NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

CTU Monthly Economic Bulletin

No. 93 (July 2008)

Comment

Economists are never that keen on comparing previous forecasts with what has actually happened. This is understandable. Usually the defence against the accusation that economics is a dismal science is that it is not always that dismal – but we also know it is not always that scientific either. This year we have seen plenty of revisions to prior forecasts. In June 2007, the Reserve Bank was picking that annual consumer price inflation would average 2.6 percent for the second half of 2008. Now they say that inflation for the September 2008 quarter will be around 5 percent. Last year the consensus forecasts for March 2009 were for annual GDP growth of 2.4 percent and annual CPI of 2.6 percent. By June this year, the forecasts for March 2009 had changed to 1.0 percent GDP growth and 3.9 percent lift in annual CPI.

To be fair, economists were predicting that house prices would fall and that the rate of economic growth would also slow. They got that right. But the combined impact of high food and oil prices and the ongoing effect of the credit crunch have made a big difference to economic outcomes. The International Monetary Fund said this week that global financial markets continue to be fragile. The IMF estimates that banks and financial institutions have had to write off $544 billion in mortgage related investments that have gone wrong. It is predicting losses of $1,277 billion. Merrill Lynch has recently reported a $6.6 billion loss amid massive write-downs from soured mortgage positions and other risky investments. And this got closer to home recently with NAB (the BNZ parent company) increasing tenfold their implied losses from collateralised debt obligations (CDOs) and ANZ downgrading earnings by $1.5 billion. Sure this is not just about the contagion from sub-prime mortgages, CDOs and the myriad of more risky financial products. It is also about exposure to commercial property and slower economies both sides of the Tasman. But it does illustrate that the fallout in terms of financial instability from such reckless practices still has some way to go.

Simon Jenkins argued in the Guardian recently that when the going gets tough, economists go very quiet. He said they are happy to take the credit in the good times, but the “disciples of this false science are hard to find as recession looms”. He notes the recent comments of Alan Greenspan, former chief of the US Federal Reserve Board that "anticipating the next financial malfunction ... has not proved feasible". Quite.

Although we should not be surprised at the instability of the global capitalist system, these are unusual times. Last week the Reserve Bank reduced the official cash rate at a time they predict inflation to rise to 5 percent – way outside their target band. And at least one bank has argued that it has limited room to reduce their mortgage interest rates despite the cut in the OCR because their cost of funds offshore has gone up significantly. As the BNZ put it "*during the global liquidity boom and, to be fair, a bit of local competition in the mortgage market, (we sourced funds at) around 70 basis points over swap, on average. Since the credit crisis has erupted, and we've had to pay a bigger premium relative to the NZ swap curve to secure global money, the two-year mortgage rate is now priced at more like 150 basis points over swap. It may yet need to be even more*".

What is clear is that the economy has slowed considerably. A second quarter of contraction is likely and a third quarter fall is also possible. There are a few bright spots on the horizon. International oil prices have fallen 18 percent in the last 3 weeks. Tax cuts start up in 2 months. And the official cash rate is likely to be cut by another 0.75 percent this year. In addition, at this stage unions are still getting reasonable wage increases in negotiations. As mentioned in the last Bulletin, while unemployment is up, the numbers on the unemployment benefit were just 17,465 at the end of May this year compared with 161,128 in December 1999.

What is also clear is that NZ is not alone. This is not a home grown problem. NZ is in a reasonable position to weather this storm. We would be better placed if monetary policy had other tools in the last few years to assist the battle against unsustainable rises in house prices and if wages had gone up more sharply in the boom years of 2000 to 2004. But, the current pressures on the economy reflect a trifecta of international 'shocks' – oil, food and sub-prime. But don't expect this to be acknowledged in the heat of an election campaign. And as for economists and their dismal science… they are not all market economists, many warned of the dangers of deregulation of financial markets, but expect the media to keep asking economists what the economy will do in the future. Sometimes they will get close… but often not.

Consensus forecasts[1] published by NZIER

The consensus forecasts were updated in June 2008.

March Year % change	**2008**	**2009**	**2010**
GDP	2.9	1.0	2.4
CPI	4.0	3.9	2.7
Wages (QES)	4.1	4.5	3.9
Employment	-0.2	0.4	0.9
Unemployment	3.6	4.2	4.4

[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. Because the consensus forecasts are done only every 3 months, some of the more recent forecasts will be more accurate.

