NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

CTU Monthly Economic Bulletin

No. 135 (May 2012)

Commentary

After the Budget: how well is the government managing the economy?

Summary

The media coverage of last week's Budget has emphasised its petty nastiness such as the removal of the tax exemption for newspaper girls and boys, and the move to stricter assets tests for people needing support when going into residential aged care.

But these are really just the bits that make easy headlines. Our biggest worry is the effect yet another "zero" budget will have on the economy when unemployment remains high and is rising. Treasury's analysis is that over the next four years, Budgets will be contractionary. It requires huge faith in private sector and export growth, and the Christchurch reconstruction, to be confident that the economy will not go into recession. Plan B, which was looking increasingly necessary because of international developments even as the Budget was presented, seems to be "the same, but more of it": more "zero Budgets" in 2013 and 2014. This is a recipe for the kind of downward spiral that is being rejected by European voters.

The Budget showed the Government's priorities. A wide range of measures hit low and middle income earners. Beware the ending of apparently minor regular adjustments such as for inflation which over several years become highly significant cuts in support and services. Despite "reprioritisation" of $4.4b over 4 years, there is little for low income earners such as carers in aged care. Our priorities would be getting the economy moving, looking after the people who are hardest hit, and investing in changes in the economy to build its export capacity and reduce its reliance on overseas capital.

An underlying question is whether the current Government has been a good economic manager over the period of the Global Financial Crisis (GFC) and its continuing aftermath. Although all OECD countries have experienced difficulties, New Zealand's economy was let off more lightly than most. However, the way that the New Zealand Government has managed these challenges has left us falling or at best remaining static in rankings within the OECD of important aspects of economic performance. I also comment on Treasury wage forecasts.

A lot has been said (as usual) about last week's Budget, and we put out media releases and our CTU Budget Report which covered our general reactions and many of the details. The media coverage has emphasised its petty nastiness such as the removal of the tax exemption for newspaper girls and boys, and the move to stricter assets tests for people needing support when going into residential aged care (buried at the bottom of a Ministerial media release).

But these are really just the bits that make easy headlines. Our biggest worry was the effect yet another "zero" budget would have on the economy when unemployment remains high and is rising. The concerns I outlined in the [last Economic Bulletin](#) were confirmed. Treasury's analysis is that over the next four years, Budgets will be contractionary. The Government's focus on rapidly reducing expenditure as a proportion of the economy (from 33.5 percent of GDP in the year ended June 2012 to 30.2 percent in the year ended June 2016) while revenue continues to increase will suck growth out of the economy, peaking next year with about two percentage points of potential growth being squeezed out. That puts huge reliance on the Christchurch reconstruction, private sector and export growth to achieve the Budget's highly optimistic growth forecasts peaking at 3.7 percent in September 2013.

Plan B, which was looking increasingly necessary even as the Budget was being presented due to international developments, seems to be "the same, but more of it": more "zero Budgets" in 2013 and 2014. This is a recipe for the kind of downward spiral that is being rejected by European voters, bringing hundreds of thousands of justifiably angry people out into the streets – and is being increasingly rejected by economists because putting the economy into recession (or depression in the case of Greece with 21 percent unemployment and Spain with 25 percent) is certainly not going to help repay debt and rebuild the economy. Even the usually conservative New Zealand Institute of Economic Research has been saying for some time that growth prospects are dismal. Its latest set of predictions said "the economy is stagnant", predicted only 2.5 percent growth in 2013, and slow progress with the Christchurch rebuild.

Our situation is of course nowhere near that of Greece, and the downward spiral won't be as intense as it has been in the U.K., but the issue of economic management is certainly raised by New Zealand's lack of progress. Below I will argue that although all OECD countries have experienced difficulties, New Zealand's economy was let off more lightly than most, but the way that the New Zealand Government has managed these challenges has left us falling or at best remaining static in rankings within the OECD of important aspects of economic performance.

The Budget certainly shows the Government's priorities, and while we argue that it has more room to move, lack of money does force choices that demonstrate what it thinks is most important. The Government boasted of $4.4 billion of "reprioritisation" of funds over the next four years, yet while the top 10 percent of income earners receive about $2.2 billion in tax cuts each year there is tightening up in a whole list of services that affect middle and low income families. Beware the ending of apparently minor regular adjustments such as for inflation. Examples include family tax credits for over-16 children, Working for Families abatement rates and thresholds in last year's Budget; this year the student allowance parental income threshold, early childhood education funding and the asset testing thresholds for residential aged care support; and over several years the funding of most government agencies. This eats away at the value of support and government services in a way that is difficult to resist year-by-year, but over several years becomes highly significant. Most of them hit low and middle income earners.

