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Comment
There is now an accumulation of economic indicators pointing to slower economic growth. Despite relatively low levels of unemployment, the prospect of higher dairy returns, improving terms of trade and the likelihood of a solid Budget in May, in general it has to be acknowledged that the key economic issue is not inflation – but ensuring that slower growth does not tip over into a recession.

The drought is biting into farm output and prices. Hydro lake storage is at worrying levels. The housing market is slowing – at last. Retail spending is flat. Net immigration is down. The latest reports from Treasury indicate that company tax receipts are slowing ($151 million below forecast in the latest update) and that the forecast levels of fiscal surpluses are, for a change, going to be too high rather than too low. Meanwhile, the lower US dollar is combining with high interest rates in NZ to drive up the exchange rate damaging export returns.

There must now be a significant risk that the obsession with inflation in New Zealand will mean that most economic analysts will not support a reduction in the official cash rate even though the economy is slowing rapidly. If the Reserve Bank does not reduce in the next 2 months then the pressure will be to wait until after Budget Day in late May – and then not reduce after that because of the inflation impact – real or perceived – of tax cuts and Government spending announcements.

In the USA, inflation is running at 4.4 percent, yet the Federal funds rate is at 3 percent. Compare that with an official cash rate in NZ of 8.25 percent and inflation of 3.2 percent. The USA focus is on avoiding a recession rather than reducing inflation. The USA can be seen as an outlier in a sense and several economists are warning of that the ‘Fed’ is seriously underestimating the inflation risks. Some critics even warn of stagflation – job losses alongside high inflation. But NZ appears to also be an outlier in the other direction. Australia has a cash rate of 7 percent and inflation of 3 percent. The UK reduced the bank rate to 5.25 percent this month while inflation is 2.1 percent. The Bank of Canada lowered its rate to 4 percent in January this year while inflation is 2.2 percent. So although we have higher inflation by a small margin – we have higher interest rates by a much larger margin.

That is not to say cost pressures are absent. Producer prices out this month showed input prices 3.4 percent higher in the December year and output prices up 4.0 percent. Certainly, oil and food prices are continuing to put pressure on households. But these price pressures are not driven by excess demand so it is hard to see how monetary policy can have much impact. Some analysts continue to warn that wages are putting pressure on inflation but we have had a tight labour market since late 2000 and it is simply not credible to hold interest rates at such high levels on this basis.

Because banks are having to pay more for funds, there is every chance that even if there was a reduction in wholesale interest rates, the banks will use that as an opportunity to restore margins (on top of the increases in retail interest rates they have already put through with 2-year fixed mortgages from ANZ, National and ASB going to 9.7 percent) rather than drop mortgage interest rates. But it would in time lead to lower interest rates and perhaps prevent further increases.

Perhaps the tide of analysis is turning? For instance, the BNZ said this week that “Inflation expectations clearly need to come down” but also stated “there's a very good chance they will do so, if we are to believe the degree of economic slowdown depicted in (the latest) National Bank of NZ survey”. The National Bank said simply “brace for leaner times ahead” as the survey results were consistent with GDP growth of 1 percent for the year. The BNZ also said they predict a mild easing cycle (in monetary policy) to start in December 2008, but acknowledged that “the risks seem to be tilting to something a touch earlier and perhaps more aggressive than 25 point moves per meeting”.

In fact there is a strong case for a reduction in the official cash rate right now. Of course there is a risk that a drop in two steps say to 7.25 percent would rekindle some house price inflation or other inflationary pressures. But the evidence at the moment points to a higher risk that waiting too long to drop rates could drive the economy into a recession. Meanwhile designing tax cuts in such an uncertain fiscal environment can’t be easy…but that is another story.

Consensus forecasts[1] published by NZIER

The consensus forecasts were updated in December 2007.

March Years percent	**2008**	**2009**	**2010**
GDP	2.9	2.1	2.7
CPI	3.1	2.8	2.8
Wages (QES)	4.1	4.1	3.7
Employment	1.1	0.8	1.1
Unemployment	3.8	4.2	4.3

[1] The consensus is made up of the average of forecasts from NZIER, Berl, ANZ- National Bank, ASB Bank, BNZ Bank, First New Zealand Capital, Deutsche Bank, UBS, Westpac, Reserve Bank of New Zealand and Treasury. They are done every 3 months which means that we sometimes have actual figures for some of the forecasts.

