NEW ZEALAND COUNCIL OF TRADE UNIONS
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Commentary

Do price rises hit people on low incomes harder?

Summary

We often say that low income families are hit harder by rises in the prices of necessities than high income families. That is very topical with the big rises in food prices in the last year – 7.5 percent from June 2010 to June 2011 – and petrol up 20.1 percent between the two June quarters. They are hit differently because a bigger proportion of low income people's spending goes on necessities than it does for high income people. We've taken a look at how expenditure and prices affect three groups of households: low income (the bottom 30 percent), middle income (the middle 40 percent) and high income (the top 30 percent).

For the low income households, 15.1 percent of their expenditure goes on fruit, vegetables, meat and fish, and grocery food. In the top income households, these take only 10.9 percent of their expenditure. Low income households also spend proportionately more on housing. In low income households it takes 30.7 percent of their expenditure, but only 23.6 percent for high income households and 25.0 percent for the middle incomes. Interest payments are weighted much more heavily to high income households: 7.7 percent of expenditure compared to 3.7 percent for low income households.

Low and middle income households are more badly affected by rising prices as a result of these differences. Just how much depends on whether you include interest in their expenditure. For example, since December 2008, ignoring interest payments, prices rose by 7.7 percent for both low and middle income households, and 7.3 percent for high income households. But including interest payments, prices for low income households rose 6.4 percent, for middle income households 5.3 percent, and high income households just 4.7 percent.

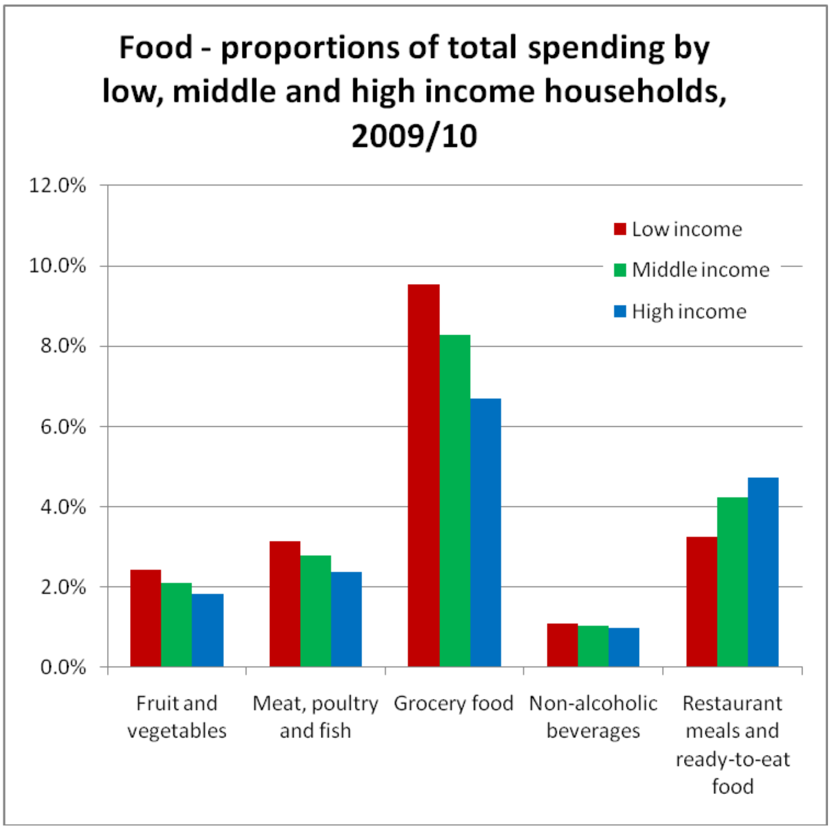
These results are approximate, but a more detailed analysis could show even greater differences. We are right to be concerned that the CPI doesn't show the full price changes faced by low income households.

We often say that low income families are hit harder by rises in the prices of necessities than high income families. That is very topical with the big rises in food prices in the last year – 7.5 percent from June 2010 to June 2011 – and petrol up 20.1 percent between the two June quarters. Why should they be hit differently? Because for low income people, a bigger proportion of their spending goes on necessities, and they spend a greater proportion of their income. People with higher incomes have more income over which they have greater choice. That could include saving, and spending on luxury items such as travel, dining out, and additional or more expensive cars and houses. How much different are these patterns of expenditure and what difference do they make?

