NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

CTU Monthly Economic Bulletin

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Welcome back …

This is a new-look Bulletin with changes made as a result of the review we polled you on last year, and a lot of thinking on our part. You'll see the difference in the information section following the commentary. It's designed to be easy to skim read, but with links you can click for further information if you want to dig a bit deeper. As always, we're interested in comments. We will develop the concepts further as we go on. I'd like to thank Andrew Chick who has done most of the work on this, and will be continuing to update it

… to an eventful year

SUMMARY: In New Zealand, the year ahead is likely to see high inflation due to government charges such as GST, but low underlying inflation reflecting the difficult times most people are experiencing. Unemployment will reduce only slowly with 130-140,000 people out of work during the year, with slow GDP growth, though more than 2010. The outlook for wages is brighter, with signs they may get ahead of inflation, unlike 2010. High food and log prices are keeping up our exports but are not helping a move to greater value-added exporting, and high food prices may do more damage than good to the New Zealand and world economy. We are very reliant on the Australian and Chinese economies, which in turn rely on the European and US markets. All have some question marks over them, but particularly the highly indebted European countries and the US, where there is already high unemployment. There is a risk that the austerity programmes in Europe and being pushed in the US by the Republican opposition will return those countries to recession. There is a similar debate in New Zealand – to cut government spending or to continue to stimulate the economy. A risk to continuing government support for the economy is that the money markets turn on New Zealand. But New Zealand's high indebtedness is due to private debt (mainly bank debt), not government debt which is low by world standards. The link markets may make between the two is the risk that bank indebtedness gets dumped on the government. The response should be to reduce that risk.

I hope you had a restful and refreshing break. There's a big year ahead with many uncertainties. In New Zealand the election is already in politicians' minds with battle lines being drawn around asset sales, taxes, savings and economic development. The economy is important in most elections, but it will dominate it this year. More than that, the economy could eclipse the election if it turns bad.

Within New Zealand, the situation is uncertain but things are unlikely to get better quickly. While inflation will not be as high as feared (remember Treasury had forecast 5.9 percent for the year to March 2011) it has still reached record heights mainly as the result of GST and other government charges. Underlying inflation is quite low: the Reserve Bank thinks about 2 percent, perhaps even lower. It thinks the peak in annual inflation will not be in March (for which it forecasts 4.3 percent) but in June at 5.0 percent. There are still some of the effects of GST to be felt for example.

However the low underlying inflation is a reflection of how difficult it still is for many people. Shops didn't do well over Christmas, house prices are stagnant or falling. Business investment, which might create new jobs, has still not taken off and has bumped along the bottom all year. The government is plugging the line that this is actually good: people are changing their habits and saving or paying off their mortgages rather than spending. I'll come back to that, but just say here that even if it is true, it is unlikely to be across the income spectrum. Low and middle income people didn't get the benefit of the tax cuts and so don't have any spare income to use in this way. The polls are confirming what we have consistently said: most people feel they are worse off and that they weren't properly compensated for the GST increase. As time goes on, that unfairness will only feel worse.

Unemployment forecasts suggest a very slow recovery in jobs. The Reserve Bank forecasts it will still be at 5.8 percent at the end of the year, meaning 130,000 to 140,000 people out of work during the whole year. While technically we're told we are out of recession, it doesn't feel like it. Remember too that the year to September 2010 was the first quarter since September 2008 in which GDP per person did not fall year-to-year. GDP growth will have been under 1 percent for 2010, including the fall in the September quarter. The Rugby World Cup and the reconstruction in Canterbury will help boost it in 2011, but these are one-offs (though the Reserve Bank thinks reconstruction won't really be underway until the second quarter, and it will be two years before it nears completion). Wages at best just kept up with inflation in the year to September but will certainly fall behind after the GST rise is factored in. They may do a little better in 2011. NZIER consensus forecasts have the average private sector wage rising 2.9 percent in the year to March 2012, ahead of inflation, and some recent settlements give that credibility.

