NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

# CTU Monthly Economic Bulletin

**No. 103 (June 2009)**

**Comment: Hard times. Are the banks helping?**

The news last week that the economy's output (GDP) had fallen by 1.0 percent in the three months to March sends shivers down the spine. This is the fifth consecutive quarter in which output has decreased, and the first time since 1992 that a decline in output for a full year has occurred. The annual fall, also of 1.0 percent, is higher than Treasury's Budget forecast of 0.9 percent, so we must be increasingly concerned about unemployment unless additional government action is urgently taken. Treasury's already frightening forecast of a peak of unemployment late next year of 8 percent or around 180,000 people could well be exceeded. That becomes a major social crisis as well as economic and financial one.

Manufacturing and other goods producing industries continue to be particularly hard hit. Manufacturing alone fell a huge 7.2 percent in just those three months to March – the largest quarterly decrease in 23 years of recording this data – and 5.4 percent for the year. Even the services sector, until now relatively unscathed, is now hit – down 0.1 percent for the quarter, with wholesaling (down 3.8 percent), retailing, accommodation and restaurants (-2.9 percent) and transport and communications (-4.5 percent) worst hit. Construction is down 8.9 percent for the year, though it actually grew 0.4 percent in the three months to March. Investment in residential buildings was down almost a quarter over the year – 23.4 percent. Across the whole economy for the year to March, private expenditure, capital investment, exports, and imports all fell. The only component that grew was government spending. It needs to increase even more to keep people in work and head off more closures of firms.

Newspapers report increasing numbers of layoffs, but also that some employers are doing their best to keep staff on, in the hope that the bad times won't last too long, with skill shortages still very much in mind. We hope that those who recognise the value of their staff dominate, but the longer the hard times last, the more pressure they will have to cut short term costs. We also hear about apprentices being laid off. As a leader in industry training remarked to me, we don't tell people educating themselves in our tertiary institutions to be nurses, lawyers, engineers and teachers that they have to stop their education because there are no jobs available. Yet that is what is happening to apprentices. It is important that we don't come out of this recession with a skills deficit as we did after the 1990s. It is disappointing and surprising that the government didn't increase its investment in education and training in the Budget to recognise this.

The CTU was worried when the Budget was announced that it had not done enough to further stimulate the economy, and we said the government could afford to borrow more to do so. The evidence is that our concerns were justified.

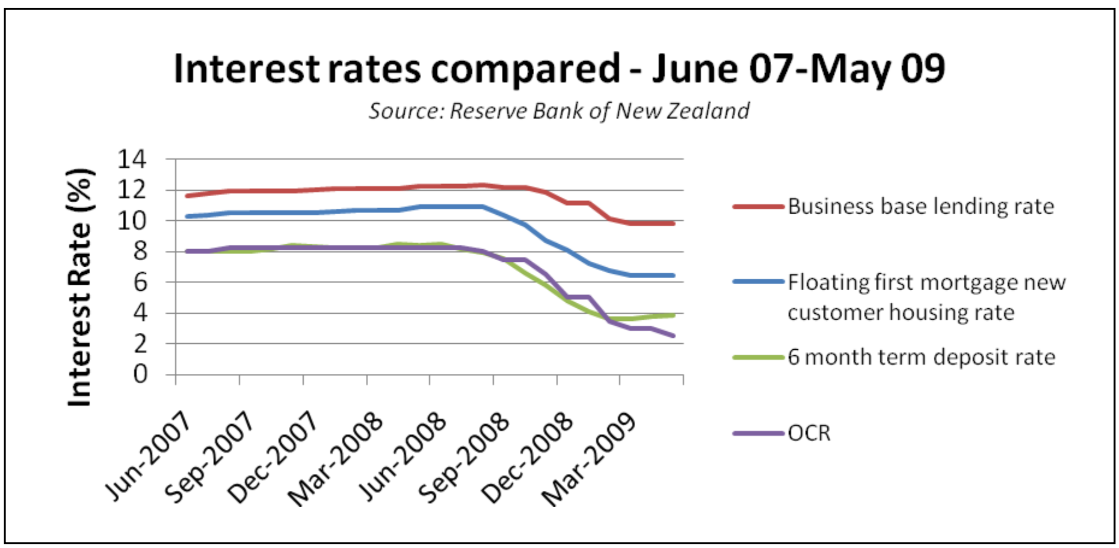
**Are the Banks helping?**

There has been much public debate as to whether the banks have dropped their interest rates enough in response to the Reserve Bank's reductions in its Official Cash Rate (OCR). In May, Statistics New Zealand in its latest Producers Price Index, reported that in the March quarter "the margins that financial intermediaries [mainly banks] make on their borrowing and lending operations… increased due to the rates for borrowing falling more than the rates for lending." This followed increases in the previous six months, and both the quarterly and annual increase were the largest since records began in 1994.