The most readily available statistics on these matters is Statistics New Zealand's Household Economic Survey, which surveys the spending and income of New Zealand households. I'm using their latest detailed expenditure survey which is for the year to June 2010. It is available split by household income "deciles". Each decile is a tenth of the households (about 162,000 in each), ranked in order of the income they received. The bottom decile (decile 1) is the lowest income tenth of households (in 2010, they had incomes of $20,000 or less). The top decile (decile 10) is the highest income tenth (in 2010 these households had incomes of $147,700 and above). To simplify, I report results from just three groups of households – the **low income** 30 percent (deciles 1 to 3), the **middle income** 40 percent (deciles 4-7) and the **high income** 30 percent (deciles 8-10).

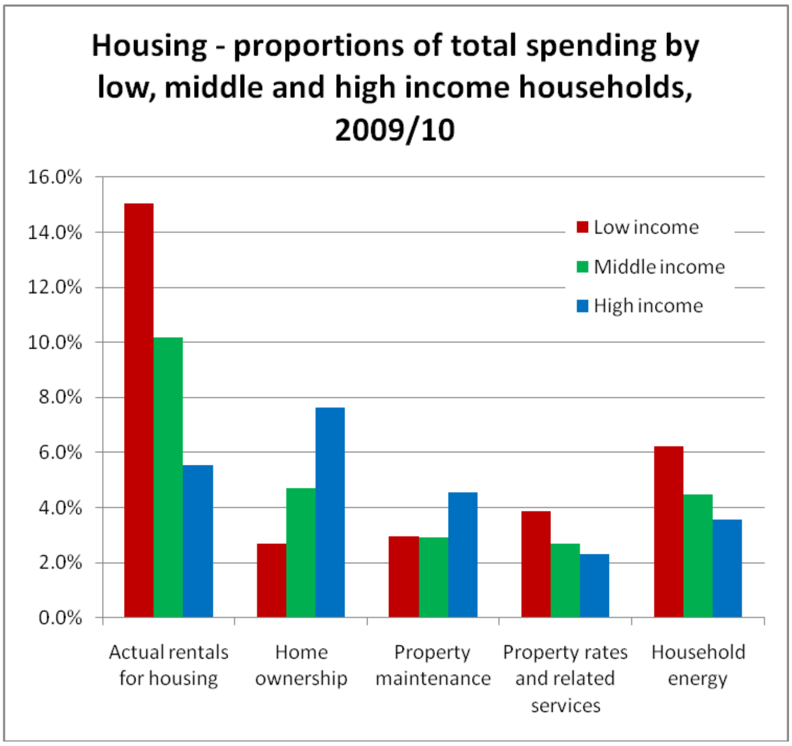
There are some problems looking just at household income deciles, and some other "health warnings" about the data which I describe in more detail in the box at the end of this commentary. The effects are that the method I use probably underestimates the income effect rather than overestimates it, and that these results will not be identical to the official Consumer Price Index (CPI), and must be treated as approximate. In addition, the official index does not include interest payments, but the following expenditure data does, in order to provide a more realistic view of household spending.

Do lower income households have different spending patterns than high income households? Yes.