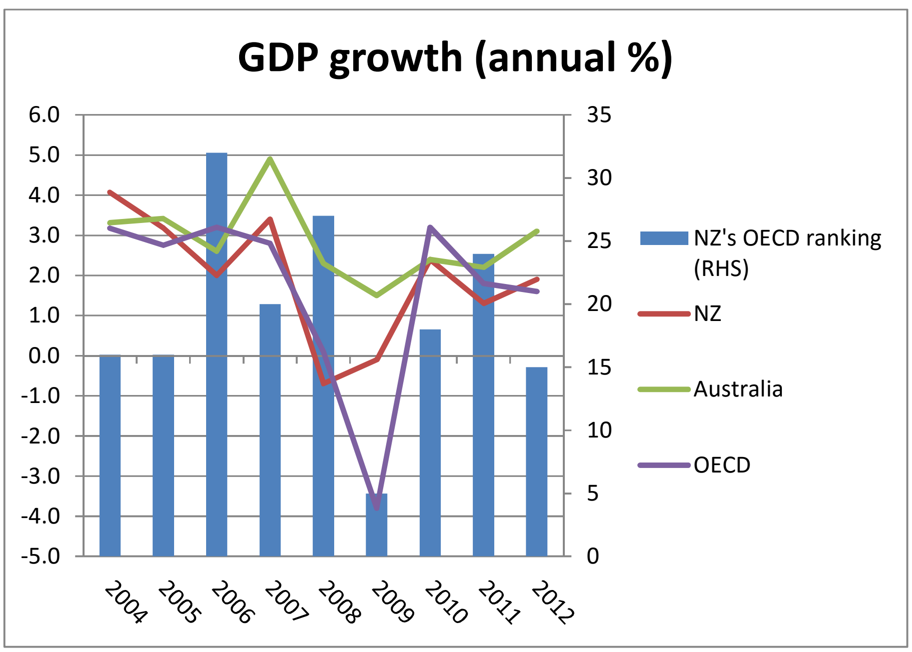
There are growing numbers of services funded by the government where low pay levels are a national disgrace. The sleepover case and the plight of people looking after aged people in residential care (highlighted by the superb piece of research by Equal Employment Opportunities Commissioner Judy McGregor) are examples. The Government has begrudgingly assisted with the back pay and put $90 million towards the transition to minimum wages in the sleepover case, but has refused to countenance addressing the disgraceful treatment of carers in private residential care. Yet whether the $4.4 billion is new money or "reprioritisation", these people on shamefully low incomes should be a high priority in getting some of it – if only as a partial redress for the huge tax hand-out to those who least needed it which has helped worsen the government's accounts.

In the same spirit, the IRD, with the money it has been given to chase after tax dodgers, has apparently been focusing on "tips in the hospitality industry and under the table payments to seasonal workers"[1] rather than tradespeople doing cash jobs – and we have to wonder what they are doing about corporate tax avoidance and the list of the 161 wealthiest people in New Zealand (with wealth over $50 million) which it monitors, only 67 of whom reported an income over $60,000 in 2008. We definitely don't condone tax avoidance – taxes support good public services, and the government's ability to tide us collectively and individually over hard times – but aiming at low paid seasonal, hotel and restaurant workers to fill the gap left by the tax cuts to top income earners is far from what most us would have in mind as a priority in a decent society.

Our priorities would be getting the economy moving, looking after the people who are hardest hit, and investing in changes in the economy to build its export capacity and reduce its reliance on overseas capital.

An underlying question is whether the current Government has been a good economic manager over the period of the Global Financial Crisis (GFC) and its continuing aftermath. One way to look at this is to look at New Zealand's relative position before and after the 2008-09 crisis. If we were particularly hard hit, then it would be reasonable to expect the aftermath to be particularly difficult. But if we were not as hard hit as similar countries (the OECD) and we are now doing worse, then the Government's economic management must come under scrutiny. Here is a quick look at some indicators, comparing us with the OECD and Australia. All come from the OECD, and 2012 data is their forecast. In each case I've plotted actual values as lines and the ranking for the indicator in the OECD is shown as bars with small being good (e.g. ranking 3 in unemployment means the third lowest unemployment rate).