Parliament's Finance and Expenditure Committee was told by Deputy Reserve Bank Governor Grant Spencer that "It is disappointing that banks have not dropped mortgage rates further as more people face loan defaults in the coming year". The Committee reported that "We are concerned that New Zealand businesses find it increasingly difficult to access credit from the major Australian-owned banks, where lending decisions are reportedly now being made by offshore bank parties rather than onshore relationship managers." There were calls (as yet unheeded) for an inquiry into the banking system.

In its June Monetary Policy Statement, the Reserve Bank again complained that "it appears as though the most recent reductions in the OCR have not been passed on to borrowers to the extent that we would have expected. While there has been some increase in funding costs from higher retail deposit rates and longer-term interest rates offshore, this does not appear to fully explain the relative lack of movement of interest rates at shorter terms."

The following graph from Reserve Bank data illustrates the widening bank margins. Since about March, interest rates have levelled out or risen despite continuing cuts in the OCR.



In defence, the banks say they have to borrow at higher interest rates domestically because of competition for bank deposits, and rates have risen overseas where they still source almost 40% of their funds, because of the state of those financial markets. In addition, they need to tighten up their lending conditions and raise interest rates because business risks have increased due to the recession. Clearly though, the Reserve Bank is not convinced.

There are at least two explanations for what is happening, both of which may apply. The first is that the big four Australian banks are taking advantage of their dominant position and pushing out their margins between their borrowing and lending costs to protect or expand their profits. Statistics New Zealand and the Reserve Bank provide some evidence for that. However it is difficult to believe that is the full story. The small New Zealand banks – Kiwibank and TSB included – have increased interest rates almost as fast. Given their competitor status, they would be more likely to have taken advantage of the increasing margins to undercut the Big Four.

A second explanation is that because we have virtually unregulated movement of funds between New Zealand and the rest of the world – open international capital markets – we to a large degree import the monetary conditions of the rest of the world (interest rates and availability of finance). To simplify, if interest rates offered to savers here are lower than the rest of the world, fund managers can take their money to where interest rates are higher, forcing banks here to raise the rates they offer. If our domestic rates go higher than international rates, the banks can (and will) borrow more cheaply overseas in order to lend for mortgages and business loans. There are complicating factors such as margins for risks in our economy and changes in the exchange rate, but it means that the Reserve Bank has much weakened ability to influence monetary conditions within New Zealand. It has some influence on short term interest rates, because the OCR is for short term lending. But longer term rates are much more connected to international conditions because they can be funded profitably from overseas. We saw an opposite symptom of the same cause when the economy was at its height – the Reserve Bank had to set the OCR punitively high to have any effect. Now, no matter how low it cuts the OCR, it seems that longer term rates won't respond sufficiently. The result undermines the needed stimulus to a depressed economy, and contributes to a persistently overvalued exchange rate, penalising exporters.

A revealing scenario is being played out at the same time. The Reserve Bank wants to wean the major banks off their risky habit of borrowing at short terms (like 90 days, often overseas) and lending for mortgages longer term, and in general to lengthen the terms of their borrowing. It is likely to be worried that another freeze in world financial markets would force it to repeat what it did last year: arrange overseas funding lines to be used to prevent New Zealand's financial system from freezing up too. The new regulations it is putting in place have been delayed, presumably under pressure from the big four Australian banks which are the main perpetrators, and Westpac came out recently saying that being forced to borrow longer term would further increase costs, which they would pass on to borrowers in higher interest rates. We said these regulations are important, and the banks have a responsibility to keep interest rates down by absorbing some of the costs – if they exist – into their profit margins. It is interesting that, according to an article in the Reserve Bank of Australia's June Bulletin, the same four banks when operating in Australia borrow overseas for longer terms (they borrow relatively little short term overseas). Yet a Sunday Star-Times survey of international interest rates reported on 14 June indicated that while interest rates on deposits are lower here, mortgage interest rates are already higher than Australia. The OCR is currently higher in Australia too (3.0 percent compared to 2.5 percent here). The banks have some credibility issues.