Economic Snapshot

Consumer prices rose 1.6 percent in the June 2008 quarter, and were up by 4.0 percent annually. The next CPI update is on 21st October 2008. Food prices rose 1.3 percent in June 2008, and increased 8.2 percent over the past 12 months. Unemployment is at 3.6 percent. Maori unemployment is 8.6 percent and Pacific peoples' unemployment is at 8.2 percent, compared with 3.0 percent for European/Pakeha. The minimum wage is $12.00 an hour and $9.60 for new entrants aged 16 or 17 for the first 3 months or 200 hours whichever ends first. Ordinary time hourly wages, as measured by the Quarterly Employment Survey (QES) for March 2008, were up annually by 4.6 percent (4.4 percent in the private sector and 5.4 percent in the public sector). The QES showed that the average ordinary time hourly wage is now $23.63 ($21.96 in the private sector and $30.58 in the public sector). The female rate of pay is $21.94 which is 87.8 percent of the male rate of $24.99. The Labour Cost Index (LCI) shows that ordinary time wages went up by 3.4 percent in the March 2008 year (3.5 percent in the private sector and 3.4 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 4th August, 2008. Economic growth decreased by 0.3 percent in the March 2008 quarter compared with a 0.8 percent increase in the December 2007 quarter. On an annual basis, the economy grew by 3.0 percent over the year to March 2008, and the current account deficit rose by $266 million to $13.8 billion (equivalent to 7.8 percent of GDP). The next GDP update is on 26th September. On 24th July, the Official Cash Rate (OCR) was reduced from 8.25 percent to 8.0 percent.

CPI

The Consumer Price Index increased by 1.6 percent in the June 2008 quarter, its biggest quarterly rise in 18 years. This rise followed increases of 0.7 percent in the March 2008 quarter, and 1.2 percent in the December 2007 quarter. Annual CPI was 4.0 percent. In the year to June 2008, petrol prices have risen 26 percent and this was the most significant contributor to the rise in the CPI. Tradables inflation was up by 2.3 percent for the June quarter and 4.8 percent for the year. Non-tradables inflation was up by 0.9 percent for the June quarter and 3.4 percent for the year.

Food Prices

Food prices rose in the year to June 2008 by 8.2 percent. This is the largest annual increase since June 1990, and at that time, the rise was a consequence of a GST increase. Grocery food prices were up 11.8 percent, fresh milk up 21.5 percent, cheese up 59.4 percent, bread up 13.9 percent, and butter up 80.1 percent.

2008 cost of living international survey

The cost increases faced by New Zealanders have led to a higher rank according to the international Mercer's 2008 Cost of Living Survey. Auckland moved up to 78th place and Wellington 93rd, up 21 and 18 places respectively. The perception that Australia is cheaper is however shown to be wrong, with Sydney in 15th place, Melbourne 36th, Perth 53rd and Brisbane

57th. The cost of living is going up faster than average for working people on modest incomes because the largest price increases are for basic items. Items such as petrol, dairy foods and school fees are rising, while items like domestic air travel, stereos and phone equipment are falling in price.

Atlas of Socioeconomic Deprivation in New Zealand 2006

The above report was recently released; a graphic statistical illustration of the location of deprivation in New Zealand. Using nine variables taken from the 2006 Census (such as income, home ownership, employment, qualifications, telephone and car access), the authors had the task of mapping 1792 areas across the country, and graduating them accordingly. The Atlas was created by health researchers as a ‘tool for public health action’, as health patterns so closely follow the pattern of poverty. Head author Professor Peter Crampton, said little had changed since he put out the first index of deprivation in 1991, with the gap between poor and rich just as large.

Incomes Survey

A report from the Ministry of Social Development based on interviews with 3,000 households shows the impact of Working for Families. The report shows that from 2004 to 2007, median household incomes grew by 6 percent in real terms and that over the same period, income inequality reduced for the first time since it began to rise in the late 1980s. The report states that incomes for low to middle income households grew much more rapidly than for above average income households – this is mainly attributed to the Working for Families package. Overall poverty fell from 19 percent in 2001 to 13 percent in 2007 using the Social Report measure. This represents a total of 190,000 fewer New Zealanders in households with incomes below the fixed poverty line in 2007 compared with 2001. Child poverty fell from 29 percent in 2001 to 16 percent in 2007 using the fixed line measure used in the Social Report. This represents a total of 130,000 fewer children in households with incomes below the poverty line in 2007 compared with 2001.

