NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

CTU Monthly Economic Bulletin

No. 102 (May 2009)

Comment

So, what to think about the Budget. This was never going to be an easy one in the midst of economic and financial crisis. Whoever won the 2008 election would have had difficult decisions to make. It said something about the quality of the election campaign that such matters were barely discussed, even when it became obvious that an economic storm was rapidly approaching.

And to give credit to Bill English and John Key (who obviously were not entirely of one mind on the directions the Budget would take) , this is not a Ruth Richardson search and destroy budget. Most of the social protections built up in recent years remain (even if some of Richardson's legacy lives on in low benefit levels and high income inequality).

But this Budget needed to do two things. It first needed to ensure that New Zealanders (and vulnerable New Zealanders in particular) are cushioned from the drastic downturn. Second, it needed to give some plan, and hence hope, for the future, post-crisis. The CTU has pointed out in a number of statements its concern that not enough is being done to protect and create jobs, and to assist people thrown out of jobs in the transition to new ones. And there is no apparent plan for the future other than the old story of creating an environment in which new investment is theoretically supposed to thrive, and then hoping it will come in the right quantity, quality and sectors.

In this commentary I will burrow down a little further into each of these. Our Budget Report sent out on Thursday contained a quick analysis of the changes in spending, and affiliates will by now have done their own analyses so I will not go into that detail.

SP - Social Protections vs Standard and Poor's

There are many areas in which the government has directed spending that will maintain services or create jobs in 2009/2010. There are others in which there have been significant cuts. Those cuts have particularly hit public service staff, and the process of "value for money reviews", which is stated to be an ongoing one, threatens to recreate the destabilising and paralysing atmosphere of the 1990s which can do no good for the long run effectiveness of the advice and services provided by government employees.

While recognising that there are limits to a debt level which is prudent, the CTU asked why the Budget had not done more for social protection, and job creation in particular. Elsewhere in the OECD, debt is forecast to increase from about 75% of GDP in 2008 to almost 110% by 2014 (according to

Treasury, quoting the International Monetary Fund). Yet the Budget forecasts gross debt (technically, Gross Sovereign-Issued Debt – more of this shortly) to peak below 40% of GDP in the main forecast, and below 50% even in the pessimistic forecast.

The problem is in fact greater in subsequent years than in 2009/2010. And we should bear in mind that Treasury is forecasting that 2010 will be a truly awful year, investment falling by 21% and unemployment peaking at 8% late that year. Forecast expenditure in many central areas of government spending rises in 2010, but then flat-lines (e.g. Health and Education) or rises very slowly (e.g. Superannuation and welfare benefits). The provision for new initiatives (the quaintly named "operating allowance"), which would allow the government to react to further social pain, is severely cut back – from $1.75 billion in previous years, to $1.45 billion in 2009/10, to $1.1 billion (adjusted only for inflation) in subsequent years. As Health has increased by $750 million a year in recent years, this implies either substantial constraints on public health provision or very little new spending elsewhere. In addition, even these lower levels of flexibility rely on high expectations of the continual "line by line" reviews of government spending which are forecast to result in over $500 million per year savings each year from 2010/11 to 2012/13. If these highly optimistic (and potentially damaging) expectations of savings are not met, then there will be only minor sums available for new initiatives.

Surely there was room to do more?

In part the answer lies in the instincts of the government to reduce the size of government. The crisis provides an opportunity to seize. But in part it also lies with the pressures of the international investors, presented most publicly by the credit rating agency Standard and Poor's.

Putting aside for now their desperately bad performance in failing to warn of the risks that led to this world-wide financial crisis, it is useful to understand their part in influencing this Budget. The credit rating agencies were clearly in the minds of the government, John Key going as far as saying that "our primary focus for this Budget is to avoid a credit rating downgrade". The government notes in its Fiscal Strategy Report that:

> "In January, Standard and Poor's revised their outlook on New Zealand's sovereign AA+ rating from stable to negative, and highlighted the need for this year's Budget to present a credible fiscal consolidation plan. Ahead of the event it is difficult to identify the exact triggers for a change in investor confidence although there are some pointers:
>
> - The extent to which we demonstrate the ability to make decisions to remedy the fiscal position. We have made decisions for Budget 2009 regarding savings and a lower operating allowance. The policy actions in Budget 2009 demonstrate a commitment to make hard decisions.
> - The extent to which New Zealand's fiscal position looks out of line with other economies."

