NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

# CTU Monthly Economic Bulletin

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## *Commentary*

### Our relationship with Australia; and preparing for the next bank crisis


***Summary***

Recently we've made submission on topics as varied as the relationship with Australia and protection of our bank deposits. This commentary covers some of the issues we raised.

**The relationship with Australia**

The Australian and New Zealand Productivity Commissions are jointly studying "deeper economic integration between the two countries". We made a joint submission with the Australian Council of Trade Unions.

We emphasised that we are independent sovereign nation states and that that must be respected. We made clear that "we do not accept the fundamentalist view that unfettered markets deliver the best of all possible worlds nor that the nature of reform consists in the reduction of 'barriers' that impede the free functioning of market forces." Integration must be to the highest common factor, not the lowest common denominator, and 'improved economic outcomes' must mean improved community welfare in a broad sense and not narrow economic efficiency.

In particular, we pointed out that missing from the discussion was any mention of the social protection floor including minimum wages, conditions of employment, and standards of social security provision, health services, and education. Rights at work including minimum wages and conditions of employment promote genuine productivity growth and insure against 'race to the bottom' competition.

**How safe is your money in the next bank crisis?**

Learning the lessons of the Global Financial Crisis, the Reserve Bank is putting measures in place to ensure banks respond rapidly if they get into trouble. Each bank will have to be able to close its doors, estimate how much it has lost, and reopen the next day making available to depositors – you and me – an amount that has been cut back enough to be covered by the assets the bank estimates it has left. The government would then guarantee the remaining deposits that are covered by bank assets. However other policies the Reserve Bank is pursuing mean that fewer assets will be available to protect our deposits. One example is "covered bonds" which are a form of derivative in which banks set aside some of their lowest risk assets as backing for lower cost borrowing. In a crisis, those assets would not be available to cover deposits, and losses to depositors would be greater. There's no need to panic but there's still a lot to be fixed in the financial system.

Recently we've made submission on topics as varied as the relationship with Australia and protection of our bank deposits. Here are some of the issues we raised.

## The relationship with Australia

The Productivity Commissions of Australia and New Zealand have been instructed by the two Prime Ministers to conduct a joint study on "strengthening trans-Tasman economic relations" which would "identify reforms that will boost productivity, increase competitiveness and drive deeper economic integration between the two countries".

While integration of the two economies is already very deep (think of banking for a starter) and has many benefits, it also raises concerns (again think of banking). While economic integration is often associated with the 1983 Australia-New Zealand "Closer Economic Relationships" (CER) agreement, that is only a small part of the picture. Among the benefits of the relationship is free migration for citizens of the two countries. The agreements enabling that date back well before CER. And many "arrangements" – formal and informal – have been made between the two countries, and between business and professional interests in the two countries, since the CER agreement.

Work towards a "single economic market" between the two countries continues. A recent addition was an agreement on investment. However according to the Issues Paper[1] published by the Commissions in asking for submissions, "there has been no comprehensive assessment of the extent to which businesses have made practical use of the concessions granted under the CER agenda and whether it has enhanced overall community welfare in Australia or New Zealand".

One of the concerns in this kind of process is that it will be used to force the pace of unpopular domestic changes. The officials negotiating the CER agreement in the 1970s and 80s included people like Roger Kerr, Tim Groser and Graeme Scott who had a wider political agenda of forcing through the kinds of reforms which Rogernomics and Ruthenasia brought us. It appears there is some such thinking in the current initiative, at least on the Australian side.

The NZCTU and our Australian counterpart, the ACTU made a joint submission[2]. We emphasised that we are independent sovereign nation states and that the study must respect our distinctive national identities and assume continued national policy autonomy. We made clear that "we do not accept the fundamentalist view that unfettered markets deliver the best of all possible worlds nor that the nature of reform consists in the reduction of 'barriers' that impede the free functioning of market forces." Integration must be to the highest common factor, not the lowest common denominator, and "improved economic outcomes" must mean improved community welfare in a broad sense and not narrow economic efficiency. Welfare considerations should include how fairly the burden or benefit is shared: distributional issues have been significant impacts of trade and investment liberalisation.