They show that we weren't nearly as hard hit as most other OECD countries (hardly news – our banking system didn't collapse, though with help from the Reserve Bank and government) but we are either falling in our rankings or getting no better in relative terms despite that. Certainly the Canterbury earthquakes were an added burden, but their effect on most of these indicators would have been minor, short term and by now probably turning positive. Their biggest current effect is on debt levels (bad for

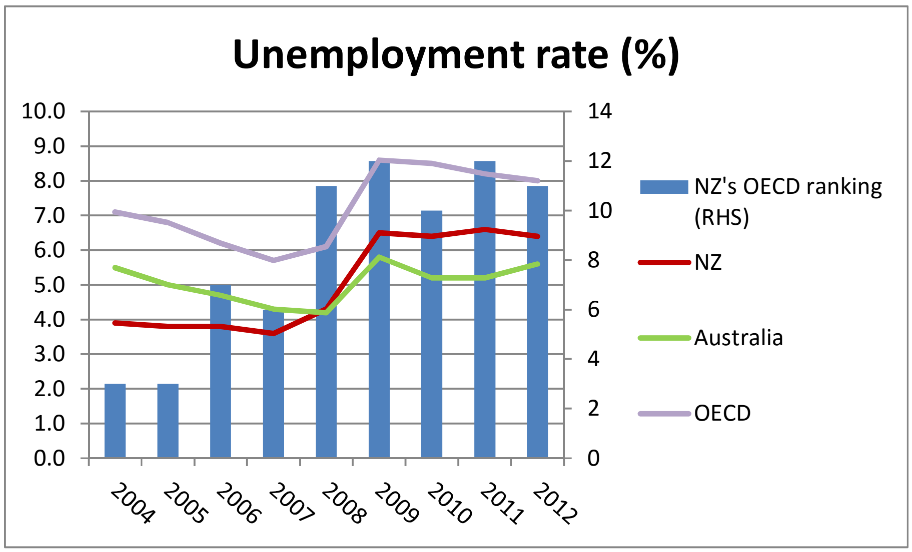


[1] "IRD to target 'hardcore' tax avoiders", Jazial Crossley, *Dominion Post*, 26 May 2012, p.C10

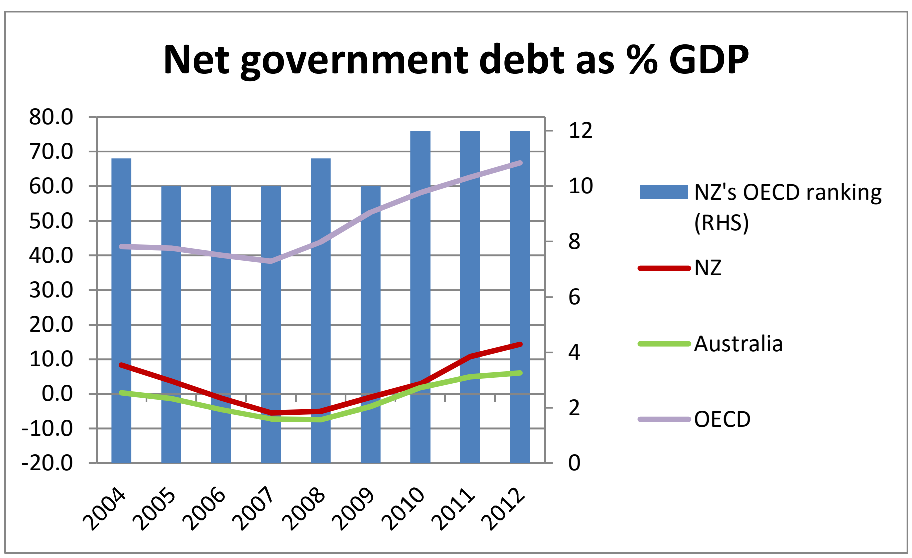
government debt, temporarily good for international debt as reinsurance money sits around in the books waiting to be spent), but even that is not big compared to the devastating effect on balance sheets of the banking meltdown.

New Zealand was not as hit as hard by the crisis as the rest of the OECD. The lines in the “GDP Growth” chart on the previous page shows the OECD going into deep recession in 2009 with an average GDP fall of 3.8 percent – while New Zealand’s economy contracted by just 0.1 percent. It had been hit earlier (in 2008) by falling commodity prices but in total was hit nothing like the rest of the OECD. Australia didn’t go into recession at all – probably because of the action taken by its Government. Looking at rankings (the bars; remember low is good), in 2009 New Zealand had the 5th best GDP increase (or least worse fall) in the OECD. By 2011 it was back to being one of the poorest performers (24 out of 34) and will be only middling (15th) in 2012 according to OECD forecasts. The Government says our GDP growth is more than many other OECD countries – but it is really just back in ranking to where it was before the crisis, and given that we got off so much more lightly should be much better ranked.

The level of unemployment reflects this. The lines on the Unemployment chart shows the steep rise in unemployment with the crisis. But for the first time in over a decade (and rare since these statistics began in 1986), New Zealand’s unemployment rate is higher than Australia’s. Even more tellingly, our unemployment rate has significantly worsened in ranking relative to the OECD: it was 3rd lowest in 2004 and 2005, but in 2011 was 12th and forecast to be 11th in 2012.

