interest free student loans and Working for Families. Certainly the pre-election position was largely "no change".

Without fundamental reform, there is little room for any tax cuts of note over the next few years with the projected surplus having been cut by $500 million per annum for the next three years largely on the back of a lower than expected tax take, especially GST. This means the combined surplus between now and mid-2018 is forecast to be $6 billion, down $1.5 billion on the May Budget forecast (i.e. annually about 1% of GDP – which is pretty marginal).

And continued risks facing NZ must be factored in:

- First, global dairy prices have taken a tumble over the last 6 months and have only recently stablised. While there has been some reduction in the NZ dollar compared with our major trading partners, this has had minimal impact on offsetting reduced returns to NZ producers.

Commodity price reductions are not only reflected in reduced dairy prices but also in prices for commodities such as logs and apples. Some of this reflects Russia's ban on some imports, including dairy and other produce from the EU, the United States, and other key international players that have been putting pressure on Russia as a result of the Russian stance on the Ukraine. Necessarily, therefore, produce from these markets which would normally go to Russia must find another home, also putting downward pressure on international commodity prices and directly affecting NZ's prices.

Technically, NZ is not affected by Russian sanctions but it is important for the country to take a responsible stance in respect to international pressures. Otherwise our long-term credibility as a reliable international nation bent on upholding the rule of law could be undermined.

- Second, growth is certainly not spread evenly across the country as a number of research studies have recently shown. This is backed up by responses from BusinessNZ's Affiliated Industries Group (AIG) which indicate that growth across various sectors and regions is still mixed.

The latest quarterly Rabobank Rural Confidence Survey – completed earlier this month – has found the country's rural sentiment at its lowest level since September 2012, with 37 percent of farmers having a negative outlook of the rural economy in the next 12 months, compared with 24 percent with that view in the previous survey. The negativity is focused not surprisingly in the dairy sector, with beef and sheep farmer sentiment – though tempered – remaining at robust levels.

- Third, international growth prospects remain patchy. Europe is still largely in the doldrums while the United States appears to be having a number of false starts. Most developed world economies are operating at well below capacity with unemployment numbers high by historical standards. On top of this, normalised monetary policies across both Europe and the US appear as yet to be still some way off. China will likely struggle to reach the 7.5 percent annual growth forecast earlier this year.

According to Standard and Poor's, in the Eurozone, the level of real GDP is about 2.5% below the global financial crisis (GFC) level, while unemployment is extremely high at 11.5%. Real GDP in the United Kingdom is essentially where it was in the first quarter of 2007. Japan is in a similar position.

On a more positive note, in the US, real GDP is now about 6.5% above its pre-crisis peak in the first quarter of 2008 whereas in Australia and NZ real GDP has continued to grow relatively steadily with real GDP in Australia around 15% higher, and in NZ about 9%.

Despite these rather pessimistic figures for major world economies, there is significant room for strong (non-inflationary) growth as capacity constraints are not the same as they were pre-GFC. Significant international capital is also available which means that global interest rates will likely remain low for a significant period of time.

- Fourth, private debt levels remain a concern, particularly with agricultural debt, largely dairy- focused, currently sitting at over $50 billion. Interest rate rises already appear to be having some impact on both business and consumer confidence, although this is not really unexpected.

It is likely that the Reserve Bank will be taking a long hard look at agricultural debt and the possibility of further controls on capital adequacy ratios could see banks taking a more rigorous approach to lending in the sector.

- Fifth, strong net migration inflows (approaching 43,500 per annum) would logically be expected to impact on inflationary pressures (particularly housing in Auckland). However, the Reserve Bank in its recent monetary policy statement considered that while there are risks associated with the extent to which strong net migration will impact on housing and construction activity will spill over into broader inflation, the economy appears to have adjusted to the interest rate hikes earlier this year.

Despite factors which would have been expected to impact adversely on inflationary pressures, headline inflation has remained moderate, reflecting subdued wage increases, well-anchored inflation expectations and weak global inflation along with the high NZ dollar. Clearly the Reserve Bank has signalled a reasonably lengthy period of monitoring economic outcomes before any decisions are made to increase interest rates towards more long-term neutral levels.