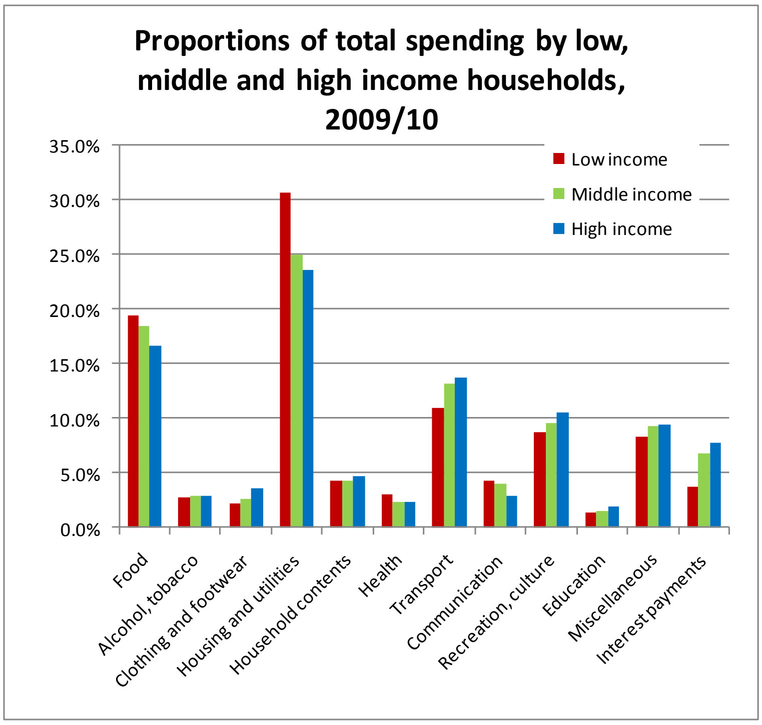


For the low income households, 19.4 percent of their expenditure goes on food – but only 16.6 percent in the high income households (and 15.1 percent in the top income decile). The difference is even greater looking at the essentials – leaving out non-alcoholic beverages and restaurant and fast foods. For the low income households, 15.1 percent of their expenditure goes on fruit, vegetables, meat and fish, and grocery food. In the top income households, these take only 10.9 percent of their expenditure. It is 13.2 percent in the middle income households. The biggest part of the difference is in grocery foods.

The second big area where low income households spend proportionately more is "housing and household utilities" which includes rents and the cost of building new houses or extending existing houses. It does not include mortgage payments which I will come to. In low income households, 30.7 percent of their expenditure is in this area – but only 23.6 percent for high income households and 25.0 percent for the middle incomes. However there are important differences within this area of spending. In low income households, 15.0 percent of their expenditure goes in rent, compared to just 5.5 percent in high income households. But for home ownership plus property maintenance, the position is reversed: it is 5.6 percent of expenditure in low income households compared to 12.2 percent in high income households. Low income households also spend a greater proportion of their income on household energy (electricity, gas, solid fuels – 6.2 percent compared to 3.5 percent) and property rates, water and refuse collection (3.9 percent compared to 2.3 percent).



Interest payments – which are mainly on mortgages – are not in the CPI, though there is a separate index available including them. If the index were to be a better reflection of the cost of living, they should be included. As the home ownership expenditure hints, they are weighted much more heavily to high income households: 7.7 percent compared to 3.7 percent for low income households.

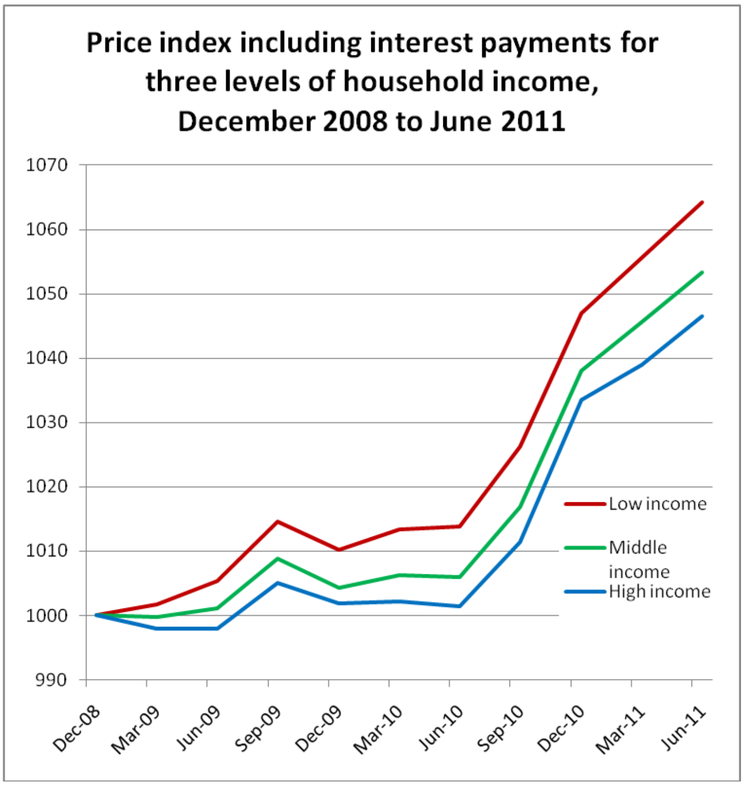


Almost all other areas of expenditure are proportionately greater in high income households than low income households: alcohol and tobacco (though it is close); clothing and footwear; household content and services (again, close); recreation and culture; education; and miscellaneous goods and services (which includes personal care such as hairdressing and appliances, jewellery, insurance, credit services, and professional services). Perhaps surprisingly, transport is also a greater proportional expense for high income households. They spend a lot more proportionately on buying cars, a shade less on servicing and fuelling them, and more on passenger transport services, probably reflecting more air travel which is about 80 percent of the category.