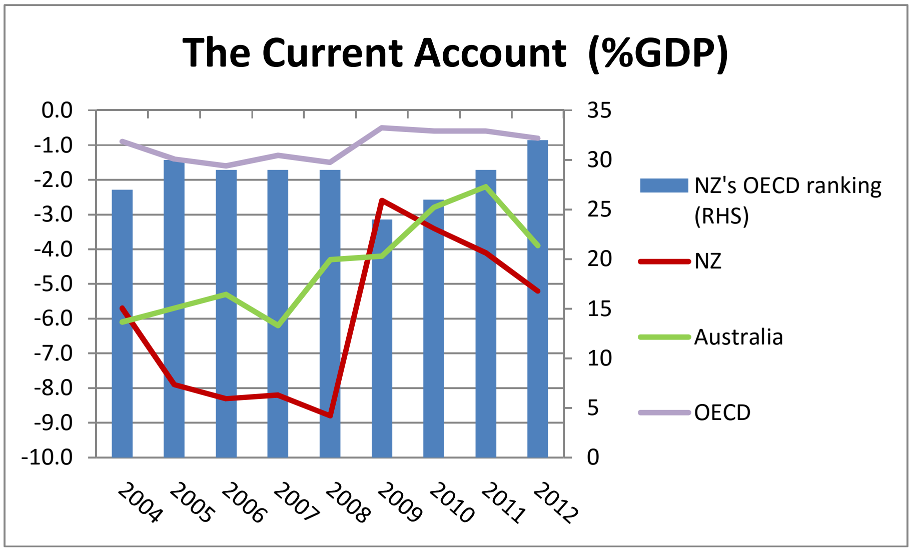


Is our level of government debt particularly bad and therefore holding us back? It’s actually very low (in 2011, 7th lowest in gross terms, and 12th lowest in net terms, which is graphed) – but has maintained those rankings with slight deterioration through the crisis. It certainly grew, but no worse than average. A large part of the increase



was due to the earthquakes. If debt management is the Government's main claim for success, there's no strong story there, and it had the great advantage of inheriting very low debt before the crisis hit.

One of the ways the global crisis was transmitted around the world was through international trade, which collapsed for some months in late 2008 and early 2009. That actually did wonders for New Zealand's trade balance – since then, we have exported much more than we have imported (though the gap is closing and the Treasury forecast is for falling exports in the year to March 2013) and there was much talk of it being a sign of the "rebalancing of the economy". A much bigger concern for New Zealand than government debt levels is the level of international debt which is largely private (and largely bank) debt. This is driven by the Current Account Balance (CAB) – the difference between what New Zealand earns and spends abroad. If it is in deficit it increases the international debt. The CAB should have improved with our much improved trade balance. For a short time, it did (the sharp move upward – less negative – in the graph), but all the forecasts are for it to steadily worsen back to the bad old levels. This is a crucial issue for Government policy, but it has failed to take the opportunity to make the "rebalancing" real, rather than a symptom of New Zealand's depressed economy not demanding as many imports, and China's hunger for quality food products. The graph shows the short-lived improvement in both the CAB (less negative) and its ranking in the OECD – but now deteriorating on both counts. And by the way, exports to China are not the reason for Australia's better performance since the crisis: theirs increased by 221 percent in value between 2008 and 2011; ours by 232 percent.



There is much more that can be said on the Government's management of the economy, but the picture is of missed opportunities and lack of action on both social imbalances (such as continuing high unemployment, low incomes and income inequality) and fundamental economic imbalances (such as the international debt).

A final note. Treasury forecasts are for quite large increases in the average ordinary time wage: 3.2 percent in the year to March 2013, 3.8 percent the year after, and 3.9 percent the year after that. I was asked how credible they are. I'll write more about this another time but the short answer is: not very. Treasury wage forecasts up to 18 months out have about one percentage point error and 3.2 percent in the year to March 2013 could be anything between about 2.5 percent and 4.0 percent. Forecasts two years ahead have about double the error – so 3.8 percent could be between about 2.0 percent and 5.5 percent. And that is on top of doubts about the credibility of the general economic forecasts on which these wage forecasts are based. Use with caution, and check other forecasts such as those below.