So the inadequate operating allowance was a deliberate signal to Standard and Poor's.

As noted, New Zealand's fiscal position is not out of line with other economies, unless that is taken to mean that New Zealand starts with much lower government debt levels and a consequent greater ability to adapt to the crisis conditions. Where New Zealand is very much out of line is its huge international liabilities (fuelled by a chronic, large current account deficit) of debt, portfolio investment and foreign direct investment, overwhelmingly private. Until recently, this was ignored as being only of concern to the private debtors. Now, however Standard and Poor's are saying that their assessment of the government's books is coloured by international liabilities. Another credit agency, Moody's, however made a little-reported more positive assessment of the government's rating, ignoring the international liabilities.

International liabilities aside, there is another reason to question the Standard and Poor's rating, and ask if we should become too obsessed with it. If insufficient government spending leads to a spiralling downturn in the economy, the government's financial position is just as threatened as it would be as a result of excessive debt. This is a significant risk if the downside forecasts turn out to be true, as they have in the last year. Perhaps the credit rating agencies should be looking at their own performance.

A final word about debt. The government's new fiscal objectives with regard to debt have a subtle but significant change. Their long term objective is now to keep **net** debt below 40 percent of GDP, and in the longer term (i.e. after the 2020's) "closer to 20 percent" of GDP. The current objective is for **gross** debt to remain at around 20% of GDP. Net debt is defined as gross debt less financial assets – but not including the assets present in student loans (and other advances) and the New Zealand Superannuation Fund. So a (very) long-run target of 20% of GDP for net debt will result in much higher levels of gross government debt in perpetuity. Servicing that debt will leave less room for social programmes, and greater susceptibility to pressure from the credit rating agencies.

Looking to the future

The government and Treasury are talking a lot about coming out of this recession in a better state with regard to productivity and international competitiveness. What is not clear is how this will be achieved. Bill English said in answer to a question in the Budget lockup that there is no silver bullet to raise productivity – it needs many different approaches. He named improved infrastructure, regulatory reviews, and more efficient public services as central to the government's approach.

Improved infrastructure could well help, in the right areas. But that is not something new. There has been significant spending in the last decade. Regulatory reviews at best will show marginal improvements: in terms of business costs, New Zealand is regularly rated as one of the easiest places to do business in the world. And each of those regulations , statutes and administrative processes has a reason. Much increased flexibility in employment law may be great for the employer but oppressive for the employee. Weakening the Resource Management Act may speed up projects, but leave undesired environmental effects for neighbours or for the nation to clean up if not properly addressed. This is not an easy area n which to move, and potentially has considerable social and environmental implications. There may also be economic implications, by shifting advantage from one sector to another. And more "efficient" public services can often be in the eye of the beholder, depending on what they need from the service – front line services or sound public policy for example.

But even if we can milk further gains from these already well-stripped teats, what then? The assumption seems to be that if the government provides a good environment for investment, then the right investment will come along. That didn't work in the 1980s and 1990s, and there seems even less reason that will work now. Over the last nine years a more active approach has been taken, with very mixed success, but what is needed is to improve those efforts rather than go backwards. Unfortunately there is little sign of thinking along these lines, or of a strategic approach from the Beehive. Instead there appears to be a rather ad hoc collection of policies that may or may not be consistent with each other.

It doesn't appear that even the government has much faith that these policies will work to increase productivity. In the projection assumptions of the budget, labour productivity growth rises to 3% in 2010 (June year) – perhaps due to rising unemployment – but then falls and flattens out at 1.5% from 2014 onwards. These are levels that National complained about during the election campaign.

This is my first Bulletin as Policy Director and Economist at the CTU. I'd like to take the opportunity to note my appreciation of Pete Conway's work in this position, and of the fact that he will still be around to make his huge depth and breadth of knowledge available. He will be a very hard act to follow.

If you have any comments about the Bulletin, I'd welcome hearing from you.

Bill Rosenberg, billr@nzctu.org.nz

NZIER Consensus forecasts[1]

These consensus forecasts were published on 24 March 2009.

