NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

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Commentary

Debt, saving and banks: who gains?

Summary

We're told that New Zealand has had an awful saving record, but that it's now turning around. Is that true? Household debt grew hugely in the US too, and the financial system, including profits and pay, grew to an absurd size, partly on the back of it. Did that happen here too?

Over three quarters of the debt is owed by the richest 40 percent of households. The poorest 40 percent owe only 8 percent of the debt. But paying off their debt took a greater proportion of poor households' incomes than the more indebted high income households.

So when we say "New Zealand has a debt problem", we need to be careful what we mean. It is overwhelmingly the high income households that have run up this debt. It is the low income households which have the greatest problems paying off their debt. The government provided the biggest tax cuts to the people who had the most debt – those on high incomes – but not those who had the greatest need to repay it – those on low incomes.

Have government policies and the Global Financial Crisis led to a turnaround in saving behaviour? New data indicates that the turnaround in fact came back in 2004, though households only started spending less than their incomes in 2011. But the long downward slide in saving actually began in 1988 – through a period of rapidly growing income inequality – and finished in 2003.

Finally, how have the banks and their employees done out of the growth in debt? The size of the Finance and Insurance sector which banks dominate has doubled as a proportion of the whole economy from 3.6 percent in 1972 to 7.1 percent in 2009. However most of that rise has been in profits which have risen almost three times from 3.5 percent of all profits in the economy in 1972 to 9.4 percent in 2009. But wages and salaries have risen by only about half, from 3.5 percent of all employee compensation in the economy in 1972 to 5.2 percent in 2009.

Some have done well though. Westpac New Zealand's chief executive George Frazis was paid $5.4 million last year. The pay for his position rose 269 percent just between 2000 and 2011.

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We're told that New Zealand has had an awful saving record, but that it's now turning around. The Minister of Finance thinks that New Zealanders' savings habits have permanently changed and householders are borrowing less and saving more. He naturally attributes it to government actions – such as income tax cuts and the increase in GST – with a little help from the Global Financial Crisis.

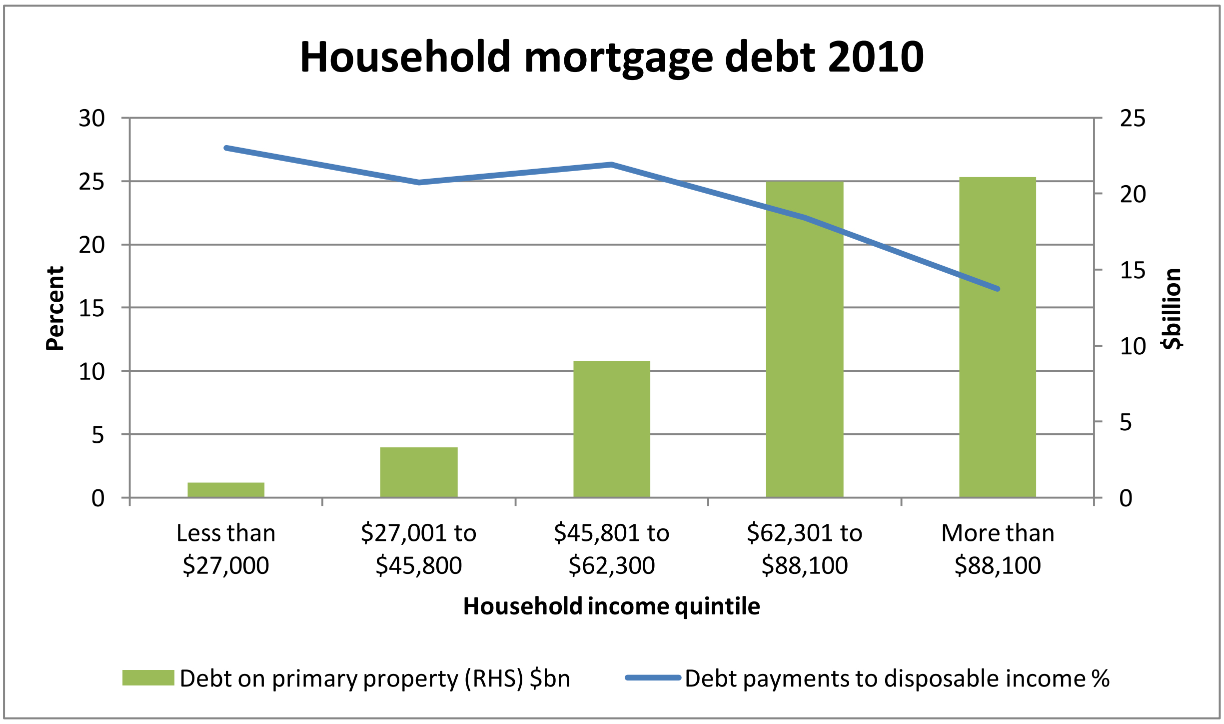
But have New Zealanders' savings habits changed under National's watch? Who were the people most in debt anyway?