However, low income households spend proportionately more on health (3.0 percent compared to 2.3 percent) and communication (which is mainly telecommunications – 4.2 percent compared to 2.9 percent).

How do rising prices affect the range of households as a result of these differences? Low and middle income households are more badly affected. Just how much depends on whether you include interest in their expenditure. Even without interest payments, between March 2004 and June 2011, prices rose for low income households by 25.1 percent, for middle income households by 24.3 percent and for high income households, 23.7 percent. Looking back only to December 2008, the differences were less but still there: prices rose by 7.7 percent for both low and middle income households, and 7.3 percent for high income households.

But when interest payments are included, the picture becomes more stark. Going back to March 2004, there were similar differences in inflation experienced by the three groups: 23.9 percent for low income, 22.1 percent middle, and 21.2 percent for high income households. But from December 2008, the steep drop in interest rates brought about by the Reserve Bank to help ride out the growing financial crisis greatly favoured those with high debt levels – mainly the high income households. Prices including interest payments for low income households rose 6.4 percent, for middle income households 5.3 percent, and high income households just 4.6 percent.



The price index usually quoted is the "all groups CPI" which doesn't include interest payments. In the last year, June 2010 to June 2011, that rose 5.3 percent. As explained, our calculations are on a slightly different basis and our "all groups" CPI rose 5.1 percent on average for all households. But for low and income households, their prices rose 5.2 percent, while high income households saw price rises of 5.0 percent.

But when interest payments are included, while the official “all groups plus interest” price index rose 4.7 percent (as did our equivalent index), prices for low income households rose 5.0 percent, for middle income households 4.7 percent, and for high income households 4.5 percent.

Of course this is only part of the picture – household income from financial investments dropped too as interest rates fell, though the speed of change would have depended on how long the investments were locked in for. But the main holders of investment funds, high income households, also benefited more from tax cuts and got hit less by the GST increase, and wages have fallen behind price rises since 2009.

There is much more detail behind all this and the analysis could be strengthened, such as by taking account of household size. This could show even greater differences. But it seems that we are right to be concerned that the CPI doesn’t show the full price changes faced by low income households. Neither does it show the costs or benefits to households of changes in interest rates. While rates were dropping, high income households benefited in lower costs; when rates start to rise again, the same households will feel more of the pain unless they have taken the opportunity to pay down their debt. But in the meantime other prices are rising too, many disproportionately affecting low income households.

Technical note

The results here need to be treated as an approximation for the following reasons.

There are some problems looking just at household income deciles. A household with a $40,000 income (right on the border between the 4th and 5th deciles) would be struggling if that income had to support a couple and two young children – but it would be moderately well off if it was only one person. People studying these matters often use adjusted measures (called “equivalised household incomes”) to correct for this, but I do not have the data or time readily available to do this. Further, the bottom decile (decile 1) includes some relatively wealthy people who have declared losses from investment or self-employment, so it is not all that it seems.

Other caveats: the CPI uses a somewhat different weighting of items than the Household Economic Survey, and it is based on an older survey, so the results reported here will be slightly different for the “all groups” price index than the official one – but not substantially so. The CPI goes down three levels of detail into types of expenditure. We are only going down two levels for most areas, but only one level for a few (communication, recreation and culture, and education) where the detailed data is not available. This analysis is about expenditure, not incomes. Many households – especially low income households – spend more than their income, and so the difference in patterns of spending on essentials may be even more pronounced as a proportion of income. While the spending we analyse here is most of household expenditure (99.7 percent for low income households and 98.4 percent for high income) it doesn’t include savings, gifts, fines, expenditure while travelling overseas, a few other items (including prostitution and illicit drugs!) nor income from sales of personal items, trade-ins and refunds.

Bill Rosenberg

Forecast

This NZIER consensus forecast was published on 20 June2011.