[1] "Strengthening economic relations between Australia and New Zealand", April 2012: see http://www.transtasman-review.productivity.govt.nz/.

[2] See http://union.org.nz/policy/actunzctu-submission-impacts-and-benefits-further-economic-integration-australian-and-new-zealand-economies

While covering issues such as the need for "harmonisation" of qualifications and standards to allow each country to raise the quality of standards and to reflect their unique needs, opposing a single currency in the light of Greek experience, and pointing out the need for an open process in any future changes, we were probably the only submitters to focus on labour issues.

The data in the Issues Paper suggests that the effect of increasing integration has been to encourage the outflow of people from New Zealand to Australia – it seems to be a bigger effect than any increase in trade or investment. Geographic issues – the magnet effects of large conglomerations of population – may be more important than conventional trade or investment. The Issues Paper mentions "hollowing out" of the New Zealand economy, which we believe should be treated with the utmost seriousness.

But missing from the Issues Paper is any mention of the social protection floor including minimum wages, conditions of employment, and standards of social security provision, health services, and education. Its mention of labour standards is one-sided and offensive, being limited to phrases such as "labour market rigidities" or "variations and impediments to efficiency in employment laws and workplace standards such as occupational health and safety". We pointed out that rights at work including minimum wages and conditions of employment are a fundamental regulatory measure in both countries. They promote genuine productivity growth and insure against "race to the bottom" competition.

Any competition should be based on a level playing field of social and labour market institutions, so that it is not competition to force down the social wage. It is one thing to acknowledge that there will be different wage levels in different parts of Australasia – just as Tasmania tends to be the poor cousin in Australia – but another to accept that the resulting differences in income and working conditions can be tolerated without marked social effects and loss of population to higher income regions. Differences in productivity and living standards will inevitably exist within the region, but the more governments cede domestic regulatory powers to liberalisation and harmonisation, the more important government support, labour market and social service underpinnings become. For a state like Tasmania there is some compensation in funding from the Australian federal government and a range of federal employment laws, institutions and social services that prevent those areas becoming the source of competition. For New Zealand, in the Australasian context, there is not.

This raises the very difficult issue of "fiscal union" – sharing tax revenue and expenditure between the countries – which has profound democratic and political implications. There are other pressures leading in the same direction. For example, if the concept of 'one labour market' is to be advanced, there are issues of who pays for the education and training needed (especially given our chronic loss of workers to Australia). Business interests are pushing for changes in company tax to allow dividend imputation credits for companies on one side of the Tasman to be claimed by owners on the other side – a move with significant tax revenue implications. There is a limit to integration without considering these critical issues – and dangers if they are not considered.

There are similar matters to be considered when further integration and opening of services markets is proposed. Integration of banking and other financial services, and further deregulation of investment may reduce or remove our ability to control our own monetary and banking systems and exchange rate.

We also urged the Commissions to take a broader view of raising productivity. The "workplace" and how well work is organised, the quality of leadership and management, workplace culture, and how organisations with similar inputs of labour and capital can achieve remarkably different results, are fundamental and at least as important as innovation and technology.  Capital per worker, the role of institutions, fairness, returns to workers, and how governments can establish an economic development environment that promotes an integrated strategy across industry and regions are all important aspects that should be considered.

Other forms of deeper integration that are floated in the Issues Paper may also bring pressures towards common government expenditure commitments. For example the paper raises the idea of "more integrated government education and health services" and "integration in the higher education sector, government-owned research institutes and science policy agencies". While we said we were interested in discussing these areas as part of a common social protection floor, we would strenuously object if they were a Trojan horse for privatisation or commercialisation of public services. We would also be greatly concerned if it implied the loss of nation state control of public services. Joint regulation and joint provision of services raise not only practical, social and economic issues but important constitutional ones as well.