- Finally, despite the government push to improve regulatory policy, there is still a lot of work required before it can reflect international best practice. It is to be hoped that this term will see a significant improvement in processes, not legislative change driven by politics rather than a sound analysis of what is in the best interests of the NZ economy and households over the longer term. It is unfortunate that pre-election activity tends to be focused on which party is providing the biggest (taxpayer funded) handouts rather than on sound policy to move the economy to a faster growth path.

Notwithstanding the above, it was very pleasing that the previous Government instructed the NZ Productivity Commission to investigate how local authorities can improve processes and the regulation of land supply and development capacity for housing. Given the quality of previous work undertaken by the Productivity Commission, the latest announcement is helpful. It is important that such issues are looked at impartially and seriously, rather than the ad hoc pre-election responses of many political parties to the question of housing affordability.

1.2 Monetary Conditions – pause for reflection

Interest rates – on hold

The 90-day bill rate is forecast to drift higher to reach 4.4 percent by September 2015 and further to 5.0 percent by September 2016, as evidenced by the forecasts below.

Forecasts: Interest Rates (90 day bills)

	As at end of		
	Sept 14	Sept 15	Sept 16
Highest	3.8	4.5	5.1
Average	3.7	4.4	5.0
Lowest	3.7	4.2	4.7

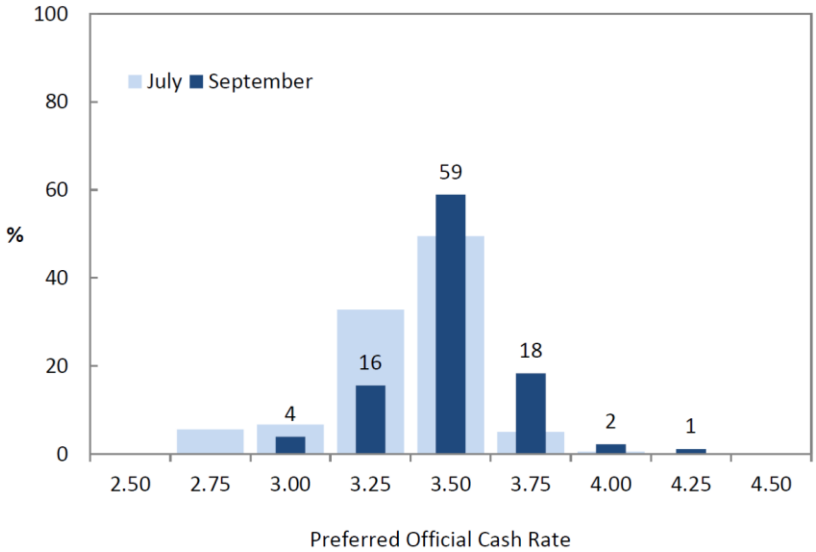
Source: ANZ, ASB, BNZ, and Westpac

The Reserve Bank has come out quite strongly that interest rates are now on hold for a significant period to allow time to reflect on the rises which have taken place over the first half of this year. The Reserve Bank has pulled back on its forecast track for the 90-day bank bill rates generally seen as a proxy for the OCR.

The Reserve Bank's Monetary Policy Statement (11th September) was perhaps a little surprising in that the Bank has changed its quite aggressive stance on inflation and has slashed its interest rate projections. It has also shifted the timing of the next hike from the first to the second quarter of 2015 and flattened the projection track to 2017 to imply an expectation that the final OCR (neutral) rate will be 4.5 percent.

The Reserve Banks's decision to put future interest rate rises on hold is strongly supported by 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). Most Board members were in favour of keeping interest rates at current levels for now.

NZIER Shadow Board says hold the Official Cash Rate Steady



Source: NZIER *Monetary Policy Shadow Board*

59% of votes supported the OCR remaining at its current position of 3.5 percent, 20 percent supported a reduction in the OCR, and a similar number (21 percent) supported an increase.

"House price inflation is easing, commodity prices are falling and inflation pressures are moderate. The Official Cash rate has moved higher in each of the last four reviews. Now it's time to take a break."

The New Zealand dollar – drifting down

Forecasts below show the NZ dollar is generally expected to drift lower against both the Australian and US dollar.