Food and Emergency Grant Changes

The Government has said that approximately 280,000 special needs grants for food were made in the year to May 2008. From 4th August 2008 the annual amount of financial assistance available through Special Needs Grants for food will double. Although the limits of between $200 for a single person and $550 for a couple with 3 or more dependent children remain the same they will apply to a 26 week period, not the current 52 weeks. In the year to May, there were also 15,500 special needs grants made under “other emergencies”. The limit for these grants will increase in August from $200 to $500.

Minimum Wage as a proportion of Average Wage

The CTU argues that the minimum wage should be based on two-thirds of the average wage. But it is interesting to look at the record. Between 1972 and 1975, Labour lifted the minimum wage from 44 percent of the average wage to 60 percent. But under National it was reduced right down to 30 percent of the average wage by 1984. From 1984 to 1990, Labour lifted the ratio back up to 54 percent by the late 1980s but it had slipped to 47 percent by 1990. By 1999, under National the ratio had slipped back again – to 40.2 percent of the average wage. The minimum wage was frozen in 1991, 1992, 1993 and 1994 and increased by only 2 percent in 1995 and 1996. Under Labour-led Governments since 1999 it has built up to 50.8 percent of the average wage.

Productivity Lift?

The Treasury says that economy-wide labour productivity growth rose to an 8-year high of 3.1 percent in the year to March 2008. This is a different measure than the measured sector productivity figures used by Statistics NZ. Treasury noted that the rate of increase in hours of work had fallen but there had been growth in plant, machinery and equipment investment.

Trade

Trade figures for the June quarter show that the total value of merchandise trade exports fell by 0.5 percent to $10.3 billion, mainly due to a $423 million fall in milk powder, butter and cheese products, restrained in production by the drought. Despite this fall, June 2008 still had the third highest quarterly exports on record. Crude oil had the greatest increase of the commodity exports, rising 56.6 percent, to the value of $898 million. Merchandise imports rose 8.5 percent in the quarter, up to $12.1 billion. The resulting trade deficit has more than doubled, to $1.9 billion in the June quarter, compared with $861 million in the March quarter. In the month of June 2008, merchandise imports were valued at $3.8 billion, the highest value for a June month, up 16.9 percent from June 2007. This increase was led by crude oil. Merchandise exports were valued at $3.6 billion in June 2008, up 30.9 percent from June 2007. This is the largest percentage increase from the same month of the previous year since January 2001. The increase in exports was dominated by crude oil and milk powder, butter and cheese. Fonterra has said that their company alone contributed 25 percent of NZ export earnings in the May 2008 year. According to the Trade Weighted Index, the New Zealand dollar dropped 1.7 percent in June 2008, and is down 7.5 percent from the same month last year.

Retail sales

A 15 percent drop in motor vehicle sales is the principal factor behind a 1.2 percent fall in total retail sales for the month of May 2008. With the automotive industries excluded, there was a 0.7 percent rise since April 2008, but this is explained by the rise in grocery prices. Total sales were up just 1.1 percent on May 2007 figures. In the 3 months to the end of May, fuel sales were valued at 22 percent above those of a year ago. The BNZ is picking a 2.2 percent fall in the volume of June quarter retail sales.

Migration

In the year ended June 2008, there were 85,200 permanent and long-term arrivals, up 2,500 (3 percent) from the June 2007 year and 80,500 departures, up 7,900 (11 percent). In the year ended June 2008, there was a net inflow of 7,300 migrants from the United Kingdom, down from 9,400 the previous year. There were also net inflows from India (4,400), the Philippines (3,500), Fiji (2,600), South Africa (2,400), China (2,200), and Germany (1,600) in the June 2008 year. The net outflow to Australia was 31,900 in the June 2008 year, compared with 25,000 in the June 2007 year. This is the highest outflow since May 1989, when 32,000 New Zealanders left for Australia.

Government Accounts
Figures for the eleven months ending May 2008 show the operating balance was $2.6 billion higher than forecast, at $5.4 billion. This difference was attributed to higher than expected corporate tax revenue. The OBEGAL was $1.6 billion higher than forecast, mainly due to a reclassification amongst ACC accounts, and was $7.3 billion. Total core Crown expenses were $3.3 billion (6.9 percent) higher than the comparable period from the previous financial year, due to increased spending in social security, health and education. Gross debt sits at 17.8 percent, down from 35 percent of GDP in 1999. However, Michael Cullen has signaled that tax receipts for the year ended June 30 are likely to be $700 million down on forecast due to lower economic growth.