## How safe is your money in the next bank crisis?

The Global Financial Crisis reminded us that banks are not infallible institutions. Around the world, many failed. In New Zealand, banks didn't fail but most finance companies did (usually as a result of their own incompetency rather than external pressures). We shouldn't be over-confident that the banks in New Zealand will never fail, either in another system crisis or from mismanagement. They came closer than anyone would like, to being unable to renew their borrowing from international money markets. In both New Zealand and Australia they had become unhealthily dependent on these short term overseas funds to fund mortgages. Only Reserve Bank support tided them over. However governments around the world are either in effect being bankrupted, or in mortal fear of it, as a result of bailing out banks.

As a result, the Reserve Bank is reviewing these matters. One mechanism they have decided to put in place (obscurely called "Open Bank Resolution") is designed to respond rapidly if a bank gets into trouble. Each bank will be required to have systems in place to close the doors before panic sets in, estimate how much it has lost, and reopen the next day making available to depositors – you and me – an amount that has been cut back enough to be covered by the assets the bank estimates it has left. The government would then guarantee the remaining deposits that are covered by bank assets. The result should be that the bank's shareholders suffer first (though not necessarily most), depositors have as little disruption to their lives as possible and are not tempted to withdraw their money causing a fatal run on the bank, and the exposure of the government (and taxpayers) to bank bailouts is greatly limited.

The amount deposits are cut back by (the “haircut” bank customers suffer, in the brutal jargon of the industry) is of course very important. We pointed out that a 2006 survey showed that most people have less than $600 in the bank (the median bank accounts of individuals was $580). That kind of amount is needed just for meeting regular bills and emergencies – it is not discretionary money or savings that would be very unpleasant to lose, but not immediately crippling. We suggested, along with banking expert David Tripe, that there should be a minimum amount guaranteed for all depositors (e.g. $50,000), and only amounts above that should be subject to the “haircut”.

However another of their policies might undermine this one. A bill at present going through Parliament with the support of the Reserve Bank and the banks themselves provides legal backing for “covered bonds”. These are a type of derivative in which the bank sets aside some of its best assets and uses them as security against its own borrowing (much like people use their houses as security for their mortgages). The borrowing is often from overseas. The advantage to the bank is that it can borrow at a lower interest rate. The problem is that these assets, which are chosen to be the least likely to lose their value in a crisis, are no longer available to back your deposit in the bank. So the “haircuts” on deposits will be greater – you may lose more in a crisis. Victoria University economist Geoff Bertram made a hard-hitting submission on these matters to the Select Committee. It turns out that there are other bank assets that may not be available to back depositors in a crisis – for example ones that are used to back overnight loans that banks make to each other (“repos”), and assets transferred to associated companies (such as Australian parent banks). We submitted to the Reserve Bank that it should review its policy of allowing covered bonds, and these other situations which put wholesale funders of the bank in a privileged position, should also receive attention. The Reserve Bank has yet to make public the result of its deliberations.

There’s no need to panic (your money is still safer in the bank than under your mattress) but there’s still a lot to be fixed in the financial system.