**NZIER Consensus Forecasts**[1]
These consensus forecasts were published on 23 June 2009.

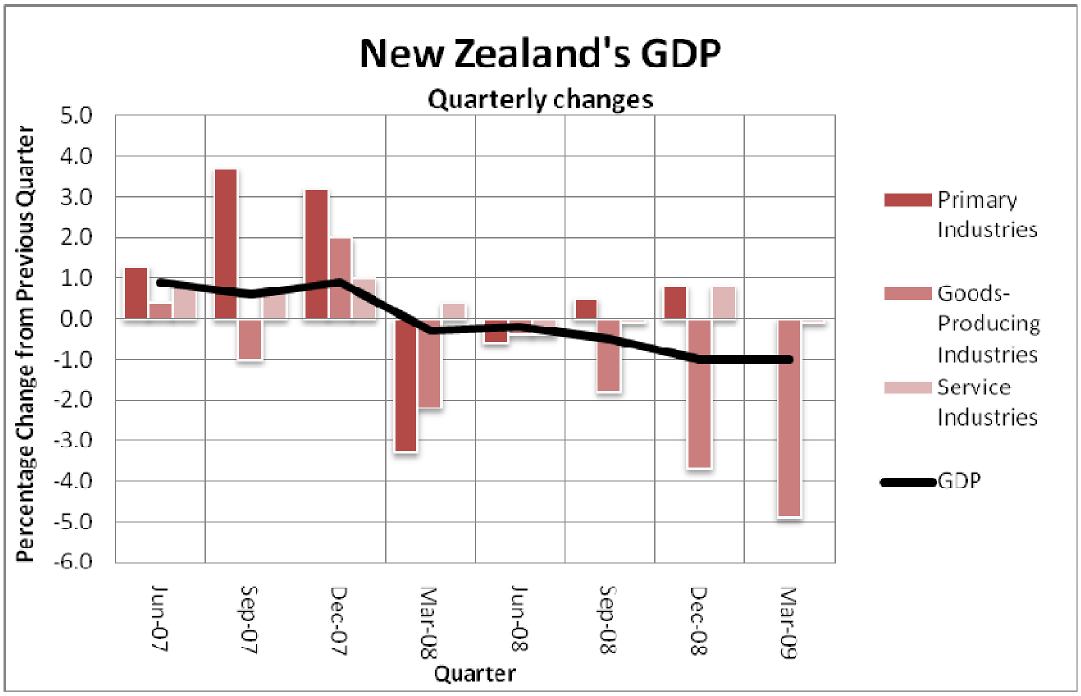
| March Year Percent Change | **2009** | **2010** | **2011** |
|---|---|---|---|
| GDP | -1.0 | -1.6 | 2.8 |
| CPI | 3.0 | 1.6 | 1.6 |
| Private Sector Wages (QES) | 5.2 | 2.6 | 1.7 |
| Employment | 0.8 | -2.7 | 0.8 |
| Unemployment | 5.0 | 7.2 | 7.2 |

**Economic Snapshot**
The Consumer Price Index rose by 3.0 percent for the year to March 2009. Food prices have risen 6.8 percent over the year to May. The unemployment figure is at a five year high, at 5.0 percent. 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. Youth unemployment is just under 20 percent and the unemployment rate for those aged 20 to 24 is at 12 percent. In March 2009, just over 37,000 people were on unemployment benefit and at the end of May it was announced that 41,336 people were receiving benefits. This figure is increasing by approximately 1,200 people every week. 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 1.0 percent in the March 2009 quarter, the fifth consecutive decline. In annual terms GDP also decreased by 1.0 percent. 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 Reserve Bank held the OCR at 2.5 percent, the first time in nine reviews that it remained unchanged.

[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 Growth**

New Zealand's annual gross domestic product (GDP) fell 1.0 percent for the year to March 2009, recording the first annual decline since March 1992. During the March quarter, the economy contracted by 1.0 percent, the fifth consecutive quarterly decline. The fall in activity is particularly significant in the goods-producing industries, which fell 4.9 percent in the quarter and 5.6 percent for the year – the largest decline since 1991. The service sector also experienced a contraction, having held up against the trend in previous quarters. Manufacturing alone fell 7.2 percent in the quarter, the largest quarterly decrease on record (23 years).




Source: Statistics NZ

There was also a 7.3 percent fall in business investment. Forecasts for NZ's GDP have been downgraded, with NZIER's consensus forecast estimating that growth will continue in negative numbers in the 2009/2010 year, changing their forecast from 0.6 percent to -1.6 percent. However, across the ditch, Australian GDP figures show that they are not experiencing a recession (two consecutive sectors of negative growth indicate a recession) with the Australian economy picking up by 0.4 percent in the March 2009 quarter, after shrinking -0.5 percent in the December quarter. Australia bucks the trend across most of the industrialised world.