Household debt grew hugely in the US too, and the financial system grew to an absurd size, partly on the back of it (and crashed when indebted people who couldn't afford the loans stopped paying). From taking up to 16 percent of all domestic corporate profits in the US in the period 1973-1985, by the 2000s the financial sector had reached 41 percent of all the profits. Average pay in the sector was little different from the rest of the economy from 1948 to 1982, but then rocketed to reach 181 percent of average – almost double – by 2007[1]. Did that happen here too?

Some recent data casts light on these matters.

First, who is in debt? Reserve Bank data released in November shows how much mortgage debt households have by their income level. In the US, banks loaned large amounts to people who couldn't afford it. In contrast, in New Zealand, banks have tight criteria for deciding who they will lend to, according to the borrowers' ability to repay. That means that higher income people will find it easier to get loans from banks while people on low incomes may have to get much more expensive loans including credit card debt, personal loans, hire credit and loan sharks. The less likely you are to need the money, the more likely banks are to lend it to you.

Here's what the Reserve Bank[2] found about people with mortgage debt on their primary property (so not including other forms of loans or mortgages on rental and other property). They divided the households with mortgages into five equal groups ("quintiles") by income. They range from the lowest income fifth of households (incomes under $27,000) to the highest income fifth (with incomes over $88,100). The graph shows the result. The green bars show the debt – and it is overwhelmingly among



[1] "The Quiet Coup", by Simon Johnson, *The Atlantic*, May 2009, http://www.theatlantic.com/magazine/archive/2009/05/the-quiet-coup/7364.

[2] Financial Stability Report, November 2011, p.21.

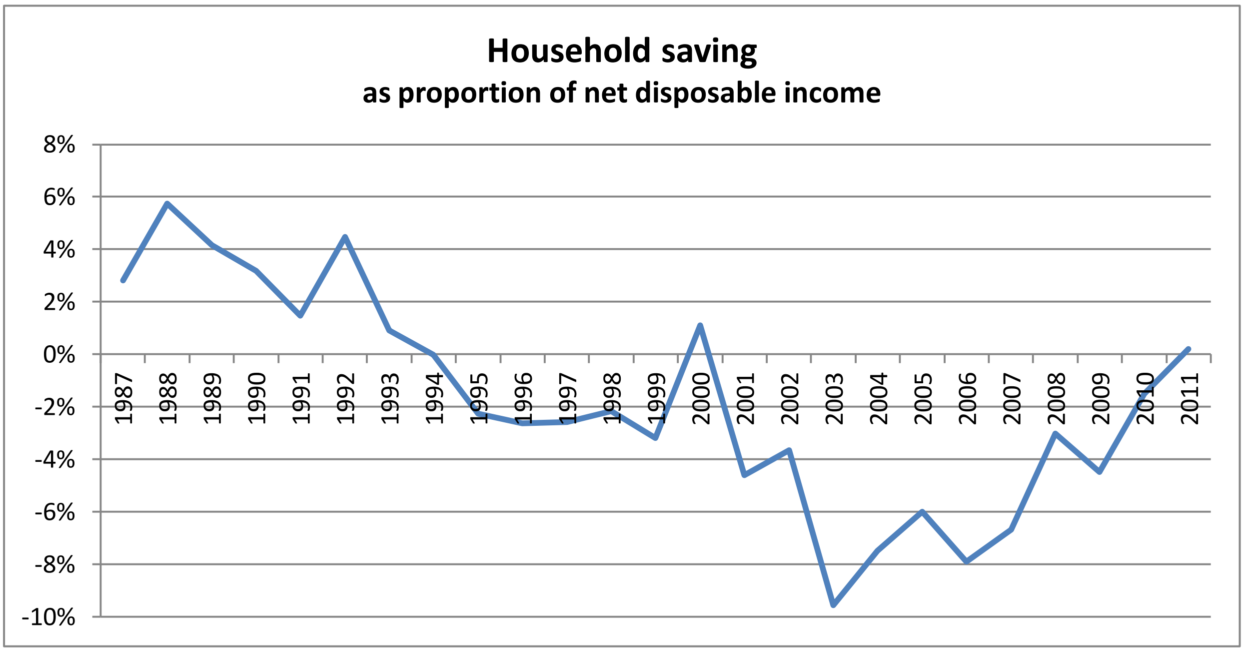
the high income households. Over three quarters (76 percent) of the debt is owed by the richest 40 percent of households. The poorest 40 percent owe only 8 percent of the debt. But that doesn't mean the poorest households didn't have hefty debt payments. The blue line shows how much of their disposable (after tax) incomes went in debt payments.