March Year Percent Change	**2009**	**2010**	**2011**
GDP	-0.9	-0.6	2.7
CPI	3.0	2.3	1.8
Private Sector Wages (QES)	5.0	3.1	2.3
Employment	0.8	-1.7	1.0
Unemployment	5.0	6.8	6.7

[1] The consensus is made up of the average of forecasts from NZIER, Berl, ANZ- National Bank, ASB Bank, BNZ Bank, First New Zealand Capital, Deutsche Bank, UBS, Westpac, Reserve Bank of New Zealand and Treasury. Because the consensus forecasts are done only every 3 months, some of the more recent forecasts will be more accurate.

Economic Snapshot

The Consumer Price Index increased by 3.0 percent for the year to March 2009. Food prices have risen 7.6 percent over the past 12 months. The unemployment figure is at a five year high, at 5.0 percent, up an additional 0.3 percentage points between the December and March quarters. Maori unemployment is 11.9 percent, Pacific people's unemployment is at 13.1 percent, and Asian unemployment is at 6.6 percent, compared with 3.8 percent for European/Pakeha. In March 2009, just over 37,000 people were on unemployment benefit. The number of people in employment decreased in the March quarter by 24,000 (1.1 percent), to a total of 2,182,000. GDP decreased by 0.9 percent in the December 2008 quarter, the fourth consecutive decline, which means annual economic growth is at 0.2 percent. GDP figures will be updated on 26 June. The minimum wage is $12.50 an hour and $10.00 an hour for new entrants aged 16 or 17 in their first 3 months or 200 hours, whichever ends first. Ordinary time hourly wages, as measured by the Quarterly Employment Survey (QES) for March 2009, were up annually by 5.3 percent (5.0 percent in the private sector and 4.4 percent in the public sector). The QES showed that the average hourly wage is now $24.89 ($23.08 in the private sector and $31.94 in the public sector). The female rate of pay is $23.18 which is 87.6 percent of the male wage at $26.32. The Labour Cost Index (LCI) shows that ordinary time wages went up by 3.4 percent in the March 2009 year (3.0 percent in the private sector and 4.3 percent in the public sector). For those workers who received a pay rise in the year, the median increase was 4.2 percent and the average increase was 5.7 percent. The official cash rate was reduced from 3.0 percent to 2.5 percent on 30 April.

Unemployment

The Household Labour Force Survey reported unemployment climbing to 5 percent, equating to 115,500 people. Although this was less than predicted in many forecasts, there are some worrying trends with the figure for youth unemployment at just under 20 percent and the unemployment rate for those aged 20 to 24 at 12 percent. Unemployment rates for Pacific Islanders have jumped to 13.1 percent up from 8.7 percent and Maori rates have increased to 11.9 percent from 9.6 percent. Unemployment in the Auckland region is at 6.5 percent, 7.8 percent in Gisborne/Hawkes Bay, and 9 percent in Northland. The jobless number (which includes the unemployed as well as those not seeking work or those who are not available to work) has increased to 224,100 from 188,500 a year ago and the number of those unemployed for more than 6 months is up by 9,000. Underemployment (the number of people who are in part time work but would like to have more work) is also on the rise with 21.1% of part timers falling into this category. In March 2009 there were 37,146 receiving the unemployment benefit, which represents 2.7 percent of the working age population (18 - 64). These numbers are yet to reflect the number of people who are actually out of work and we expect to see these rise. 70 percent were receiving this benefit were males and 86 percent of the total recipients had been receiving the benefit for less than one year.

Employment

The Quarterly Employment Survey shows that full time employment fell by 1.7 percent for full time workers, a decrease of nearly 24,000. Manufacturing jobs dropped by 17,500 for the year to March and construction jobs dropped by 9,700 in the same period, whilst health, education and government sectors all recorded increases in annual employment. Part time employment was down by 1.8 percent and the amount of overtime has reduced by 15 percent over the last year.