Annual Percentage Change (March Year)	**2010-11**	**2011-12**	**2012-13**
GDP	1.1	2.1	4.0
CPI	4.5	2.8	2.7
Private Sector Wages	1.5	2.9	3.5
Employment	1.7	1.3	2.5
Unemployment	6.6	6.1	5.3

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

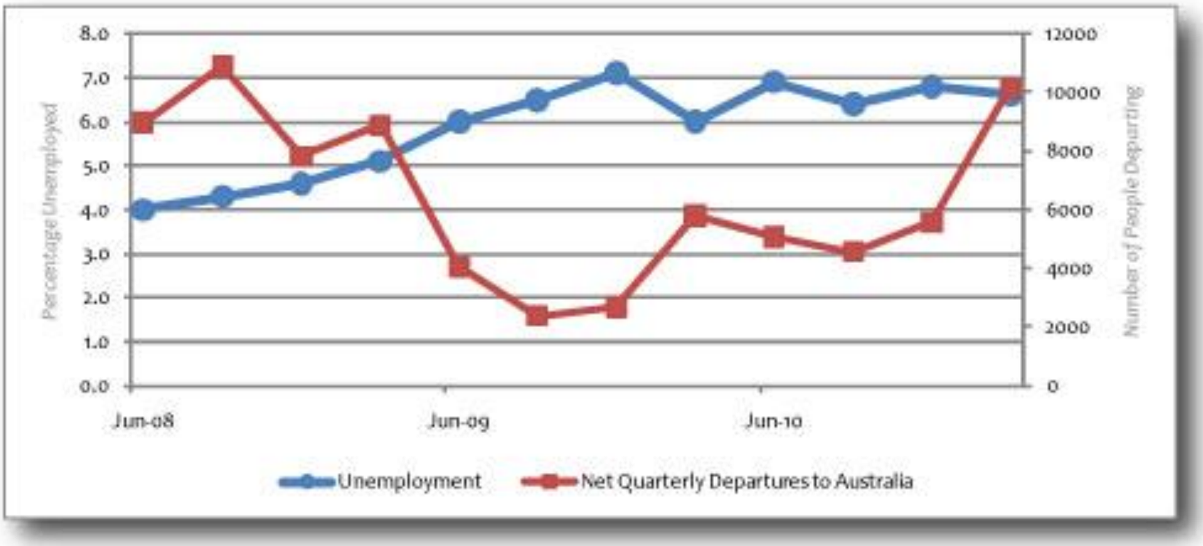
Economy

- ★ Gross Domestic Product was up 0.8 percent in the March 2011 quarter, leaving GDP growth for the year to March 2011 at 1.5 percent.
- New Zealand recorded a Current Account deficit of $1.8bn for the March 2011 quarter and a deficit for the year to March of $8.3bn (4.3 percent of GDP). This compares with a current account deficit of $4.5 billion (2.4 percent of GDP) for the year ended March 2010. Statistics New Zealand states that $1.6bn of that difference is due to "unusual banking-sector tax transactions" in 2009-10 year. Without those transactions, the annual deficit is $2.2 billion higher than the previous year, mainly due to increased profits and interest going to overseas investors plus a deficit in services trade and a reduction in non-resident withholding tax received.
- The country's Net International Liabilities were $148.2bn at the end of March 2011 – 76.2 percent of GDP and $10.4bn less than at the end of December 2010. This was the lowest since 30 June 2007, in part a result of an additional $7.6 billion due for outstanding reinsurance claims from the February earthquake. In all an estimated $11.1 billion is now due from reinsurance covering the September 2010 and February 2011 earthquakes. The government was still not a contributor to the net international liabilities – it had $3.3 billion more overseas assets than liabilities.
- ★ For June 2011 Overseas Merchandise Trade recorded a $230 million surplus – 5.8 percent of the value of exports for the month. For the year to June 2011, New Zealand recorded a surplus of $1bn (2.2 percent of exports). Exports of dairy products were up $90m or 11 percent while

imports of petroleum up $62m (9.3 percent) and imports of locomotives spiked up $43m in June compared to June 2010. During the three months to June, imports of capital goods decreased 20 percent compared to the March quarter, while imports of consumption goods were up only 0.2 percent. Exports increased 4.5 percent in the same period led by dairy products, meat, fruit and mechanical machinery and equipment, while logs, wood, and wood articles fell 0.9 percent – the largest decrease.