Forecasts: Exchange Rates

AUD (cents)			
	Sept 14	Sept 15	Sept 16
Highest	0.91	0.89	0.89
Average	0.91	0.89	0.86
Lowest	0.90	0.88	0.81

USD (cents)			
	Sept 14	Sept 15	Sept 16
Highest	0.85	0.83	0.80
Average	0.84	0.78	0.74
Lowest	0.82	0.75	0.68

TWI			
	Sept 14	Sept 15	Sept 16
Highest	81.2	79.0	74.2
Average	79.5	75.5	71.5
Lowest	78.5	71.9	70.0

Source: ANZ, ASB, BNZ, and Westpac

Despite significant drops in commodity prices, particularly dairy, which is down close to 50% on earlier highs, the $NZ has only really shed around 6-7 cents against the $US since July (see below) when the Reserve Bank Governor talked about the NZ dollar being "unjustified and unsustainable". He reiterated that statement again late last week.

Some have suggested that the Reserve Bank may have intervened to try and force the $NZ dollar down but it is unlikely that even if the Reserve Bank entered the market, the dollar would decline substantially. Reserve Bank reserves only equate to around $7-8 billion, relatively tiny compared with the $NZ amount traded on a daily basis.

More influential on the strength of the $NZ is what happens in the United States if moves continue towards tapering off quantitative easing and a more normalised monetary policy regime.

The timing of the US recovery is still uncertain with a number of false starts. Most pundits expect quantitative easing to be completed within the next few months and interest rates to rise (slowly) from a very low level towards the end of this year, putting some upward pressure on the US dollar.

The US dollar index, which measures the $US against a basket of currencies, rose to a 14-month high after the Federal Reserve Open Market Committee raised its medium estimate for federal funds at the end of 2015 to 1.373, compared with its previous estimate of 1.125 percent in June. In an historical context this could be considered negligible but does indicate that the effectively "zero" interest rate regime for some major economies may be revised upwards.

"On balance, labour market conditions improved somewhat further; however, the unemployment rate is little changed and a range of labour market indicators suggest that there remains significant underutilisation of labour resources. A highly accommodative stance of monetary policy remains appropriate", - statement by the Federal Open Market Committee.

Inflation - pressures surprisingly not being reflected in headline rates

Forecasts outlined below show inflation likely to rise slightly to reach 1.9 percent by September 2015 and 2.6 percent by September 2016 still reasonably within the Reserve Bank's target range of 1-3 percent.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Sept 14	Sept 15	Sept 16
Highest	1.3	2.0	3.0
Average	1.2	1.9	2.6
Lowest	1.2	1.8	2.4

Source: ANZ, ASB, BNZ, and Westpac

Inflationary pressures have not been reflected in headline inflation, which the Reserve Bank previously said would come under significant pressure (hence its moves last year to point to significant interest rate rises to ensure inflation remained within its target band).

It appears that earlier potential inflationary pressures (housing) and commodity price increases have not materialised to the extent that the Reserve Bank and many other forecasters expected.

The significant drop in commodity prices, notably dairy, has caused tightened expenditure in the agricultural sector generally, while Reserve Bank moves to increase interest rates earlier this year, along with restrictions on low-equity home loans, appear to have helped keep housing inflation under control – at least to date.

Notwithstanding, the above, the Reserve Bank will be keeping a keen eye on the impact of an 11-year high in migration inflows, and the effect this is having on the property sector.

The Reserve Bank's Monetary Policy Statement (MPS) stated: *"Our projection takes a view that net immigration is having a more muted and more lagged effect on house prices than in past cycles. This along with higher interest rates, strong construction activity that increases housing supply, and falling net immigration is behind the expectation that house price inflation will continue easing over the forecast horizon".*

Housing affordability is largely a supply side issue – land supply, building regulation, and consenting processes. To date, many responses from political parties pre-election were politically-driven with ad hoc-demand side initiatives, such as effectively providing subsidies to various groups to purchase housing. Moreover, responses acted in direct opposition to other recently established policies (such as the Reserve Bank's low loan to value ratios) which were targeted particularly at reducing inflationary pressures in the housing sector. Ill-thought through policy pre-election did nothing to address the underlying causes of significant and unjustified price increases associated with housing but simply added to inflationary pressures.

Notwithstanding the above, BusinessNZ welcomed the previous Government's inquiry into land supply to be conducted by the NZ Productivity Commission.