**Food Prices**

In May 2009 the price of food increased by 0.3 percent and for the year to May, the food price increased by 6.8 percent. The largest annual increases were seen in groceries, up 7.2 percent; meat, poultry and fish, up 11.3 percent; restaurant meals and ready-to-eat food, up 4.9 percent; non-alcoholic beverages, up 6.7 percent; and fruit and vegetables, up 3.1 percent. Some of the biggest single increases were seen in the price of bread, which is up 16.4 percent for the year, lamb, up 22.1 percent, fruit, up 22.8 percent and yogurt up 19.0 percent.

**Balance of Payments**

The current account deficit has been released for the March 2009 quarter. This showed a deficit of $2,682 million in the March 2009 quarter, which was $1,042 million less than the December 2008 quarter deficit of $3,724 million. The balance in traded goods improved largely due to a drop in imports. However, 88 percent of the $15.2 billion deficit (or $13.4 billion – more than offsetting what Primary Industries contribute directly to GDP) for the year ending in March was due to the deficit on investment income which is a result of the very high levels of overseas liabilities. These liabilities are partly debt (now standing at $253.5 billion gross, or $162.0 billion net), driven by continuing bank borrowing which makes up $163.2 billion of the gross amount. It is compounded by high levels of overseas ownership of New Zealand firms, whose dividends far outstrip the income from New Zealand investment in overseas firms. Despite New Zealand equity investment overseas now being equal to about three-quarters (76 percent) of the $61.3 billion in overseas equity investment in New Zealand, it only paid 15 percent as much in dividends ($1.1 billion received compared to $7.4 billion going to overseas residents for the year to March 2009).

**Trade**

The trend of falling imports was also evident in the trade figures for May 2009, which showed a trade surplus of $858 million, or 21.7 percent of exports. Import values were down 20.7 percent on the previous year, reflecting the lack of demand in the contracting economy. Export values were also up 5.8 percent on last year with Statistics NZ saying that 80 percent of this increase was due to an increase in exports to China, predominantly in dairy and wood products. Chinese consumers are reportedly buying more imported dairy products following the scandal in which melamine contaminated locally produced milk powder. In the slightly dated Overseas Trade Indexes for the March 2009 quarter, export prices fell by 8.2 percent, which Statistics NZ said was the largest quarterly fall since the December 1957 quarter. Dairy prices fell 20.5 percent and petroleum fell 28.0 percent due to lower crude oil prices. Export prices fell more than import prices down percent 5.4, meaning the terms of trade for NZ for the March quarter was down 3.0 percent. Low crude oil prices also played a significant role in imports, with prices down 35.8. If petroleum product petroleum products are excluded, there was actually a 2.8 percent increase in imports, with prices for imported machinery and transport equipment leading the way. Export volumes increased 2.0 percent, with dairy products behind much of the rise, whilst import volumes decreased 9.8 percent.

**Manufacturing**

Statistics NZ's quarterly manufacturing survey for the March 2009 quarter recorded its first rise of 0.2 percent in seasonally adjusted sales volumes in 15 months. This figure was propped up by a 23.1 percent increase in meat and dairy volumes, as well smaller rises in petroleum and chemicals sector and the beverage and tobacco sector. The most significant fall was seen in the transport equipment sector, down 32.7 percent in the quarter, whilst structural, sheet and fabricated metal fell 12.7 percent and food manufacturing fell 9.1 percent.

Manufacturing sales values faired worse than manufacturing volumes - dropping 0.9 percent - equivalent to $179 million. Transport equipment was hit badly, down 23.6 percent, as were metal products, down 9.7 percent, and wood products, down 11.3 percent. Meat and dairy sales were up 10.9 percent ($709 million). If dairy manufacturing is excluded from the survey it reveals sales volumes down 6.5 percent and sales values down 5.5 percent or $798 million. Statistics NZ says this is the largest recorded fall in values since the series started in 1992.

The slight recovery in April's Performance of Manufacturing Index (PMI) to 43.7[2] was short lived as it contracted to 42.7 in May. The employment index for the sector slipped backwards (43.0) with production (41.4), new orders (41.3) raw materials (43.0), and finished stocks (45.5) all following suit. Petroleum, coal, chemical & associated products fell (33.3), while textile, clothing, footwear and leather manufacturing remained stable (38.4), and metal products also recorded a poor result (40.1). In contrast, food, beverage & tobacco sector (51.1) continued to expand. The Northern region recorded its strongest value since October 2008 (43.2), whilst the Central region recorded its weakest result since the PMI survey began.