Low income households were paying a greater proportion of their income (28 percent) to service their debt than the much more indebted high income households (16 percent). Given this doesn't include some of the highest interest debt such as credit cards and loan sharks, which low income people often have no choice but to use, the debt payment picture may be even more lopsided.

So when we say "New Zealand has a debt problem", we need to be careful what we mean. In terms of the debt that is owed in total by households, it is overwhelmingly the high income households that have run up this debt. And this picture significantly underestimates their debt because it doesn't include rental and other investment property or holiday homes. But in terms of the people with greatest problems in paying off their debt, it is the low income households. When the government said it would encourage people to repay their debt by giving them tax cuts (if it worked, really just reducing private debt at the expense of higher government debt), they targeted the cuts at the right people in terms of who had the debt – those on high incomes – but not those who had the greatest need to repay it – those on low incomes.

Have government policies and the Global Financial Crisis led to a turnaround in saving behaviour? Well firstly, we're not out of the woods yet. House prices have fallen since 2007 which means that even if people have reduced their debt, the net amount they "own" of the current value of their house may not have increased. An indication of this is that household debt to asset ratios have been close to static since late 2009.

But revised data from Statistics New Zealand [3]shows an interesting longer term picture of household saving. Saving is difficult to estimate because it is defined as a left-over ("residual") of what has not been

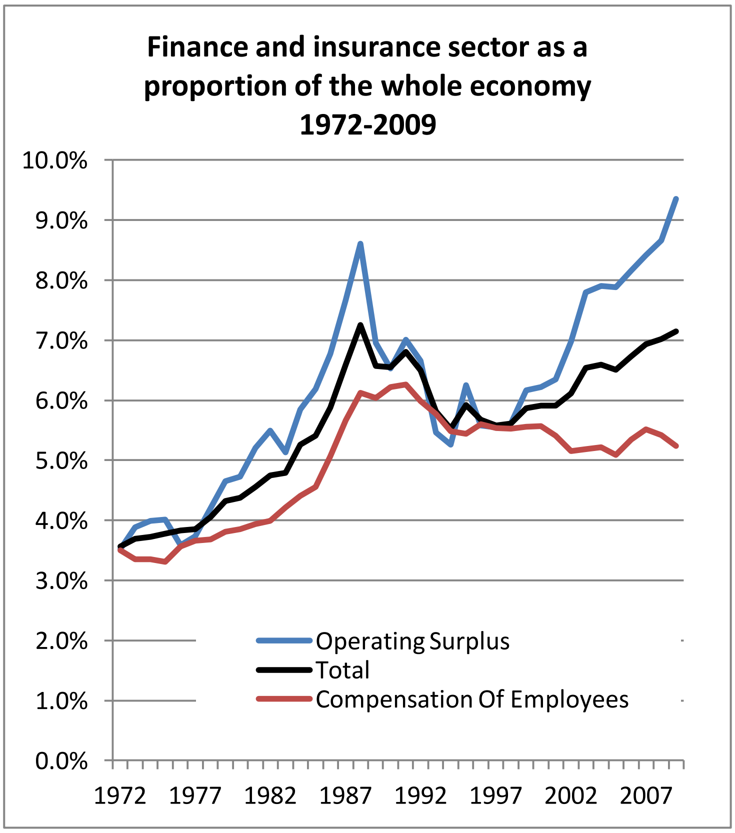


[3] National Accounts, Institutional Sector Accounts 1999-2009, Households Sector accounts 1987-2011.

spent out of the household sector's available income. So any errors in measurement, or households who don't declare all of their income, or who spend on "under the table" services such as a plumber or painter, will affect the reported saving figure. Statistics New Zealand are constantly trying to improve the accuracy of the reported data. The graph at the bottom of the previous page is their latest estimate.