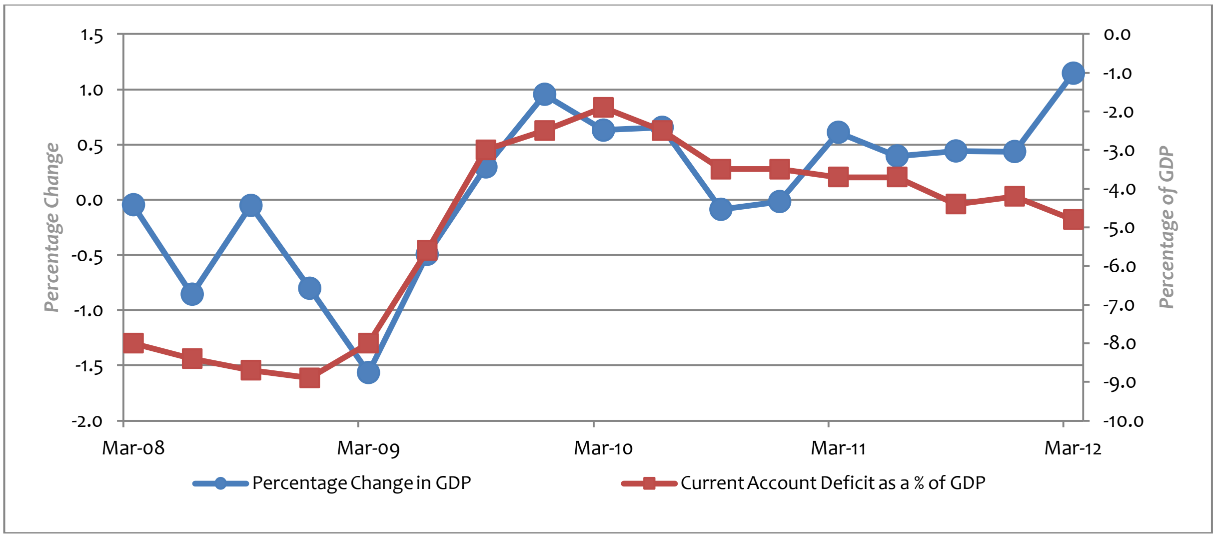
## Forecast

★ This NZIER consensus forecast was published on 18 June 2012. Figures in *red italics* are actuals rather than forecasts.

| **Annual Percentage Change** (March Year) | **2011-12** | **2012-13** | **2013-14** |
|---|---|---|---|
| GDP | *1.7* | 2.1 | 3.1 |
| CPI | *1.6* | 2.1 | 2.4 |
| Private Sector Wages | *3.8* | 3.2 | 3.1 |
| Employment | *0.9* | 1.3 | 2.2 |
| Unemployment | *6.7* | 6.2 | 5.5 |