**Service Sector**

The service sector contracted for the fourteenth month in a row in May. However, the sector showed signs of picking up with an increased Performance of Services Index (PSI) figure of 46.2[3], up from 43.7 in April 2009. The sales index rose to 43.9, and the employment index rose from 42.5 to 46.3. The property and business services sub-sector expanded for the first time in over 6 months with an index of 54.6. All other sectors showed decline but transport and storage at 41.4, accommodation, cafes and restaurants at 42.9, and retail trade at 43.5, recorded the weakest outcomes for the month.

**Retail Sales**

For the month of April seasonally adjusted retail sales increased by 0.5 percent, but motor retailing contributed to much of this increase with its sales up 3.5 percent. If we exclude vehicle related industries then core retailing actually decreased by 0.1 percent. Sales in department stores rose by 4.0 percent, whilst the biggest drop was seen in a 5.1 percent fall in other retailing (which includes sectors such as antique and used goods; garden supplies; flowers; watches and jewellery). Overall, the retail sectors sales were fairly consistent with the previous month's figures, but on a longer term analysis, sales have fallen 3.5 percent since January 2008. Wellington and all of the South Island recorded declines, whilst the rest of the country showed improved results; of note are Waikato's sales that were up 5.0 percent in April alone.

**Government Accounts**

A new set of forecasts (Budget Economic and Fiscal Update or BEFU) were released in conjunction with the 2009/10 Budget on 28 May. The BEFU predicts

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

[3] A figure under 50 shows the service industry is contracting; above 50 shows that the industry is growing. The index is an early indicator of business activity

an overall operating deficit of $9.3 billion for the fiscal year ending June 30. Actual results for the ten months ended 30 April 2009 were released on 3 June. The operating balance in the ten months to the end of April was a deficit of $7.69 billion, better than the BEFU forecast of $8.83 billion. The slight improvement can be attributed to a $1.5 billion gain from various state investment funds as well as tax revenues that were approximately $0.4 billion above forecast. Excluding gains and losses the operating balance (OBEGAL) was $1.8 billion in deficit, $0.1 billion lower than the BEFU forecast, which is forecasted to reach $2.92 billion in June. The Government's net cash position was in a deficit of $9.76 billion in April. Net Government debt stood at $17.74 billion, equivalent to 9.9 percent of GDP, which was $0.21 billion higher than forecast. In the April update, gross debt fell from 25.1 percent last month to 22.6 percent this month, equal to $40.6 billion.

*Erratum:* In the CTU Report on Budget 2009, we included some confusing figures on government debt. The Budget forecast is as follows: Gross debt is forecast to be 45% of GDP in 2012/13. Net debt (excluding the New Zealand Superannuation Fund and advances such as student loans) is forecast to be 30.9% in 2012/13. Debt is expected to peak in the June 2017 year.

**Migration**
Net immigration increased by 11,200 people between May 2008 and May 2009. This is a considerable increase compared to the year to May 2008 when net gain was 4,900. During May 2009, seasonally adjusted figures show that there were 2,100 fewer long term or permanent departures, with 1,500 fewer departures to Australia (although there was still a net outflow to Australia of 30,500 for the year). During May there was a net gain of 2,700 migrants, compared to 2,200 in April, and 1,700 in March. This is the highest figure since July 2003. May showed a slight turnaround for visitor numbers, with a 1 percent increase for the month when compared to the same period in 2008. However, visitor numbers for the whole year were down by 64,200 (3 percent).

**Housing and Property**
House prices decreased by 8.1 percent for the year to May, an improvement on the 9.2 and 9.3 percent fall recorded in previous months indicating property values are beginning to stabilise. However, average sale prices were down from $378,399 in March to $372,981 in April to $371,555 in May, which is 4.1 percent less than average house prices at the same time last year. Property values increased slightly in all the main centres. These more positive figures are being bolstered by strong net migration growth. In May 2009 the seasonally adjusted number of residential building consents increased by 3.5 percent with 1,238 new dwellings and 275 new apartments. Non-residential building consents were higher than residential consents for the month, largely due to a number of new sports facilities being built around the country. The overall decline in building consents is starting to show signs of easing.

**Global Peace Index**
This month an international report said that New Zealand was the safest country in the world ahead of Denmark, Norway and Iceland who came in second, third and fourth places respectively. The survey, by the international Economist

Intelligence Unit, rates countries according to foreign wars, internal conflicts, respect for human rights, the number of murders, the number of people in jail, the arms trade, and degrees of democracy. In the survey Iraq took last place, followed by Afghanistan, Somalia and Israel. The survey also commentated on the ill affect that the economic downturn has had on political unrest and violent conflict worldwide.

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