What it shows is that the improvement in saving behaviour is not a recent change at all: it began back in 2004. Net saving was negative until 2011 – a worry because it means people were spending more than they earned – but, with a couple of one-year reversals, it has been becoming less negative since 2004. Perhaps significant wage rises over that period made a difference. The other interesting feature of the graph is that it had been falling with only two pauses from 1988 until 2003. This included the period of rapidly rising income inequality, but we would need more information to be sure how much that was a contributing cause.

Finally, how have the banks – and bank employees – done out of all this growth in debt?



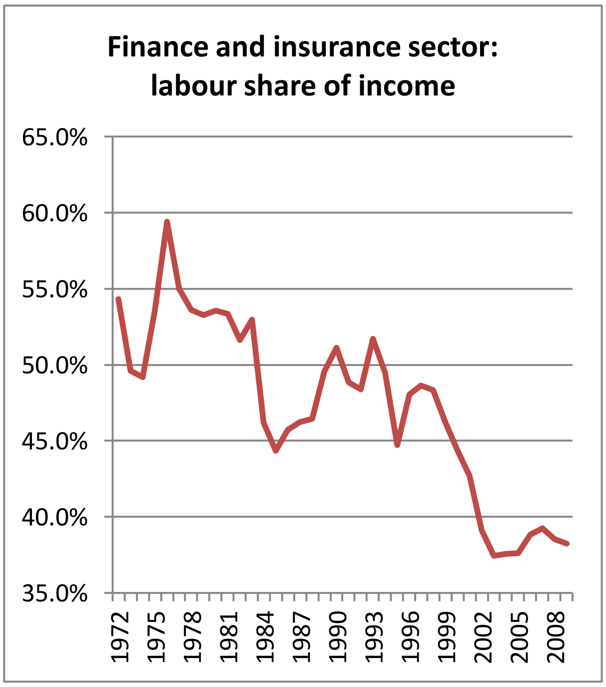
The graph to the right shows the proportion of the whole economy (GDP) that the finance and insurance sector accounts for[4]. The sector includes insurance and finance companies, but banks dominate it.

In the National Accounts, from which this comes, the output (or value added) of the sector is divided into two main parts: operating surplus (the blue line) – mainly profits and interest received – and compensation of employees (red) – mainly wages and salaries. In total (the black line), the size of the sector has doubled as a proportion of the New Zealand economy from 3.6 percent in 1972 to 7.1 percent in 2009. However there was a major peak in 1988 – doubtless related to the sharemarket bubble and then crash in 1987 which was followed by the near crash of the BNZ – at an even higher level (7.3 percent). After that it fell to 5.5 percent in 1994 before rising to its current height.

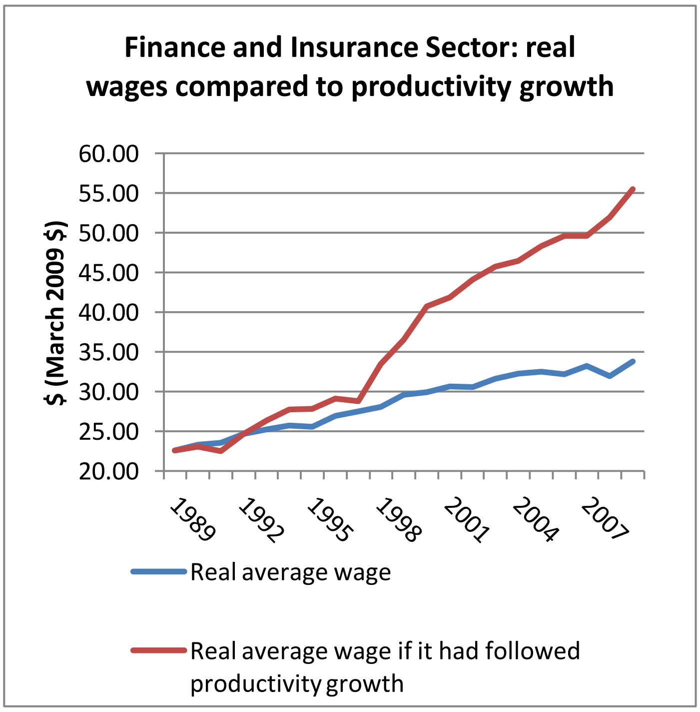
However most of that rise has been in profits – operating surplus. This has almost tripled from 3.5 percent of all operating surplus in the economy to 9.4 percent of it in 2009. It rose to 8.6 percent in 1988. But wages and salaries have risen by only about half, from 3.5 percent of all employee compensation in the economy in 1972 to 5.2 percent in 2009. They rose steeply (a little like what happened the US) until 1988, then levelled out and fell for most of the remaining period. This reflects major falls in staff numbers rather than falls in real wages and salaries, but does show a considerably different picture from the US.