- ★ The Performance of Manufacturing Index for June 2011 fell to 54.3[1], down from 54.7 in May. However, the employment sub-index continued to rise reaching 51.7.
- ★ The Performance of Services Index for June 2011 was 54.7[1], up 1.7 from May. The employment sub-index also rose from 50.8 to 51.6.
- ○ The Retail Trade Survey found retail sales were up 2.0 percent between the December 2010 and March 2011 quarters and up 3.4 percent on the March quarter in 2010.
- ★ On July 28, 2011 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be on 15 September 2011.
- ★ The REINZ Housing Price Index recorded a 1.3 percent increase in house prices for the month of June 2011, with the median house price rising $10,000 to $360,000. But house prices were still down 0.1 percent for the year to June.

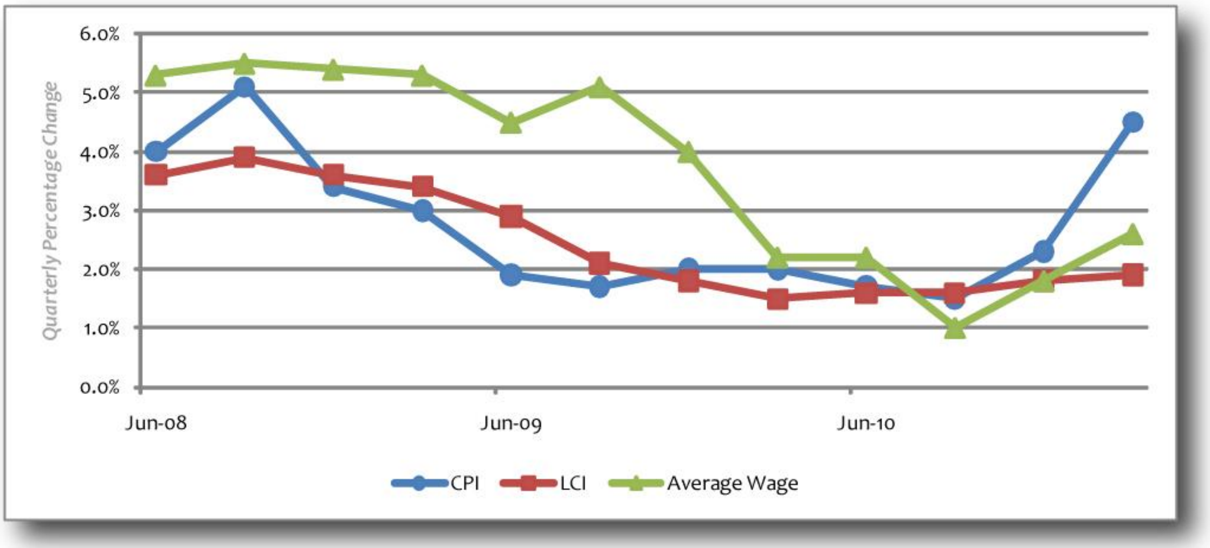
Employment



- ○ According to the Household Labour Force Survey the unemployment rate in the March quarter was 6.6 percent, down 0.1 percent on the December quarter. The participation rate was 68.7 percent – up 0.8 percent on December. Māori unemployment was 16.1 percent, Pacific unemployment was 14.0 percent, Asian unemployment was 9.3 percent and European/Pakeha unemployment was 4.9 percent. Youth unemployment (15-19 year olds) was 27.5 percent.
- ★ At the end of June 2011 there were 55,655 people on the Unemployment Benefit, a decline of 802, or 1.4 percent, from May 2011. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)
- ★ In the three months to the end of June 2011 Job Vacancies Online increased 2.3 percent and advertised vacancies for skilled jobs increased 1.5 percent.

★ International Travel and Migration figures show 5,436 permanent and long-term arrivals to New Zealand in June 2011 and 6,927 departures. Net migration in the year to June 2011 was 3,867 arrivals. Net migration to Australia in the year to April was 29,915 departures.