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

## Economy



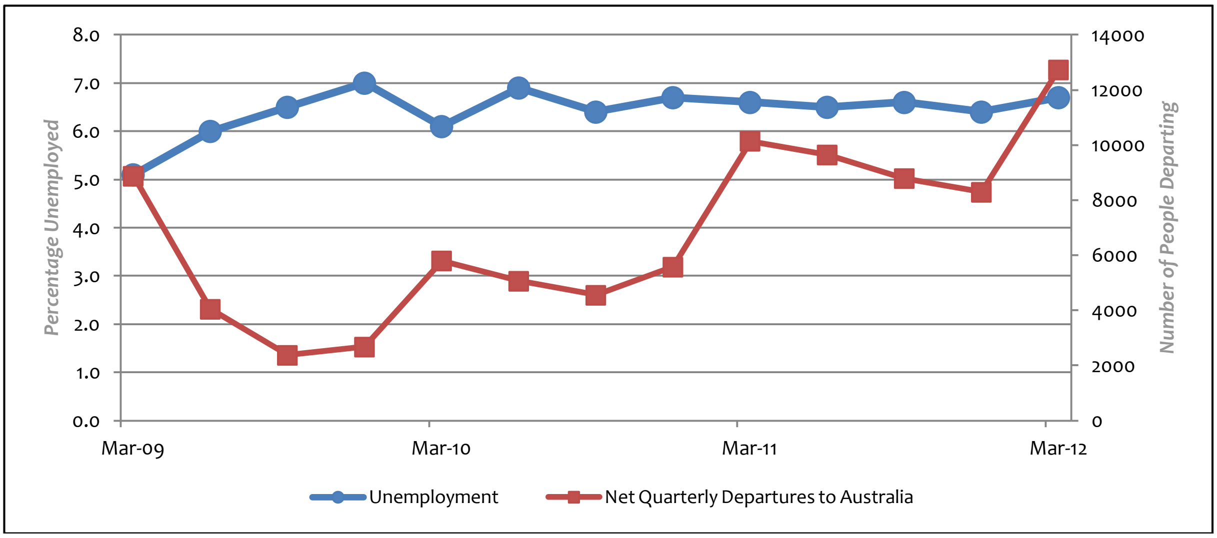

- Gross Domestic Product was up 1.1 percent in the March 2012 quarter, and GDP growth for the year to March 2012 was 1.7 percent. The quarterly rise was well above expectations, and is not expected to be repeated. Primary industries rose 2.4 percent in the quarter, with agriculture increasing 2.3 percent in the quarter and 7.5 percent in the year, driven by higher milk production. However primary industries fell 0.5 percent for the year, largely because of a fall in output from mining, which was down 12.7 percent for the year. Goods-producing industries rose 1.0 percent in the quarter, the first increase since December 2010, leaving the sector 11.6 percent below its December 2007 peak. It fell 0.6 percent for the year. Manufacturing increased 1.8 percent in the quarter but electricity, gas, water and waste services fell 0.7 percent and construction 0.1 percent. Food, beverage and tobacco manufacturing rose 3.2 percent and metal manufacturing rose 6.1 percent but petroleum, chemical, polymer, and rubber product manufacturing fell 1.4 percent, and transport equipment, machinery, and equipment product manufacturing was down 1.5 percent. Manufacturing had its first annual rise (3.1 percent) since March 2008. Construction fell 8.1 percent in the year and is 25.0 percent below the December

2007 peak and at December 2003 levels. Services rose 0.4 percent in the quarter and 2.2 percent for the year. Household consumption expenditure rose only 0.1 percent in the quarter, including a 0.5 percent fall in purchases of non-durable goods. However it rose 2.2 percent for the year. Investment (gross fixed capital formation) rose 1.7 percent in the quarter, but is still 16.8 percent lower than its December 2007 peak. Investment in residential buildings fell 0.6 percent for the quarter and 11.9 percent for the year. However business investment rose 2.1 percent for the quarter and 2.4 percent for the year.

- New Zealand recorded a Current Account deficit of $2.8bn for the March 2012 quarter in seasonally adjusted terms, $624m worse than the December 2011 quarter. For the year to March the deficit was $9.7bn (4.8 percent of GDP) compared with $7.2bn (3.7 percent of GDP) for the year ended March 2011. The annual deficit is mainly due to profits and interest going to overseas investors (a $10.8bn deficit, not seasonally adjusted, resulting from $16.1bn going overseas less $5.3bn coming in from New Zealand investments abroad) plus a deficit in services trade ($1.3bn). This is partially offset by a positive balance on goods trade of $2.7bn.
- The country's Net International Liabilities were $143.2bn at the end of March 2012 – 70.9 percent of GDP compared with $146.3bn or 72.9 percent of GDP in December 2012, and $133.3bn or 68.0 percent of GDP in March 2011. Reinsurance claims owed but not yet paid for the Canterbury earthquakes totalled $11.9bn at the end of March, compared to a revised $13.1bn at the end of December 2011. These have been falling since June 2011 when they stood at $15.0bn. Without them, international liabilities would be $155.1bn. Total claims from all Canterbury earthquakes was estimated to be $15.7 billion, of which a total of $3.8 billion had been settled with overseas reinsurers. In March, the Government had net international liabilities of $3.8bn, $272 million more than the previous quarter, the first time it had had net international liabilities since December 2005.
- ★ For the month of June 2012, Overseas Merchandise Trade recorded a seasonally adjusted $92 million surplus – 2.2 percent of the value of exports. Exports rose by 13.6 percent or $494 million in the month and imports rose by 1.7 percent or $66 million compared to May. However for the three months to June, exports fell 1.6 percent and imports fell 1.9 percent in seasonally adjusted terms compared to the March quarter, and there was a trade deficit of $664 million, or the equivalent of 5.9 percent of exports. The fall in exports was driven led by milk powder, butter, and cheese, which were down 5.7 percent in both value ($164 million) and quantity. Fish (down 6.2 percent), wool (down 11 percent) and meat (down 1.5 percent) were also down in value, while casein (up 32 percent), fruit (up 14 percent) and logs, wood, and wood articles (up 3.4 percent) rose in value. Among imports, crude oil was down 30 percent, but tends to be very variable, while consumption goods (consumer items) were up 3.2 percent and capital goods up 1.6 percent including machinery and plant (up 13 percent) and transport equipment (down 37 percent). For the year to June 2012, New Zealand recorded a trade deficit of $747 million (1.6 percent of exports).
- ★ The Performance of Manufacturing Index for June 2012 decreased to 50.2[1], a sharp decrease from 55.8 in May. The employment sub-index also decreased to 48.9 from 52.0 in May.
- ★ The Performance of Services Index for June 2012 was 54.3[1], a decrease from 56.6 in May. The employment sub-index rose to 52.8 in the month of June from 50.4 in May.