[4] 2008 and 2009 are from a series with a new industry classification (ANZSIC06) and so are an approximation.

While finance sector profits are a much smaller proportion of the economy than in the US, the sector's profits seem to have risen as fast as the US as a proportion of the economy. Total employee income has fallen. The graph to the right shows the result of this: the proportion of the value added in the industry that was paid to employees fell dramatically from a 59 percent peak in 1976 to just 38 percent in 2009. However this was largely because of greatly reduced staff numbers as a result of the major technology changes and branch closures in the sector rather than falling pay: the average wage in the sector actually rose from 107 percent of the economy-wide average wage to 136 percent between 1989 and 2009 – but not nearly as fast as productivity. If it had risen as fast as productivity it would have been \$55.52 in 2009. Instead it was \$33.78. See the last graph.



The Labour Cost Index, taking into account all labour costs (such as employer superannuation contributions and ACC levies), which reflects the increases in costs of a worker in the same position with no increases for experience or skills, rose only 4 percent after inflation between 1996 and 2009 in the sector, while average Collective Employment Agreement settlements negotiated by Finsec (now part of FIRST union) rose 13 percent. Union members did better than non-unionised workers in the sector, though none but a few were adequately recognised for their productivity growth.



But of course there are some extraordinary salaries paid in the sector. Westpac New Zealand's chief executive George Frazis was paid \$5.4 million in the year to September 2011, the second year in a row his pay exceeded \$5m, making him "almost certainly the highest paid chief executive in New Zealand" according to the *Dominion Post*. The bank employees union, FIRST, has calculated from Westpac New Zealand's Annual Reports that its Chief Executive's pay rose 269 percent just between 2000 and 2011, or 171 percent in real terms (that is, after inflation).

We have some of the excesses of the US system, but it is in profits and executive pay, not the average finance sector employee.

Bill Rosenberg

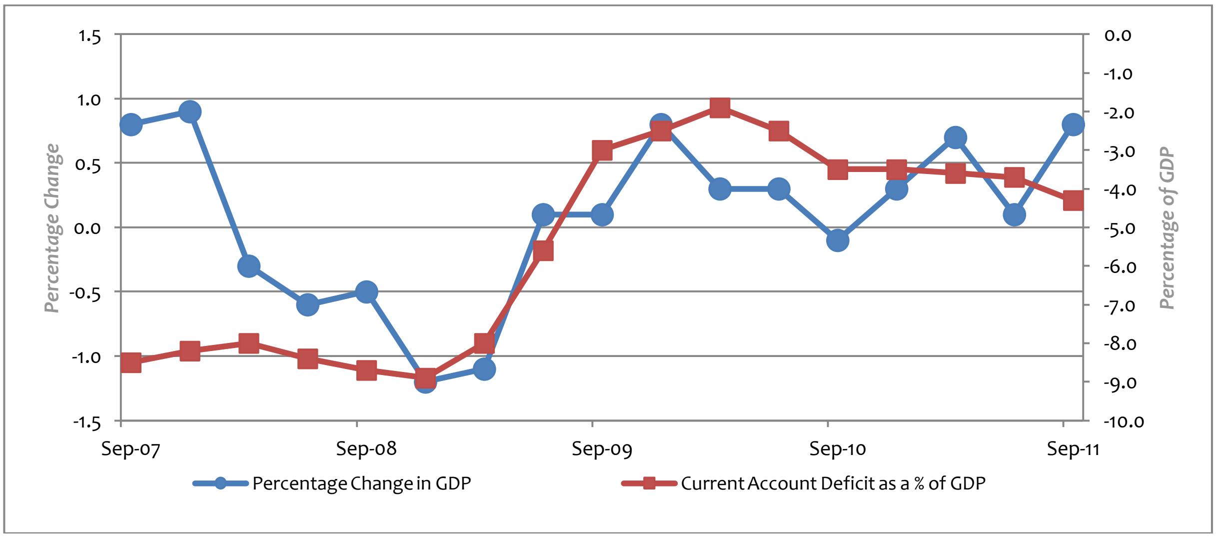
Forecast

- This NZIER consensus forecast was published on 12 December 2011.