Internationally, high food and log prices are keeping our export income up – but digging us further into our rut of relying on products with little value added. There is another down side to the higher food prices: a recent New Zealand Institute for Economic Research report estimated that New Zealand is a net loser from higher prices because consumers suffer more from the high prices than farmers gain. The food prices are contributing to poverty – and street protests – in the low income countries where this can be a life-or-death matter: NZIER says that "our modelling also shows that no one in the world wins from higher food prices". So the high prices – which some studies conclude are pushed up by speculation in these commodities – cannot last.

We are also reliant on the health of the Australian economy (especially for manufactured exports) and the Chinese economy (mainly for low value commodities) for our current relatively strong export performance. But there are many risks in the international scene. Australia will have taken a hit from the devastating floods, though it will bounce back from that (how much will depend on how many people were uninsured against floods) but we also need to remember its economy is very dependent on China too. China has its own problems of unwise lending, growing inflation and the imbalances caused by the dominance of exports in its economy, including demands for higher wages and high income inequalities. We would be unwise to assume that its historically astronomical growth rates which are carrying the world economy will still be there in five years time.

China will also be affected by two other external factors. First, some forecasts have the price effects of the peak in world oil reserves showing as soon as next year (bearing in mind though that crude oil prices are lower in real terms than they were at their previous peak in 1980). In any case, oil prices are expected to rise next year. Second, China is very dependent for its exports on the huge European and US markets. Both could well return to recession as a result of the austerity policies being followed already in Europe and threatened in the US. These are in place in the UK as well as the debt-ridden "PIIGS" – Portugal, Ireland, Iceland, Greece, Spain – and perhaps will be in Italy and Belgium too. In the US, the Republicans gained strength in the November election and are baying for similar government cut-backs, despite the unemployment rate being 9.6 percent there. Currently the US is trying to stimulate the economy through "quantitative easing" (increasing the supply of money) which is spilling out of the US economy threatening inflation and pushing up exchange rates in countries like Brazil which in turn is using capital controls to resist the pressure. Ominously, money markets are starting to show signs of doubt that the US strategy is credible. Unemployment will rise further in those European countries this year and unemployment rates are already 20.5 percent in Spain, 13.9 percent in Ireland, 12.2 percent in Greece and 10.7 percent in Portugal. They will certainly rise in the US from the current 9.6 percent if cut backs in government spending begin. The UK economy contracted in the last three months of 2010.

This brings us back to New Zealand. The debate between continuing the stimulus or cutting back government expenditure is being played out here too. National's plan for asset sales is another aspect of the same debate. But there is a real risk that the current situation has been misdiagnosed. In times like these, the economy can fall into a "liquidity trap". People realise they cannot service their high indebtedness and stop spending in order to reduce their debts. Because they are not spending, others lose jobs, prices fall, and more people get into problems with their debt. Because the value of their properties is falling, even if they are paying off debt, their net indebtedness (the difference between their debt and the value of their property) may not fall. If their real wages fall – or they become unemployed – things become even more difficult. The economy goes into a downward spiral, with the only way out being additional spending by the government or debt write-offs. So we should be very careful before acclaiming the apparent debt reduction which is apparently occurring. We may be experiencing an (at present) mild version of the liquidity trap.

A risk to continuing government support for the economy is that the money markets turn on New Zealand, compare it to the PIIGS and stop lending. I will write about this more in a future Bulletin, but the crucial point is that New Zealand's high indebtedness is due to private debt (mainly bank debt), not government debt which is low by world standards. The link markets may make between the two debts is the risk that bank indebtedness gets dumped on the government. The response should be to reduce that risk and take stronger action against banks borrowing huge sums abroad, rather than asset sales or violent cuts in government spending.

Little of this news looks good. It is a brutal and irrational economic system that punishes billions of blameless working people for the shockingly irresponsible misbehaviour of a financial system whose overpaid executives continue as if nothing had happened and actively resist real change. Alternative economic policies are desperately needed.