Economic Snapshot

Consumer prices rose 1.2 percent in the December 2007 quarter, and were up by 3.2 percent annually. The next CPI update is on 15th April 2008. Food prices rose 0.4 percent from December 2007 to January 2008, and 4.4 percent over the past 12 months with grocery food prices up 8.0 percent. Unemployment is at 3.4 percent. Māori unemployment is 7.3 percent and Pacific peoples' unemployment is at 4.7 percent, compared with 2.3 percent for European/Pākehā. The minimum wage is $11.25 an hour for a person who is aged 18 or over and $9.00 an hour for those aged 16 or 17 years old or a trainee. Ordinary time wages, as measured by the Quarterly Employment Survey (QES) for December 2007, were up annually by 4.2 percent (4.0 percent in the private sector and 5.0 percent in the public sector). The QES showed that the average ordinary time hourly wage is now $23.29 ($21.73 in the private sector and $29.49 in the public sector). The female rate of pay is $21.59, compared to the male rate of $24.68. The Labour Cost Index (LCI) shows that ordinary time wages went up by 3.3 percent in the December 2007 year (3.5 percent in the private sector and 3.1 percent in the public sector). However for workers who got an increase in the last year, the median increase was 4.0 percent and the average increase was 5.6 percent. The next update of wages data is on 5th May, 2008. Economic activity increased 0.5 percent in the September 2007 quarter, compared with 0.8 percent in the June 2007 quarter. In the year ended September 2007, the economy grew 2.7 percent, up from the 1.6 percent growth recorded in the September 2006 year. The next GDP update is on 28th March. The Official Cash Rate (OCR) remains at 8.25 percent.

Wages

Total gross weekly earnings rose by 7.0 percent in the December 2007 year. This includes increases due to more people employed, more hours and also higher pay rates. Ordinary time wages, as measured by the Quarterly Employment Survey (QES) for December 2007, were up annually by 4.2 percent (4.0 percent in the private sector and 5.0 percent in the public sector). The QES showed that the average ordinary time hourly wage is now $23.29 ($21.73 in the private sector and $29.49 in the public sector). The female rate of $21.59 is 87.5 percent of the male rate which is $24.68. The Labour Cost Index (LCI) shows that ordinary time wages went up by 3.3 percent in the December 2007 year (3.5 percent in the private sector and 3.1 percent in the public sector). For those workers who actually got an increase in the last measured quarter, the average rate of increase was 5.3 percent (5.2 percent in the private sector and 5.6 percent in the public sector) and the median increase was 4.0 percent (4.0 percent in the private sector and 3.9 percent in the public sector). The average increase for the year was 5.6 percent (5.7 percent in the private sector and 5.0 percent the public sector) and the median was 4.0 percent (4.1 percent in the private sector and 3.7 percent in the public sector).

Wage Gap with Australia

We have previously pointed out that the level of net migration to Australia, while at high levels has been even higher in the past, particularly when we express the figures as a proportion of the population. Although there are many factors that impact on Trans-Tasman migration, it does usually lead to a debate about relative wages and taxes between Australia and New Zealand. What is interesting to note is how the wage gap has grown. In 1990, the wage gap as measured by average weekly nominal wages was 18.9 percent. By 1999 it was 31.6 percent. In 2006 it rose to 41.3 percent before going down slightly to 39.6 percent last year. So the wage gap grew by 67 percent in the 1990s and has gone up by 25 percent since then. It is interesting to note that when we look at the growth in the real wage gap (taking into account inflation); it grew by 50.4 percent from 1990 to 1999 but by 1.6 percent since then to a real wage gap of 28.8 percent.

Employment

Employment growth was 2.5 percent for the December 2007 year, 23,000 in the December quarter and 53,000 for the year. Unemployment is now at 3.4 percent, which is 77,000 people. The labour force participation rate is now at 68.8 percent. The female labour force participation rate reversed last quarter's fall and increased strongly from 61.2 percent to a record high of 62.4 percent in the December 2007 quarter. Male employment was down 3000 or 0.2 percent to 1.16 million. The number of jobless (which includes those available for work but discouraged from seeking work or temporarily unavailable for work) decreased by 9.7 percent for the December 2007 year to 146,000. The number of underemployed people (those employed part-time who would like to work more hours) rose to 88,000. Pakeha unemployment is 2.3 percent compared to 7.3 percent for Maori, and 4.7 percent for Pacific peoples. Over the same period however, Maori participation increased to a record high of 68.0 percent and Pacific participation reached an 18-year high of 64.1 percent. The unemployment rate for those aged 15-19 was 12.6 percent and for those 20-24 it was 5.0 percent, compared with a rate of 1.6 percent for those aged 50-54 years. Meanwhile, there were 5,858 advertised job vacancies listed in December 2007, 4 percent fewer than in December 2006.