- The Retail Trade Survey for March 2012 showed retail sales were down 0.6 percent by volume (the largest fall since March 2009) and 0.1 percent by value between the December 2011 and March 2012 quarters. Supermarket sales volumes fell a record 3.9 percent, the largest since the series began in 1995. Volumes for core retailing, which excludes vehicle-related industries, fell 1.4 percent, the largest decrease since June 2008. This can be seen as a return to levels prior to the Rugby World Cup. Retail sales were up 4.2 percent by volume and 5.2 percent by value (to $17.2bn) compared to the March quarter in 2011.
- ★ On 26 July 2012 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be announced on 13 September 2012 which will also include a Monetary Policy Statement.
- ★ The REINZ Housing Price Index recorded a 0.3 percent rise in June 2012 after a 1.7 percent rise for the month of May, and the median house price rose to $372,000 from $369,000. The House Price Index was up 5.3 percent for the year to June.

## Employment

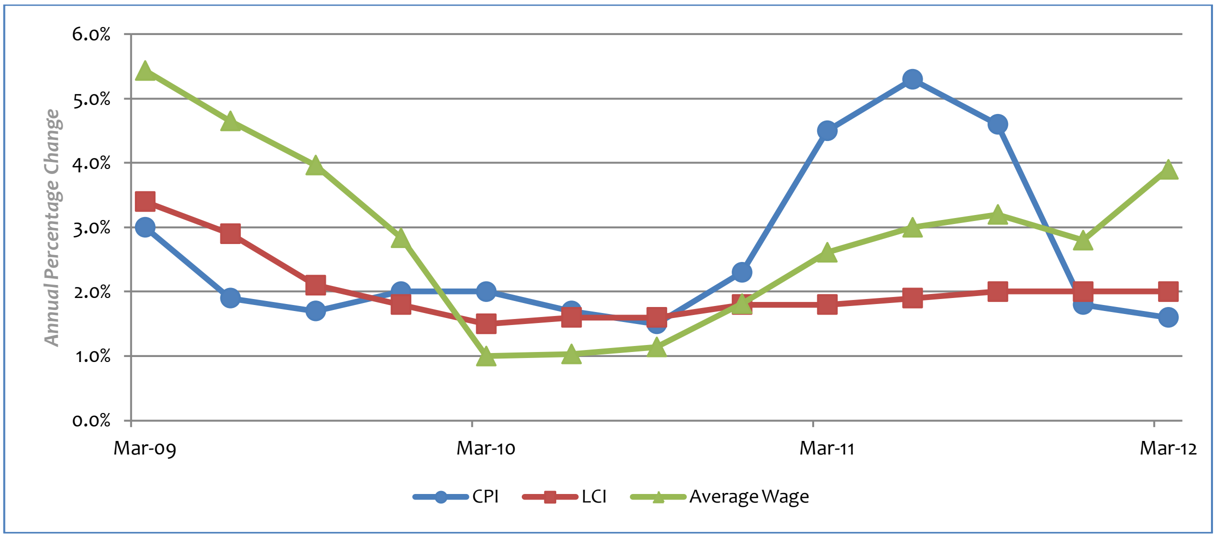



- According to the Household Labour Force Survey the unemployment rate in the March 2012 quarter was 6.7 percent, up from 6.4 percent in the December 2011 quarter. The participation rate was 68.8 percent – up 0.6 percentage points on December, and the second-highest value ever recorded. There are 160,000 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 June 2012 there were 49,622 working age people on an Unemployment Benefit, a rise of 403, or 0.8 percent, from 49,219 in May. This is the first rise in the number of people on the unemployment benefit since January 2012. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)

★ In June 2012, Job Vacancies Online fell by 4.5 percent for all vacancies and 2.1 percent for skilled jobs in seasonally adjusted terms.