Wages

The Quarterly Employment Survey for the March 2009 showed that for those in employment, wages are increasing at a rate of 5.3 percent for the year (5.0 percent in the private sector and 4.4 percent in the public sector). For New Zealand, seasonally adjusted gross earnings were up by 3.3 percent. The average ordinary time wage is $24.89. Wages for men are averaged at $26.32 whilst females are $23.18. The wages in the public sector averaged at $31.94 and in the private sector at $23.08. The Labour Cost Index that was also released this month shows ordinary time wages increased by 3.4 percent (3.0 percent private, 4.3 percent public), the same percentage increase as this time last year. In the March 2009 year, 60 percent of salaried and ordinary time wages increased. For those that received a pay rise the median (i.e. middle) increase in the year to the March 2009 was 4.2 percent, and the mean increase was 5.7 percent. Both the median and mean figures were down by 0.2 percentage points from annual figures published in the December 2008, but were up slightly compared to the annual increases published in March 2008. Industries with the lowest annual percentage increases were retail and wholesale at 2.2 percent, finance and insurance at 2.3 percent (a big drop compared to the 5.3 percent average recorded in March 2008), forestry at 2.5 percent, cultural and recreational services also at 2.5 percent, and printing at 2.7 percent. Industries with the largest percentage increases were mining at 4.3 percent, health at 4.4 percent, and education at 5.6 percent.

Food Prices

From April 2008 to April 2009, food prices increased 7.6 percent, but the size of the increase was down slightly from the highs of 9.5 percent in January 2009 and the 8.6 percent in March 2009. For the year, grocery foods are up 6.7 percent, meat, poultry and fish are up 11.5 percent, fruit and vegetables are up 9.9 percent, restaurant meals and ready-to-eat foods are up 5.2 percent, and non-alcoholic beverages are up 7.5 percent. For specific food items the largest rises for the year were for fruit, rising a staggering 21.3 percent and pork up 24.5 percent. Bread was also up 12.8 percent. Falls were certainly the exception rather than the norm; however some were recorded in the price of dairy products, namely cheese, which fell by 8.2 percent.

Trade

For the year to April 2009 the value of merchandise exports fell by 4.6 percent and imports both fell by 18.1 percent. The reduction in exports values was primarily due to crude oil, which dropped 61.3 percent ($204 million) for the year and aluminum dropped 51.1 percent ($65 million). However, export values for fruit were up 27.7 percent ($61 million) and meat was up 12.5

percent ($60 million), bucking the overall trend. The drop in imports was the largest since these trade records began in 1962. It was partly caused by a high April 2008 figure that was the result of one-off capital items being imported, but irrespective of these the decrease would have still been 7.3 percent. Substantial decreases in imports of machinery and equipment and automotive parts and vehicles led the fall. For the month of April there was a surplus trade balance of $276 million, which is equivalent to 7.5 percent of the value of exports. The annual trade balance for the year to April 09 was a deficit of $4.1 billion, equivalent of 9.5 percent of exports.

Manufacturing
The Performance of Manufacturing Index recovered slightly to 43.7[2] in April, from 40.3 in March and 38.9 in February. The employment index for the sector, whilst still showing contraction, did improve considerably, up 5.8 points on March to 44.8. The sectors showing the greatest contraction in April were: textiles (38.4), wood & paper manufacturing (38.8) and petroleum, coal, chemical products (40.3). On the contrary, food, beverage & tobacco (54.3) showed some expansion. Australia, which is NZ's largest manufacturing export market, gave its worst PMI result on record, falling to 30.1.

Service Sector
Performance in the service sector also experienced contraction according to BNZ and Business NZ's monthly survey that recorded a value of 43.7 for April 2009 (a value below 50 shows contraction, whilst a value above 50 indicates contraction). This was a decrease of 3.4 points from the previous month. Employment contracted to 42.5, whilst activity, orders, deliveries and inventories also recorded declines. Wholesale trade dipped to 39.3, whilst retail trade and the hospitality sector showed a slight recoveries of 44.6 and 43.4 respectively. The only sector to expand was the health and community services sub group at 51.1.

Producer Prices
Producer prices give some indication as to the rate of inflation, and this month's mixed report shows producer prices falling by 1.4 percent for the quarter, but still increasing 6.5 percent for the year. These results points towards disinflation. Prices for dairy manufacturing fell by 24.3 percent for the quarter, petroleum was down by 18.2 percent, horticulture down 10.6 percent, mining by 8.3 percent and electricity, gas, and water were down by 4.7 percent. Transport equipment prices showed the largest rise of 15 percent, followed by finance sector at 14.6 percent. Annual figures for most sectors were being propped up by stronger figures in 2008.