Wages

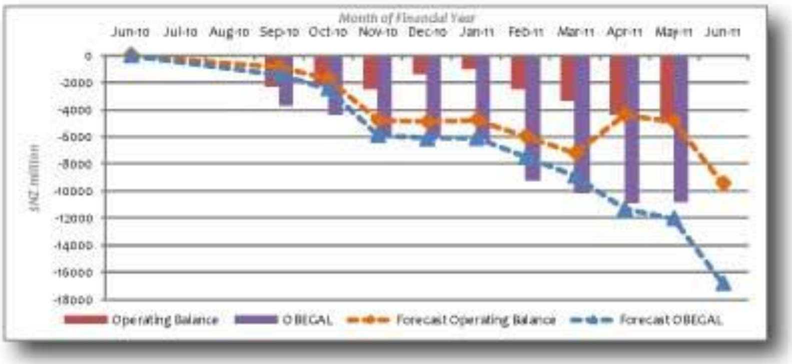


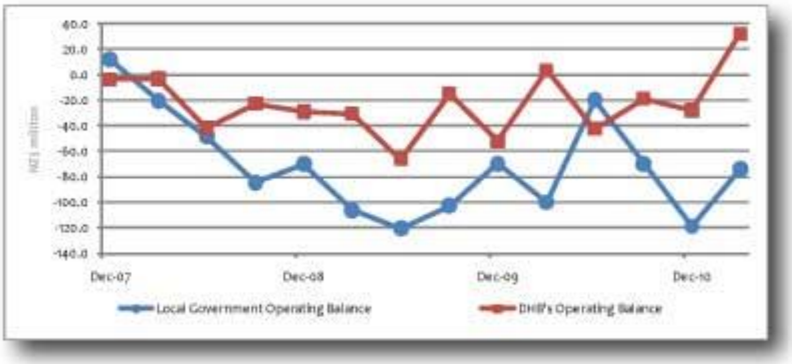
- The Labour Cost Index (Wage and Salary Rates) (LCI) rose 1.9 percent for the year to March 2011 and 0.5 percent for the March quarter. For those surveyed who received an increase in their salary or wage rate during the year, the median increase was 3.0 percent.
- The March 2011 Quarterly Employment Survey found the average hourly earnings for ordinary-time work was $25.93, up 0.4 percent on the December quarter. The average ordinary-time wage was $23.93 in the private sector (up 0.3 percent in the quarter and 2.5 percent in the year) and $33.46 in the public sector (up 2.3 percent in the quarter and 2.8 percent in the year). Per hour, female workers earned 87.5 percent of what male workers earned.

★ The Consumer Price Index for the June 2011 quarter rose 1.0 percent, and 5.3 percent for the year to June. For the quarter transport costs were up 2.7 percent, food costs 1.1 percent and utility costs 0.9 percent.

★ The Food Price Index rose 1.4 percent in the month of June, contributing to a 7.5 percent increase in food prices between June 2010 and June 2011. Between May and June fruit and vegetable prices rose 12.2 percent.

Public Sector





- According to Treasury's Month End Financial Statement for the eleven months to the end of May 2011, government revenue was down \$295m (0.6 percent) on the forecast in the Budget Economic and Fiscal Update (BEFU) (though tax revenue was up \$214m) and expenditure was down \$770m (1.2 percent). The operating deficit before gains and losses (OBEGAL) was \$10.8bn, \$1.3bn better than forecast. The operating deficit was \$5bn, \$113m worse than forecast. The Government's net debt is 20.4 percent of GDP, 0.1 percentage points better than budgeted in the BEFU.
- District Health Boards recorded an operating surplus of \$32.1m for the March 2011 quarter compared to a deficit in the December 2010 quarter of \$28m. Employment costs were \$1.19bn, down 0.8 percent for the quarter, compared to total expenses of \$3.18bn, down 1.4 percent.
- Local Government recorded a 1.1 percent increase in income and a 0.4 percent increase in operating costs for the March 2011 quarter, resulting in a deficit for the quarter of \$74.0m.

Notes

1 For the Performance of Manufacturing Index (PMI) and Performance of Services Index (PSI) a figure under 50 shows the sector is contracting; above 50 shows that it is growing. Previous month's figures are often revised and may differ from those published in a previous Bulletin.

Correction: in last month's Bulletin, the graph in the commentary comparing the Labour Cost Index with Australia's equivalent had an error. It did not affect the analysis presented in the commentary, but a corrected version of the graph is available in the online version of the bulletin.

An online version of this bulletin is available at http://www.union.org.nz/economicbulletin126
For further information contact Bill Rosenberg.