Bill Rosenberg

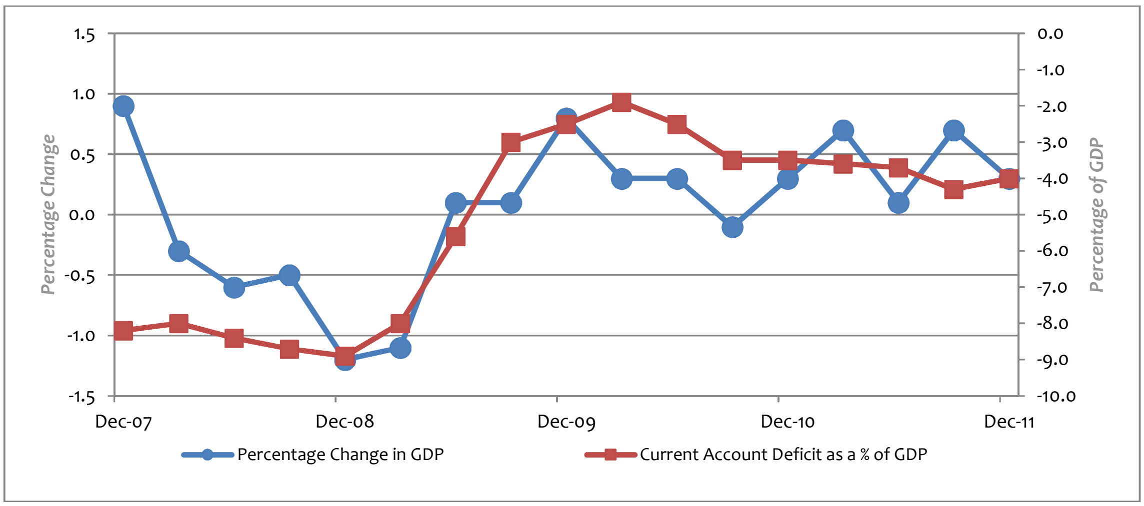
Forecast

★ This [NZIER consensus forecast] was published on 19 March 2012. The next one will be published on 18 June. Figures in *red italics* are actuals rather than forecasts.

Annual Percentage Change (March Year)	**2011-12**	**2012-13**	**2013-14**
GDP	1.8	2.7	3.2
CPI	*1.6*	2.1	2.5
Private Sector Wages	*3.8*	3.0	3.4
Employment	*0.9*	1.8	2.1
Unemployment	*6.7*	5.9	5.2

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

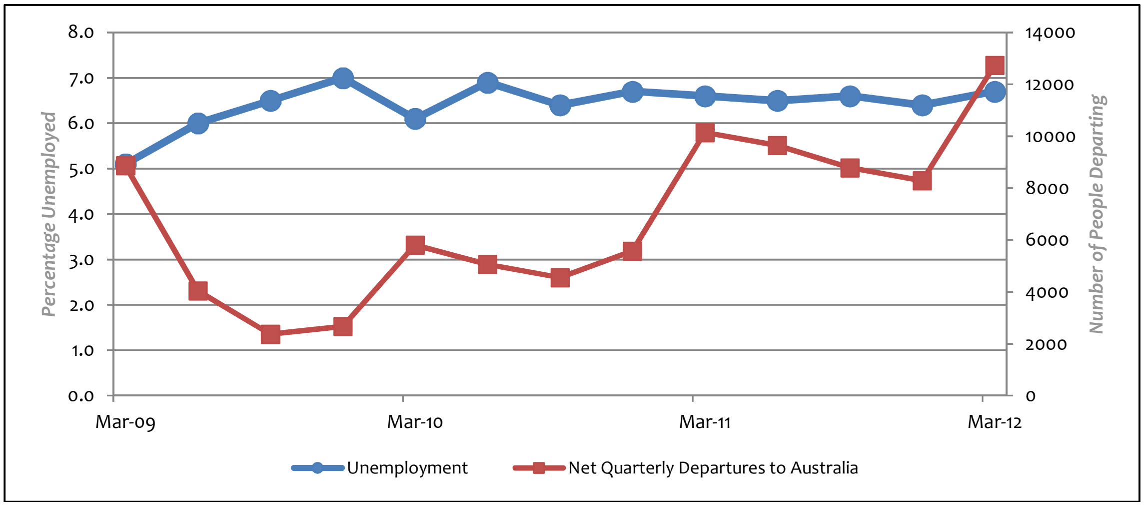
Economy



- Gross Domestic Product was up 0.3 percent in the December 2011 quarter, and GDP growth for the year to December 2011 was 1.4 percent. The largest contributor was finance, insurance, and business services which rose 1.3 percent in the quarter, with agriculture (up 3.5 percent) and retail, accommodation and restaurants (up 2.2 percent) also strong. However there were significant falls in manufacturing (down 2.5 percent), electricity, gas and water (down 2.4 percent) and government administration and defence (down 2.3 percent). Agriculture and retail, accommodation, and restaurants were both up 7.6 percent from the December quarter in 2010, while construction was down 8.0 percent for the year.
- New Zealand recorded a Current Account deficit of $2.8bn for the December 2011 quarter ($2.0bn seasonally adjusted) and a deficit for the year to December of $8.3bn (4.0 percent of GDP). This compares with a current account deficit of $6.8bn (3.5 percent of GDP) for the year ended December 2010. The annual deficit is mainly due to profits and interest going to overseas investors ($10.4bn deficit) plus a deficit in services trade ($1.0bn) partially offset by a positive balance on goods trade ($3.6bn), all of which worsened during the quarter.