Bill Rosenberg

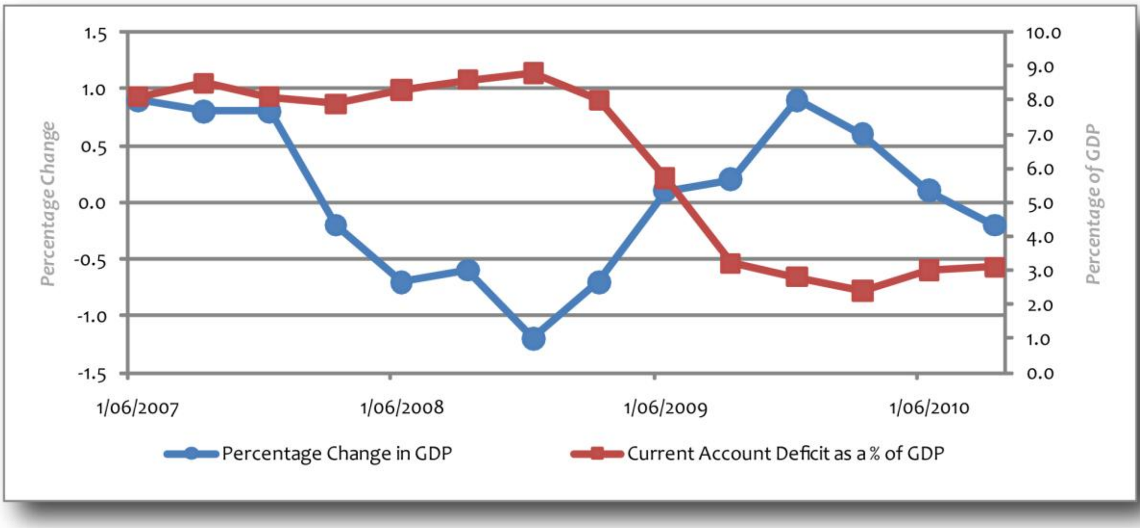
Forecast

This NZIER consensus forecast was published on 14 December 2010.

Annual Percentage Change (March Year)	**2010-11**	**2011-12**	**2012-13**
GDP	2.1	3.5	2.6
CPI	4.6	2.6	2.5
Private Sector Wages	1.8	2.9	3.3
Employment	1.3	2.4	1.8
Unemployment rate	6.2	5.5	5.1

A ★ indicates information that has been updated since the last bulletin.