The inquiry into how local government is managing land supply for new housing is critically needed not only because of the pressing need for more affordable housing but because of the impact on the wider economy of significant house price increases.

BusinessNZ Chief Executive Phil O'Reilly said in a statement welcoming the initiative that *"a good outcome from the inquiry would be an expectation on councils that they will:*

- *Actively make provision for land for new housing*
- *Plan for future provision of land so there is an ongoing pipeline of supply for new housing*
- *Simplify and make more understandable their zoning and land supply rules*
- *Not seek to minimize their own risk by imposing unnecessarily high requirements on those seeking to build"*

1.3 Business and consumer confidence – at more realistic levels.

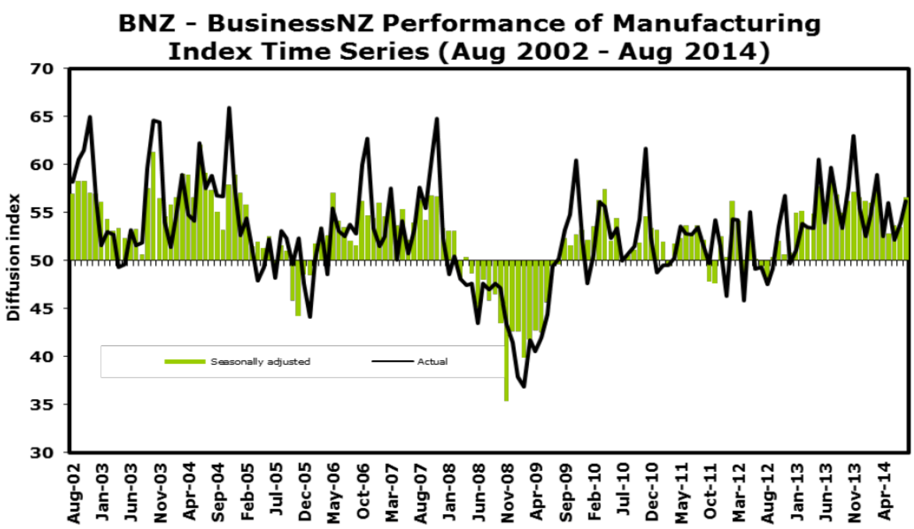
Business confidence – still solid despite dropping from historical heights

While business confidence has continued to trend downwards this year, the trend may not be quite what it seems. Although coming off historic highs, business confidence still remains firmly in positive territory but with recent results suggesting a more realistic assessment of future growth outcomes. Also don't forget that the outcome of the general election probably caused significant uncertainty for investors (given the wide variety of, in some respects, quite radical prescriptions being dished up to voters by some of the minor parties pre-election). With all this, along with the impact of rising interest rates, a continued elevated $NZ and significant reductions in commodity prices, it is probably not surprising that business confidence took something of a hit pre-election.

Even so, hard data appears to show the economy as still resilient to the pressures outlined above and this is reflected in continued capital investment and solid growth in both the manufacturing and services sectors. Housing and general construction are booming although the agricultural sector is facing some head winds after having what can only be described as a bumper 2013/14 season.

Both the BNZ-BusinessNZ Performance of Manufacturing (PMI) and Performance of Services (PSI) continue to show relatively strong growth in both major sectors of the NZ economy. Perhaps even more importantly, both surveys point to relatively strong employment growth.

The BNZ-BusinessNZ seasonally adjusted PMI for August stood at 56.5, 3.0 points higher than July and the strongest level of activity since March. The sector has now been in expansion for two years.



Four of the five seasonally-adjusted main diffusion indices were in expansion during August. *Production* (60.1) was at its highest level since July 2013, while *new orders* (58.3) also improved from July, rising 2.8 points. *Employment* (53.2) rose 1.7 points to reach its highest level since May, while *deliveries* (55.7) increased 2.0 points. *Finished stocks* (48.5) decreased during August, although this may have been due to increased activity levels overall.