★ International Travel and Migration figures show 7,720 permanent and long-term arrivals to New Zealand in June 2012 and 7,240 departures in seasonally adjusted terms, a net gain of 490. There was a net loss of 3,191 migrants in the year to June 2012. Net migration to Australia in the year to June was 39,809 departures. There was an increase of 7,444 permanent and long-term departures from New Zealand nationally for the year to June 2012 compared to the year to June 2011, the increase more than accounted for by Australia.

## Wages

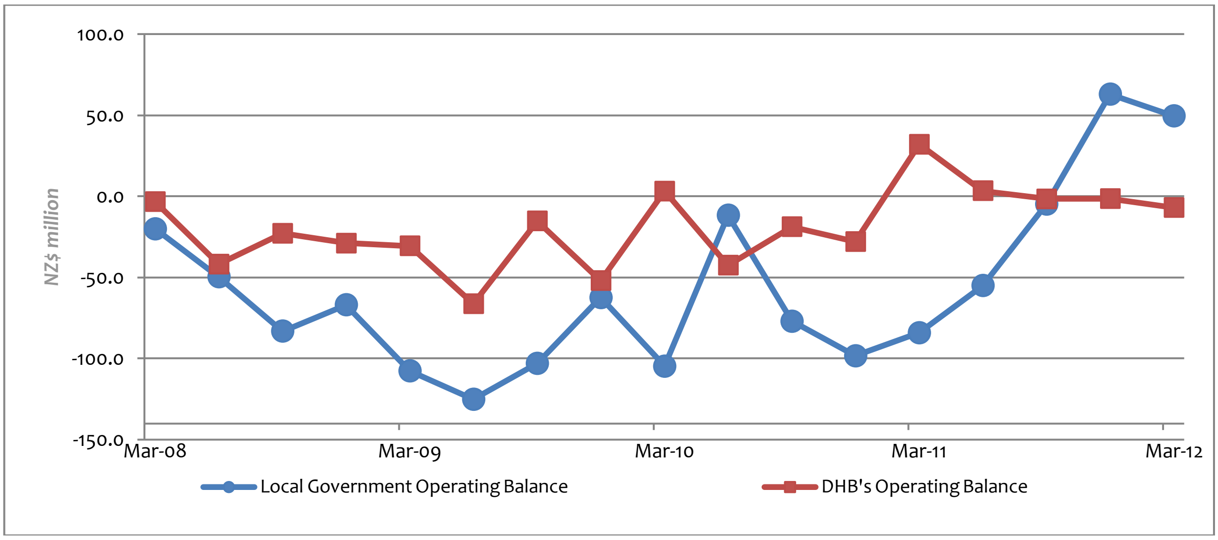


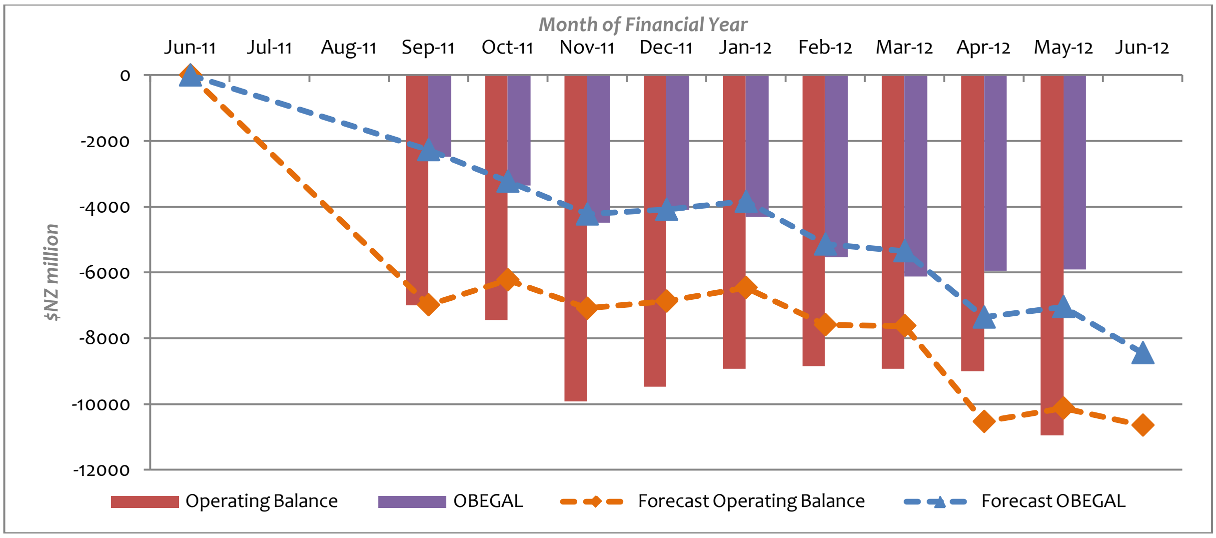

- The Labour Cost Index (Wage and Salary Rates) (LCI) rose 2.0 percent for the year to March 2012 and 0.4 percent for the March quarter for salary and ordinary time rates. It rose 1.6 percent in the public sector and 2.1 percent in the private sector for the year. For the 57 percent of those surveyed 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 June 2012 quarter rose 0.3 percent, and 1.0 percent for the year to June. This was the smallest annual change since a 0.5 percent increase for the year to December 1999 quarter. For the quarter, the largest contributor to the increase was a 4.5 percent rise in electricity prices. Vegetable prices also rose 11 percent as a result of higher prices for tomatoes (98 percent rise). Food and education prices each rose 0.1 percent , while communication prices fell 2.5 percent, and recreation and culture prices fell 0.3 percent.

★ The Food Price Index rose by 1.4 percent in the month of June 2012 compared to May 2012, and food prices decreased 0.2 percent in the year between June 2011 and June 2012. Between May and June, Fruit and Vegetable prices rose 9.0 percent, Grocery food rose 0.3 percent, Meat, Poultry and Fish rose 1.3 percent, Non-alcoholic Beverages prices fell 1.5 percent, and Restaurant Meals and Ready-to-eat food prices rose 0.3 percent.