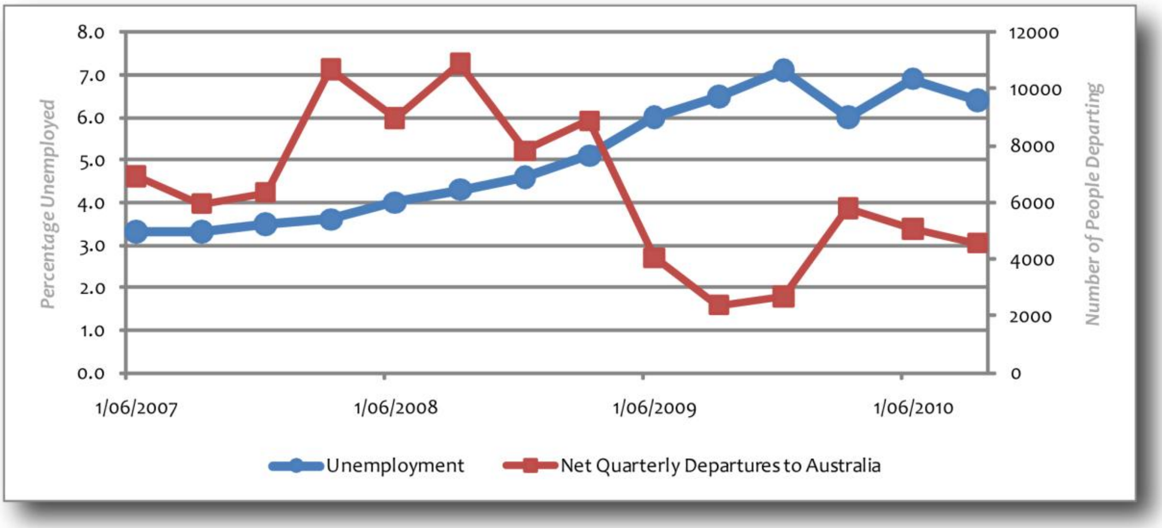
Economy



- ⭘ Gross Domestic Product was down 0.2 percent in the September 2010 quarter, leaving GDP growth for the year to September 2010 at 1.4 percent.
- ★ New Zealand recorded a Current Account deficit of $1.7bn for the September 2010 quarter and a deficit for the year to September of $5.9bn – 3.1 percent of GDP.
- ★ The country's Net International Liabilities were $162.5bn at the end of September 2010 – 85.2 percent of GDP but $600m less than at the end of June.
- ★ For November 2010 Overseas Merchandise Trade recorded a $186m deficit – 5.1 percent of the value of exports for the month and $94m less than the deficit for the same month in 2009. However for the year to November 2010, New Zealand recorded a surplus of $1.3 billion (3.1 percent of exports). This was the first annual surplus for November since 2001. The stagnant economy is still reducing demand for imports and company profits.
- ★ The Performance of Manufacturing Index for December 2010 was 53.1 up from 52.7 for November. The employment sub-index recorded 51.1 up from 50.6. (Under 50 shows the sector is contracting; above 50 shows that it is growing.)
- ★ The Performance of Services Index for December 2010 was 52.5 up from the November figure of 51.4. The employment sub-index continued to show contraction at 49.4, but was up slightly on 49.0 in November. (Under 50 shows the sector is contracting; above 50 shows that it is growing.)

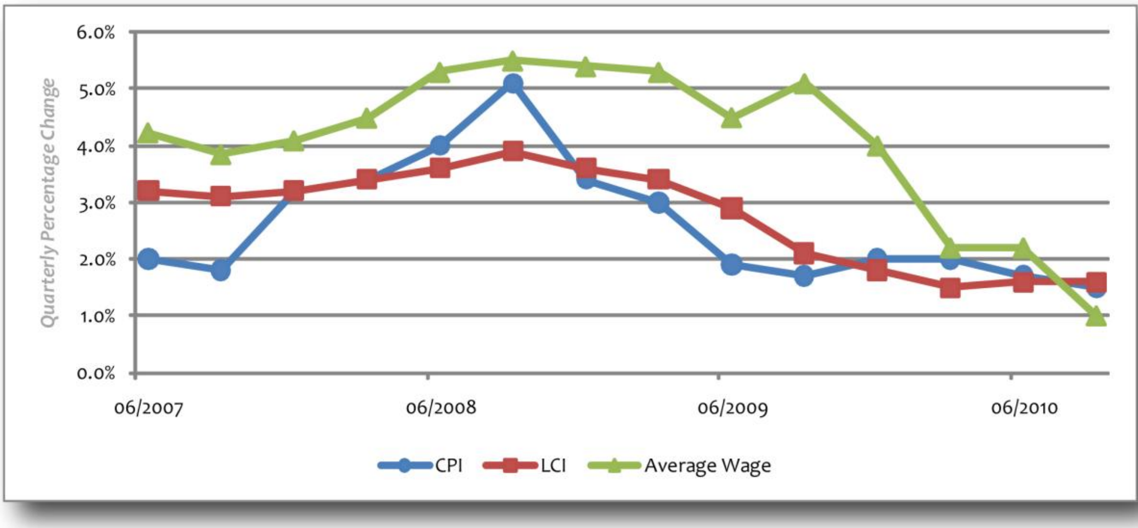
- The Retail Trade Survey found retail sales up 1.5 percent for the month in November 2010 and up 2.5 percent on November 2009.
- On 2 January 2011 the Reserve Bank left the Official Cash Rate unchanged at 3.00 percent. The next review will be on 10 March 2011.
- The REINZ Housing Price Index recorded a 0.6 percent decline for the month of December 2010, with the median house price falling $8,000 to $352,000. House prices are down 1.6 percent for the year to December.