Government Accounts

Figures for the six months ending December 2007 show the operating balance was $1,696 million (67.5 percent) lower than forecast at $815 million. This was mainly due to investment losses recorded by Crown Financial Institutions (CFIs), and an increase in the ACC unfunded liability. Core Crown residual cash was $356 million lower than forecast at -$812 million. This was mainly due to higher than expected operating payments ($235 million) and lower than expected tax receipts ($154 million). The OBEGAL (this stands for Operating Balance Excluding Gains and Losses and replaces the OBERAC) was $20 million (0.8 percent) lower than forecast at $2,529 million (compared to a forecast of $2,549 million). Gross debt was 18.1 percent of GDP.

Housing and Property

REINZ figures show that the property market dipped to $340,000 in January 2008, down from the national median sales price of $345,000 in December 2007. Homes took noticeably longer to sell, at 49 days nationally, the highest since the January 2002 figure of 54 days. Quotable Values' January 2008 statistics reported an 8.9 percent growth in national property values over the past year, down on the 10.0 percent growth reported in December 2007. The average New Zealand sale price increased to $390,636 this month (from $388,253 last month). Building consents data shows that the trends for both the number of new housing units and the value of residential buildings are continuing to decline, with 1,743 new housing units authorised in January 2008, 137 fewer compared than January 2007.

Meanwhile the Centre for Housing Research, Aotearoa New Zealand (CHRANZ) has released research that shows that the rate of home ownership has fallen from a high of 73.7 percent in 1986 to 66.9 percent in 2006. Also, a smaller proportion of those under 40 years old are buying their own homes, they are taking longer to do so and it is costing them relatively more than in previous years.

Trade, Balance of Payments and International Investment Position

No surprise that exports of milk powder, butter and cheese lie behind the reduced trade deficit in January 2008. But Tui oil exports are increasingly making an impact. Overall, January exports were 24 percent higher than in January 2007. Exports were $3.1 billion compared with imports of $3.4 billion with a trade deficit of $320 million. The annual trade balance for the year ended January 2008 was a deficit of $4.8 billion (12.9 percent of exports), down on the deficits for the year ended January 2007 ($6.0 billion) and the year ended January 2006 ($7.0 billion). Statistics New Zealand say that this is the first time since April 2005 that a rolling annualised trade deficit has been below $5 billion. They also noted that although dairy exports showed large increases in value, quantities all showed decreases. This may reflect recent high world dairy prices and also the dry conditions that prevailed in December 2007 and January 2008 in New Zealand could be a contributing factor to the drop in export quantities. It is also anticipated that a slowing NZ economy could reduce the level of imports.

Retail Sales

Retail sales for 2007 were up by 6 percent but rose by only 0.1 percent in December. In the December 2007 quarter, retail volumes rose 0.3 percent, following their 0.2 percent advance in the September quarter and a 0.7 percent fall in the June quarter.

Migration

In the year ended January 2008, there were 82,500 permanent and long term arrivals, down less than 1 percent from the January 2007 year and there were 77,700 departures, up 13 percent. As a result, net migration was 4,800 in the January 2008 year, down from 14,100 in the January 2007 year. There was a net inflow of 6,900 migrants from the United Kingdom, down from 10,700 the previous year. There were also net inflows of 3,700 from India, 3,200 from the Philippines, 2,500 from Fiji, 1,900 from South Africa, 1,800 from China, and 1,700 from Germany. The net outflow to Australia was 28,600 in the January 2008 year, compared with 21,600 in the January 2007 year. This is the highest annual net outflow to Australia since the August 2001 year (29,100). The proportion of migrants to Australia who were born overseas was 28 percent in the 2007 year.

Stock Numbers

Sheep numbers last year fell 4 percent from 2006 to 38.6 million. This compares with 70.3 million in 1982. The 2007 result was the lowest recorded since 1955. Meanwhile dairy cattle numbers reached 5.3 million, up 2 percent on the 2006 figure. There are 1.4 million more dairy cattle than in 1994.

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