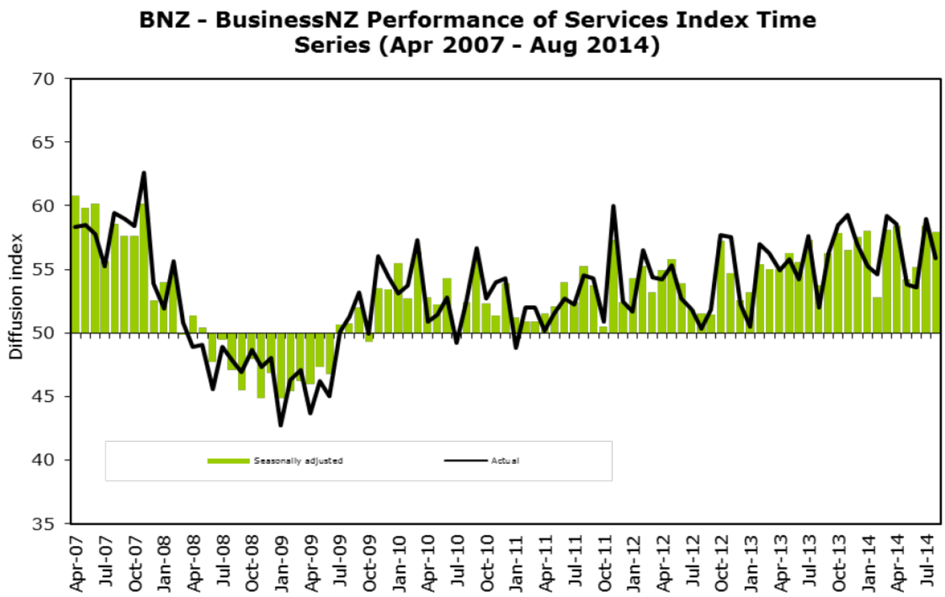
Three of the four regions were in expansion during August. In the North Island, the *Northern* region (60.6) showed strong growth with its activity level over 60 for the first time since December 2013. In contrast, the *Central* region (46.3) produced another contractionary result, largely on a par with July. In the South Island, the

Canterbury/Westland region (54.7) rose 2.4 points, while the *Otago-Southland* region (57.9) went back into expansion after three consecutive months of contraction.

Manufacturing by industry sub-groups was mostly positive during August. *Petroleum, coal, chemical and associated product manufacturing* (63.5) went back into strong expansion after a period of decline. *Machinery & equipment manufacturing* (52.3) continued to experience expansion, although down on the level seen in July, while *food, beverage & tobacco manufacturing* (66.9) continued to expand at a strong clip. In contrast, *metal product manufacturing* (49.2) experienced its first level of contraction since December 2013.

The proportion of positive comments for August (61.2%) was up on July (57.4%), June (55.2%) and May (60.8%) Globally, the JPMorgan Global manufacturing PMI for August (52.6) saw the sector in a holding pattern, with the rate of output expansion broadly unchanged from that registered in June and July.

The seasonally-adjusted BNZ – BusinessNZ Performance of Services Index (PSI) for August stood at 57.9. Although this was down 0.5 points from July, it continues to show healthy activity in the sector, with an average monthly result of 56.6 so far for 2014.



For the third consecutive month, all five main sub-indices were in expansion. *Employment* (56.0) recorded its highest result since the survey began in 2007, as did *supplier deliveries* (59.0). In addition, *stocks/inventories* displayed its second highest result, only bettered by the November 2007 figure. *New orders/business* (58.5) continued to lead the charge having the highest overall result for August, while *activity/sales* (57.6) experienced a slip in expansionary levels.

Activity continued in positive territory throughout the country. In the North Island, the *Northern* region's (57.0) result was largely similar to its July result, while the *Central* region (56.2) experienced a dip in expansion after breaking through the 60-point barrier in July. In the South Island, the *Canterbury/Westland* region (51.9) fell 5.6 points in August, while the *Otago/Southland* region (55.8) returned to standard levels of growth.

Service sector results by sub-sector were mostly in expansion during August. *Wholesale trade* (57.8) inched up from its July result, while *health & community services* (57.3) was close behind. *Property & business services* (56.8) moved down from a result above 60 in July, while *retail trade* (47.4) was one of the few sub sectors to show a contraction.

The proportion of positive comments from respondents in August (62.0%) was down on July (65.8%), but almost identical to June (62.1%). Internationally, the JPMorgan Global Services PSI for August (55.5) continued to expand at a solid pace.