Employment



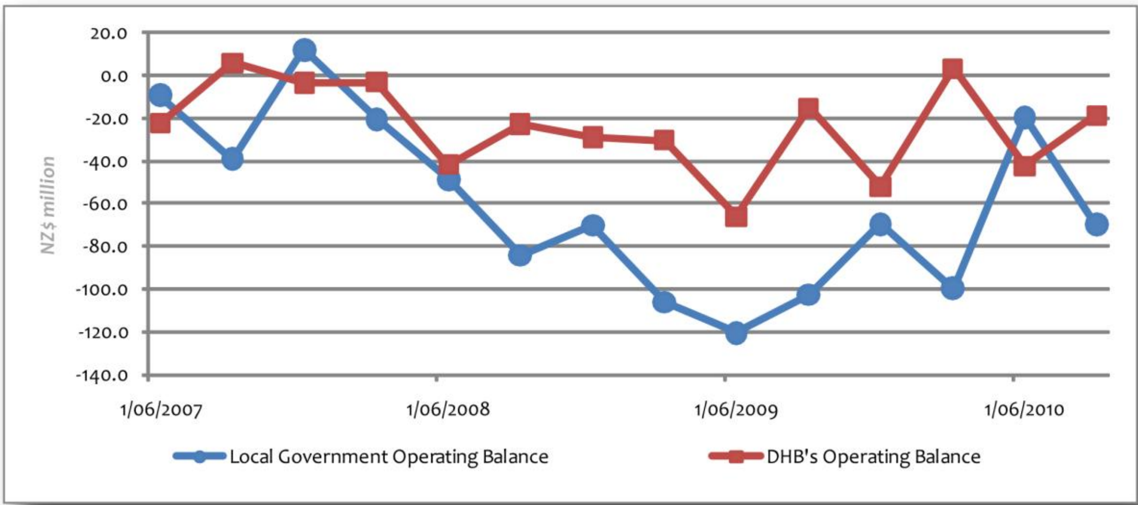
- According to the Household Labour Force Survey the unemployment rate in the September quarter was 6.4 percent, which was down 0.5 percent on the June quarter. The participation rate was 68.3 percent – up 0.2 percent on June. Māori unemployment was 16.2 percent, Pacific unemployment was 13.5 percent, Asian unemployment was 8.0 percent and European/Pakeha unemployment was 4.3 percent. Youth unemployment (15-19 year olds) was 23.3 percent.
- At the end of December 2010 there were 67,084 people on the Unemployment Benefit, an increase of 1803, or 2.8 percent, from the end of September.
- In the three months to the end of November 2010 Job Vacancies Online increased 2.6 percent and advertised vacancies for skilled jobs increased 2.7 percent.
- International Travel and Migration figures show 6,857 permanent and long-term arrivals to New Zealand in November 2010 and 5,447 departures. Net migration in the year to November 2010 was 11,519 arrivals. Net migration to Australia in the year to November was 20,075 departures.

Wages



- The Labour Cost Index (Wage and Salary Rates) rose 1.6 percent for the year to September 2010 and 0.5 percent for the September quarter. For those surveyed who received an increase in their salary or wage rate during the year, the median increase was 2.9 percent.
- The September 2010 Quarterly Employment Survey found the average hourly wage earned for ordinary-time work was $25.71, up 1.0 percent on the June quarter and up 1.1 percent for the year. The average ordinary time wage was $23.72 in the private sector (up 1.0 percent for the quarter) and $32.61 in the public sector (up 0.2 percent). Per hour female workers earned 87.8 percent of what male workers earned.
- ★ The Consumer Price Index for the December 2010 quarter rose 2.3 percent, and 4.0 percent for the year to December. It was heavily affected by the rise in GST in October which would have accounted for up to 2.0 percent of the increase.
- ★ The Food Price Index fell 0.8 percent in the month of December, but food prices were 4.2 percent higher in December 2010 than in 2009.

Public Sector



- ★ According to Treasury's Month End Financial Statement for the five months to the end of November 2010, Government revenue was down $278m (1.2 percent) on budget figures, and expenditure was up $272m (1.0 percent), resulting in an operating deficit of $2.5bn. The Government's net debt is 18.8 percent of GDP, compared with the prediction of 18.9 percent in the Half Year Economic and Fiscal Update published in December 2010.
- ★ District Health Boards recorded a $42.4m deficit for the September 2010 quarter, up from a deficit of $18.7m in the June Quarter. Employment costs were $1.2bn, up 3.0 percent for the quarter, compared to total expenses of $3.2bn up 0.2 percent.
- ★ Local Government recorded a 2.0 percent decrease in income and a 0.8 percent increase in costs for the September 2010 quarter, resulting in a deficit for the quarter of $69.8m.

For further information contact Bill Rosenberg or Andrew Chick.