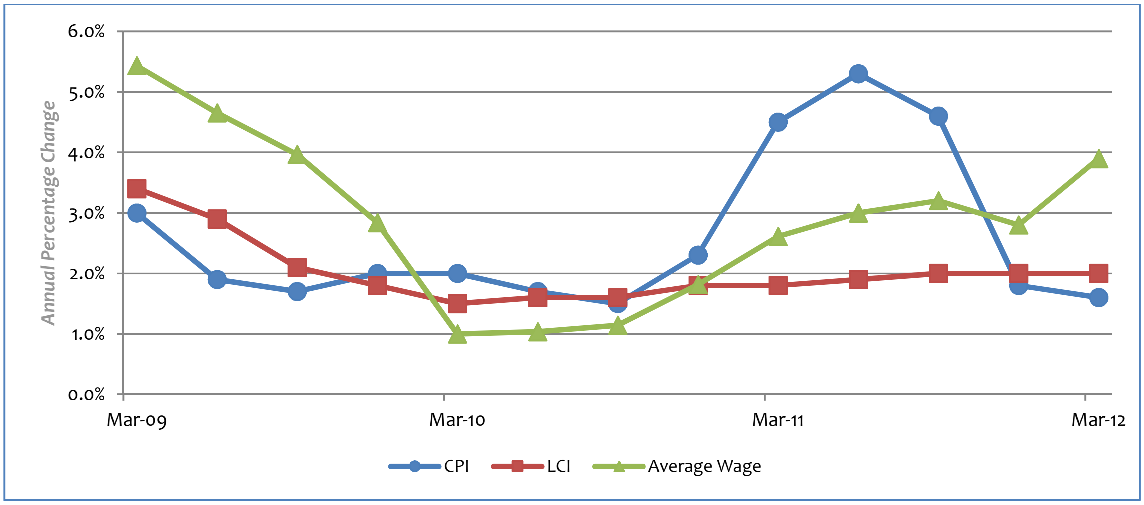
- The country's Net International Liabilities were $147.0bn at the end of December 2011 – 71.9 percent of GDP compared with $146.2bn or 72.0 percent of GDP in September and $146.5bn in December 2010. Reinsurance claims owed but not yet paid for the Canterbury earthquakes totalled $12.7bn at the end of December 2011. Without them, international liabilities would be $159.7bn. In December, the Government for the first time since December 2005 became a contributor to the net international liabilities with net overseas liabilities of $3.5bn despite $4.5bn of unpaid reinsurance claims which are counted as an asset.
- ★ For the month of April 2012, Overseas Merchandise Trade recorded a seasonally adjusted $201m deficit – 5.5 percent of the value of exports for the quarter. Exports fell by 0.6 percent or $20 million in the month. The largest fall was for milk powder, butter, and cheese, which were down $69 million, but fruit exports rose by $27 million. Imports fell by $145 million (3.6 percent). For the year to March 2012, New Zealand recorded a trade surplus of $355 million (9.1 percent of exports).
- ★ The Performance of Manufacturing Index for April 2012 fell to 48.0[1], a steep fall from 53.8 in March. The employment sub-index fell to 51.2 from 52.1 from in March.
- ★ The Performance of Services Index for April 2012 was 56.7[1], a rise from 54.2 in March. The employment sub-index also rose: 55.1 compared to 52.7 in March.
- ★ The Retail Trade Survey for March 2012 found retail sales were down 1.5 percent by volume and 0.8 percent by value between the December 2011 and March 2012 quarters. Volumes for core retailing, which excludes vehicle-related industries, fell 2.9 percent, the largest decrease since the series began in 1995. Similarly, supermarket sales volumes fell a record 7.4 percent. This can be seen as a return to levels prior to the Rugby World Cup. Retail sales were up 3.4 percent by volume and 4.4 percent by value compared to the March quarter in 2011.
- On 26 March 2012 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be announced on 14 June 2012 when the bank will also release a Monetary Policy Statement.
- ★ The REINZ Housing Price Index recorded a 0.3 percent fall in April 2012 after a 1.9 percent rise for the month of March, and the median house price fell to $365,000 from $370,000. The House Price Index was up 2.7 percent for the year to April.