## Public Sector




★ According to Treasury's Financial Statements of the Government of New Zealand for the eleven months ended May 2012, Government revenue was up $689m (1.3 percent) on the forecast in the 2012 Budget Economic and Fiscal Update (BEFU). The difference to forecast was mainly due to tax revenue being $667m (1.3 percent) above forecast, including corporate tax up $389m and GST up $192m on forecast. Expenditure was $431m (0.7 percent) lower than forecast. As a result, the operating balance before gains and losses (OBEGAL) was $1.1bn better than forecast, showing a deficit of $5.9bn.. The operating deficit was $10.9bn, $820m above forecast, largely due to a further $1.1b in actuarial losses on ACC's liabilities for outstanding claims as a result of a decrease in the discount rate. The Government's net debt is 24.6 percent of GDP, 0.5 percentage points better than forecast in the BEFU.

- District Health Boards recorded an operating deficit of $6.9m for the March 2012 quarter compared to a deficit of $1.4m for the December 2011 quarter. Employment costs were $1.3bn, up 0.7 percent for the March 2012 quarter, compared to total expenses of $3.4bn, down 0.6 percent. Further information is on the Ministry of Health web site.
- Local Government recorded a 0.3 percent increase in operating income and a 1.0 percent rise in operating expenditure for the March 2012 quarter compared to December, resulting in an operating surplus for the quarter of $49.6m, compared to a surplus of $63.0m in the December quarter, all in seasonally adjusted terms. Without seasonal adjustment, their surplus for the March quarter was $90.6m, compared to a $37.7m deficit in the March 2011 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/economicbulletin137.*
*For further information contact Bill Rosenberg.*