Early Childhood Education
The Government has reported that over 85,000 children enrolled in 2,300 services now benefit from free early childhood education. In August ABC Learning Centres, the largest provider still outside the scheme, will be joining up to 20 Hours Free. The rates for 20 Hours Free increased from July 1, 2008. All day services with 100 percent registered teachers, for instance, will now receive $12.26 per hour, up from $10.89 when 20 Hours Free ECE was introduced. All day services with between 50 and 79 percent registered teachers will receive funding of $9.75 per hour, up from $8.91 last year.

Work Stoppages
There were 26 work stoppages (including 2 lockouts) which ended in the March 2008 year, compared with 40 stoppages for the March 2007 year. The industry distribution of strikes show that there 7 in the manufacturing sector, 4 in transport and storage, 3 in health and community services, 3 in education and 9 in all other industries combined.

One in three work 50+ per week
Research released by the Department of Labour and the Families Commission has confirmed what many know already; that a significant proportion of the total workforce works 50 hours or more per week. One third of all New Zealand workers make up this profile according to the 2006 Census.

KiwiSaver
KiwiSaver has been operating just over a year and was initially projected to have 270,000 members by 1st July. As at 24 July the number of KiwiSavers stood at 753,576. Nearly 30 per cent of KiwiSavers are under the age of 25. Meanwhile the Government hopes to finalise Trans-Tasman portability of private retirement savings by September.

Trade Me reveals pay gap
On the same day that the National Business Review released its annual ‘Rich List’ (announcing that the rich have become $5.8 billion richer since 2007), the jobs section of the Trade Me website revealed that the poor had become poorer. Over the same period of time, an analysis of 73,000 jobs listed on the website showed a severe deterioration in pay for low skilled workers, while rates for skilled workers surpassed inflation. Trade Me sources the pay rates

from the employers when they advertise, although this information is not accessible to the applicants. While keeping in mind the non-scientific nature of this survey, according to Trade Me, 'unskilled groups at the bottom of the heap went backwards in nominal terms before even taking the annual inflation rate of 4 percent into account'. The survey did show annual pay increases averaged 3.7 percent but noted that pay for kitchen staff went down from $29,625 to $28,831 and went down while waiting staff wages fell from $30,826 to $30,296, caregivers from $31,967 to $30,894, shop assistants from $32,565 to $31,668 and cleaners from $31,964 to $31,704. This shows not just the impact of a slower economy, but also that it is vulnerable workers not protected by a collective employment agreement with secure base rates that get hit the hardest.

The absurdly rich get even richer – USA

A recent paper by Emmanuel Saez from the University of California has calculated that between 2002 and 2006, the top 1 percent of income earners in the USA captured almost three-quarters of the total income growth in that period.

Housing and Property

Figures from the REINZ show that the number of sales in the June quarter dropped to 13,100, a 47 percent decrease on the June 2007 figures. This is the lowest number of sales in 17 years. In the month of June 2008, there were 4,305 house sales, compared with 4,372 in May 2008. Again, this is a significant decrease, 3,000 sales lower than the June 2007 figure of 7,474. The median house price fell from $345,000 in May 2008, to $340,000 in June 2008. Quotable Value lists the average sale price for the June quarter at $392,436 just 0.1 percent up from a year earlier. There were 1,362 housing consents issued in June 2008, the lowest number since January 2001. In 15 of the 16 regions in New Zealand, all housing consent authorisations were lower than in June 2007. Statistics NZ say that for the year ended June 2008, the value of consents issued for residential buildings fell $458 million, while non-residential buildings rose by $298 million.

Improvements in home affordability

According to the Wizard Home Loans Affordability report, there has been an improvement in the ability of households to service their mortgages. The report focuses on the proportion of a median after tax income needed to pay an 80 percent mortgage on the median house price. In November 2007, 83.8 percent of take home income was required to service a mortgage, dropping to 80.6 percent in May 2008, now down to 78.5 percent for June 2008. These figures are predicted to improve over the rest of 2008 as interest rates most likely go down, while house prices keep falling. It is worth remembering that although these signs are good, house prices are still extremely prohibitive for many trying to purchase a first home, having risen 64 percent between November 2003 and November 2007.

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