Employment



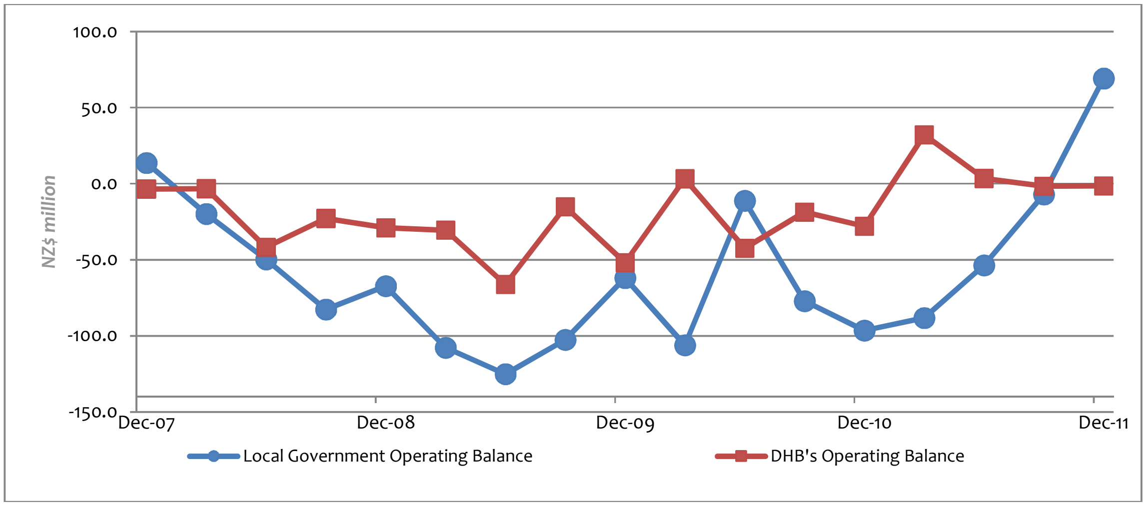
- ★ According to the Household Labour Force Survey the unemployment rate in the March 2012 quarter was 6.7 percent, up from 6.4 percent in the December 2011 quarter. The participation rate was 68.8 percent – up 0.6 percentage points on December, and the second-highest value ever recorded. There are 160,000 people unemployed. Māori unemployment was 13.9 percent (up from 13.4 percent), Pacific unemployment was 16.0 percent (up from 13.8 percent), Asian unemployment was 9.4 percent and European/Pakeha unemployment was 5.6 percent. Youth unemployment (15-19 year olds) was 23.4 percent (up from 24.2 percent). Note that the ethnicity and age statistics are not seasonally adjusted so comparisons between quarters should take seasonal factors into account. There are 87,000 people aged 15-24 years who are not in employment, education or training (NEET), which is 13.6 percent of that age group.
- ★ At the end of April 2012 there were 51,422 working age people on an Unemployment Benefit, a fall of 2,057, or 3.8 percent, from 53,479 in March. This is the third consecutive month in which there has been a reduction. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)
- ★ In April 2012, Job Vacancies Online fell by 2.4 percent for all vacancies and fell 3.1 percent for skilled jobs in seasonally adjusted terms.
- ★ International Travel and Migration figures show 6,430 permanent and long-term arrivals to New Zealand in April 2012 and 7,280 departures in seasonally adjusted terms, a net loss of 850. There was a net loss of 4,006 migrants in the year to April 2012. Net migration to Australia in the year to April was 39,800 departures, the highest-ever net loss of people to Australia. There was an increase of 9,865 permanent and long-term departures from New Zealand nationally for the year to April 2012 compared to the year to April 2011, the increase more than accounted for by Australia.