Consumer confidence – sentiment still positive

Consumer confidence is firmly in positive territory and recent surveys suggest that it is holding its own – largely on the back of an improving labour market encouraging consumers to open their wallets. On the other hand, high levels of household debt remain a significant impediment and as mortgage rate rises start to bite, consumers are likely to take a more cautious attitude to new expenditures.

The ANZ-Roy Morgan Consumer Confidence Index rose 2 points in September to 127.7 showing that confidence, after dropping for most of this year, is still reasonably positive. Those expecting to be better off in a year's time rose to a net 39 percent, up slightly from 35 percent the previous month.

Retail and electronic sales are starting to improve and with limited headline inflation to date, consumers are beginning to increase their expenditure, although still demonstrating caution in respect to major household items.

1.4 Labour market – onwards and upwards

Employment – solid growth projected

The BNZ - BusinessNZ PMI and PSI surveys show solid growth in employment outcomes, both in the manufacturing and services sectors. Other business confidence surveys also indicate strong employment growth prospects, particularly in the construction sector. The BNZ-BusinessNZ PMI *Employment* sub-index sat at 53.2 for the month of August 2014. Meanwhile the PSI *Employment* sub-index sat at (56.0) recording its highest result since the survey began in 2007.

Employment growth is on the rise with associated reductions in unemployment forecast, as outlined below. The unemployment rate is expected to reach 5.1 percent by September 2016.

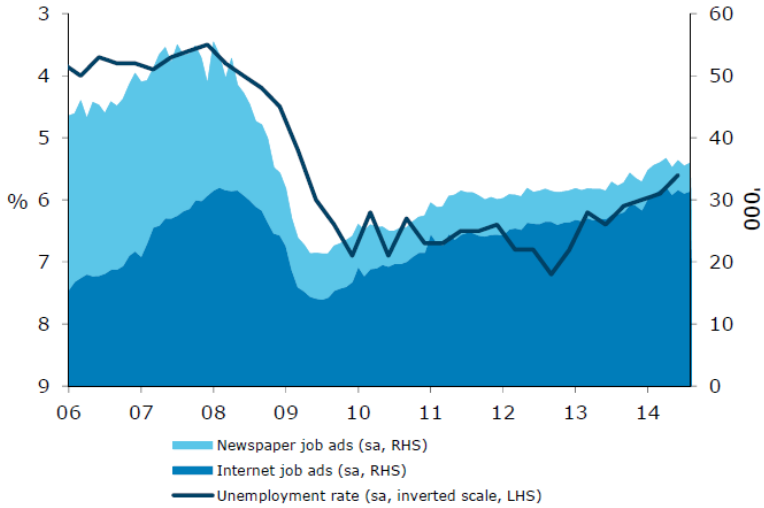
Forecasts: Unemployment % (HLFS)

	Quarter		
	Sept 14	Sept 15	Sept 16
Highest	5.6	5.4	5.7
Average	5.5	5.2	5.1
Lowest	5.4	5.0	4.6

Source: ANZ, ASB, BNZ, and Westpac

Other surveys such as the ANZ NZ Job Ads series show a reasonably positive outlook for job growth and corresponding reductions in unemployment, as can be seen below.

FIGURE 1. JOB ADS AND THE UNEMPLOYMENT RATE



Source: ANZ, Statistics NZ, Seek, Trade Me, Dominion Post, Hawke's Bay Today, Manawatu Standard, NZ Herald, ODT, The Press, Waikato Times

Labour costs – growth still relatively benign

Forecasts below indicate that labour costs are expected to increase only slowly to around 2.2 percent for the year ending September 2015 and 2.5 percent for the year ending 2016. These forecasts largely reflect the pick-up in labour market outcomes over the medium term.

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

	Years ending		
	Sept 14	Sept 15	Sept 16
Highest	1.9	2.4	2.7
Average	1.8	2.2	2.5
Lowest	1.6	2.0	2.2

Source: ANZ, ASB, BNZ, and Westpac

Private sector salary and wage rates (including overtime) increased 1.8 percent in the year to the June 2014 quarter. Public sector salary and wage rates (including overtime) increased 1.2 percent in the year to the June 2014 quarter.

There will likely be some upward wage pressure over the coming year as labour resources become increasingly constrained, although there is little evidence of any significant upward pressure at this stage. Labour market pressures are largely confined to specific sectors and regions e.g. Auckland and Christchurch in respect to housing and construction.