Retail Sales
Retail sales volumes dropped by 5.8 percent for the year, and 2.9 percent for the quarter. This was much worst than most forecasts had anticipated. Auto related sales continued to lead the fall, with vehicle retailing down 11.2 percent for the quarter, followed by appliances (down 5.9 percent), department stores (down 3.6 percent) and clothing (down 3.1 percent).

[2] A figure under 50 shows the manufacturing business is contracting; above 50 shows firms are growing. The index is an early indicator of business activity

However, supermarkets and grocery sales volumes bucked the trend with a 1.9 percent increase. The value of retail sales were also in decline by 0.4 percent for the quarter and 2.1 percent for the year with the auto sector being the main drag on this figure again.

Government Accounts

The Treasury accounts for the nine months ending March 2009 show tax revenue and receipts are $1.9 billion less than the Pre-Election Update (PREFU). This is a greater variance than the February performance, which showed a difference of $1.8 billion to PREFU. Hopes that the tax variance would come back in line with the December Update now seem less likely as corporate and individual tax revenues continue to fall in conjunction with slowing private spending and the weakening labour market. The operating balance before gains and losses is $0.2 billion which continues to diverge further from the PREFU (by $2.1 billion) as well as the December update (by $1.3 billion). There is an operating deficit of $7.7 billion, as opposed to the $3.4 billion surplus that was forecasted in the PREFU (a difference of $11.1 billion) and a $4.6 billion deficit forecast in the December Update (a difference of $3.2 billion). There have been a total of $5.7 billion investment losses on ACC, EQC, and NZS Fund in the year alone, whilst actuarial losses on non-financial instruments are at $3.6 billion. Gross debt is now at $45 billion, which is equivalent to 25.1 percent of GDP.

Migration

New Zealand experienced a net migration gain of 9,200 people in the April 2009 year. Arrivals were up 6 percent for the year to 89,000, and outflows increased only marginally (less than 1 percent) to 79,800. Permanent and long term departures are dominated by people leaving to go to Australia, with a net outflow now at 32,000 for the year, which although high, it is down on the previous monthly figures. Arrivals to New Zealand were dominated by arrivals from UK (8,600) and India (6000). For the month of April there was a net gain of 400 people, with 300 more New Zealand citizens returning home. The number of visitors coming to New Zealand has been sliding, with figures down 3 percent on the previous year – bad news for the tourism and service sector. New Zealanders are also travelling less overseas, with these figures also down 3 percent for the year.

Housing and Property

House prices decreased by 9.2 percent for the year to April, a very marginal improvement on the 9.3 percent fall recorded in month prior. However average sale prices were down from 378,399 in March to $372,981 in April which QV attribute to more lower priced houses being sold. There is some optimism in the sector with the number of sales on the rise, which is being driven by lower prices and the falling interest rates. Prices were up slightly in all the main centres except for Tauranga. In April, building consents continued to decline with a total of 1,009 new dwellings being approved. However, Statistics NZ indicated that the fall was softening and that consents for apartments had increase by 4.5 percent for the month.

Life Expectancy

The life expectancy for newborn girl is now 82.2 years and for a boy it is 78.2 years. The birth rate has risen to 2.2 births per women, the highest fertility rate since 1991. The number of births was up 1 percent with 64,160 babies being born over the year to March 2009. The majority of women giving birth were between the ages of 30 and 34. The natural increase in the population (the number of births compared to deaths) was 35,010.

Is the Government Growing?

In Business and Economic Research Limited's (BERL) monthly monitor, the myth about the growing government sector in NZ is exposed. They showed that government spending accounted for 18.8 percent of total GDP in 2007 and averaged at 18.5 percent for the last 30 years. This compares with equivalent spending in the 2007 year of 16.1 percent in the US, 17.7 percent in Australia, 19.3 percent in Canada, 20.0 percent in the EU, and 21.2 percent in UK.

For further information contact Bill Rosenberg billr@nzctu.org.nz or Gemma Habens on gemmah@nzctu.org.nz