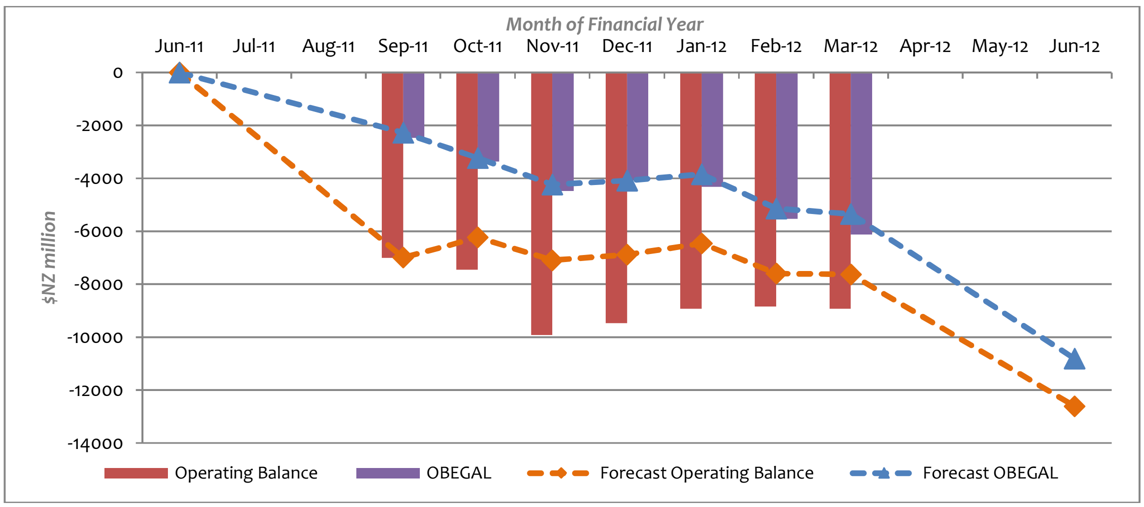
Wages



- The [Labour Cost Index (Wage and Salary Rates)]() (LCI) rose 2.0 percent for the year to March 2012 and 0.4 percent for the March quarter for salary and ordinary time rates. It rose 1.6 percent in the public sector and 2.1 percent in the private sector for the year. For the 57 percent of those surveyed who received an increase in their salary or wage rate during the year, the median increase was 3.0 percent.
- The March 2012 [Quarterly Employment Survey]() found the average hourly earnings for ordinary-time work was $26.92, up 1.4 percent on the December 2011 quarter and 3.8 percent over the year. The average ordinary-time wage was $24.84 in the private sector (up 1.3 percent in the quarter and 3.8 percent in the year) and $34.76 in the public sector (up 2.8 percent in the quarter and 3.9 percent in the year). Female workers (at $24.91) earned 87.1 percent of what male workers earned (at $28.61) for average ordinary time hourly earnings.
- The [Consumer Price Index]() for the March 2012 quarter rose 0.5 percent, and 1.6 percent for the year to March. For the quarter, the largest contributor to the increase was a 13.5 percent rise in cigarette and tobacco prices as a result of tobacco tax increases, though rents also rose 0.9 percent. Insurance rose 3.0 percent. Food costs rose 0.2 percent and education 3.1 percent, while communication prices fell 0.2 percent, clothing and footwear fell 0.6 percent, and recreation and culture fell 2.4 percent.
- The [Food Price Index]() fell by 0.1 percent in the month of April 2012 compared to March 2012, and there was no change in food prices between April 2011 and April 2012. Between March and April, Fruit and Vegetable prices rose 2.8 percent, Grocery food fell 0.7 percent, Meat, Poultry and Fish rose 0.7 percent, Non-alcoholic Beverages prices fell 2.6 percent, and Restaurant Meals and Ready-to-eat food prices fell 0.1 percent.

Public Sector





★ According to Treasury's [Financial Statements of the Government of New Zealand] for the nine months ended March 2012, Government revenue was down $1,826m (4.0 percent) on the forecast in the 2011 Pre-Election Economic and Fiscal Update (PREFU). This was mainly due to tax revenue being down $1,570m (3.8 percent) on forecast including corporate tax down $659m, source deductions (PAYE) down $236m reflecting weaker than forecast "labour market and employment and wage growth", and GST $569m down due to earthquake-related insurance refunds. Expenditure was down $1,752m (3.3 percent) on forecast, with the largest contributors being impairment of child support debt ($292m), a reduction in the carbon price under the Emissions Trading Scheme ($470m), Treaty settlements of $262m and transport projects ($163m) being behind schedule, education expenses down $126m due mainly to timing, and defence down $121m due to delays in delivery of equipment. The operating balance before gains and losses (OBEGAL) was a deficit of $6.1bn, $787m worse than forecast. The operating deficit was $8.9bn, $1.3bn worse than forecast due to $1.3bn in unforecast actuarial losses in the GSF, $388m higher than forecast actuarial losses on ACC's liability for outstanding claims due to a decrease in the discount rate, partly offset by net gains of $514m made by the New

Zealand Superannuation fund instead of a $711m net loss. The Government's net debt is 24.5 percent of GDP, 0.2 percentage points better than forecast in the PREFU.

- District Health Boards recorded an operating deficit of $1.4m for the December 2011 quarter compared to a deficit of $1.6m for the September 2011 quarter. Employment costs were $1.25bn, up 2.3 percent for the December 2011 quarter, compared to total expenses of $3.38bn, up 0.7 percent. Further information is on the Ministry of Health web site.
- Local Government recorded a 1.8 percent increase in operating income and a 2.0 percent fall in operating expenditure for the December 2011 quarter compared to September, resulting in an operating surplus for the quarter of $69.2m, compared to a deficit of $7m in the September quarter, all in seasonally adjusted terms. Without seasonal adjustment, their surplus for the December 2011 quarter was $11.0m, compared to a $143.7m deficit in the December 2010 quarter.

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.

This bulletin is available online at http://www.union.org.nz/economicbulletin135.
For further information contact Bill Rosenberg.