Annual Percentage Change (March Year)	**2011-12**	**2012-13**	**2013-14**
GDP	2.1	3.0	3.0
CPI	2.3	2.4	2.5
Private Sector Wages	3.3	3.3	3.6
Employment	1.0	1.9	1.8
Unemployment	6.3	5.8	5.1

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

Economy

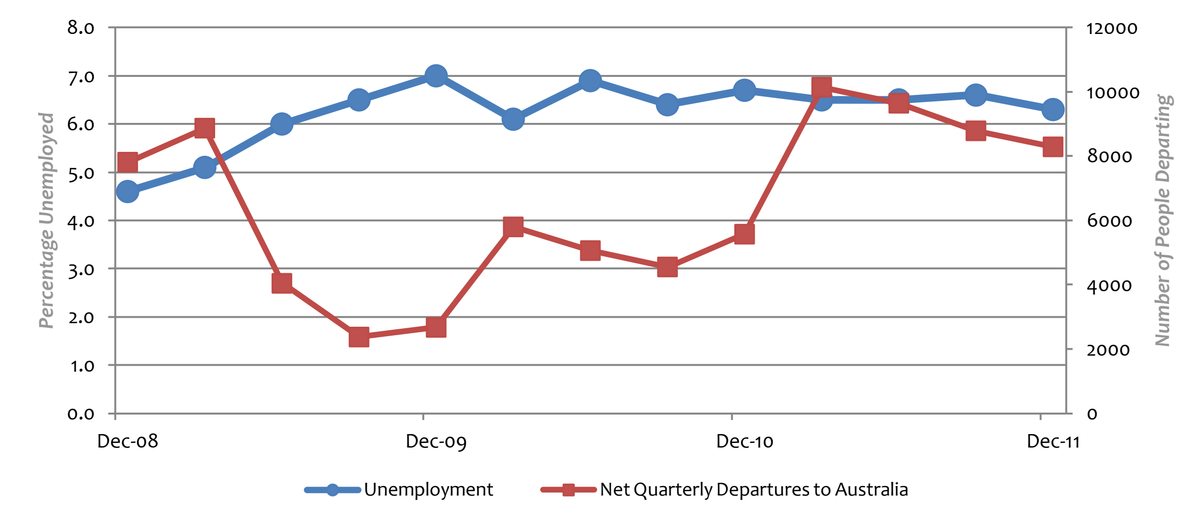


- Gross Domestic Product was up 0.8 percent in the September 2011 quarter, but GDP growth for the year to September 2011 was only 1.3 percent. The largest contributor was manufacturing which rose 2.3 percent in the quarter, mainly in food, beverage and tobacco manufacturing, and 4.9 percent in the year. However construction was down 2.2 percent in the quarter and 9.3 percent in the year, taking it to its lowest level since the June 2002 quarter.
- New Zealand recorded a Current Account deficit of $4.6bn for the September 2011 quarter ($2.7bn seasonally adjusted) and a deficit for the year to September of $8.7bn (4.3 percent of GDP; $8.8 bn seasonally adjusted). This compares with a current account deficit of $6.6bn (3.5 percent of GDP) for the year ended September 2010. The annual deficit is mainly due to profits and interest going to overseas investors ($10.3bn deficit) plus a deficit in services trade ($1.1bn) partially offset by a positive balance on goods trade ($3.0bn), all of which worsened during the quarter. The investment income deficit during the quarter was driven by bank profits.
- The country's Net International Liabilities were $148.2bn at the end of September 2011 – 72.9 percent of GDP compared with $138.4bn or 69.0 percent of GDP in June and $148.3bn in September 2010. Reinsurance claims owed but not yet paid for the Canterbury earthquakes totalled $12.7bn at 30 September. Without them, international liabilities would be $160.9bn or

79.1 percent of GDP. In September, the government was still not a contributor to the net international liabilities, though it had only $0.4bn more overseas assets than liabilities. Liabilities increased in the quarter mainly as a result of bank borrowing (reversing a reduction in the previous three quarters) but also a reduction in the values of overseas shares owned by New Zealanders as a result of falling sharemarkets. The banks borrowed a net $5.3bn from overseas during the quarter, and the government borrowed $2.8bn.

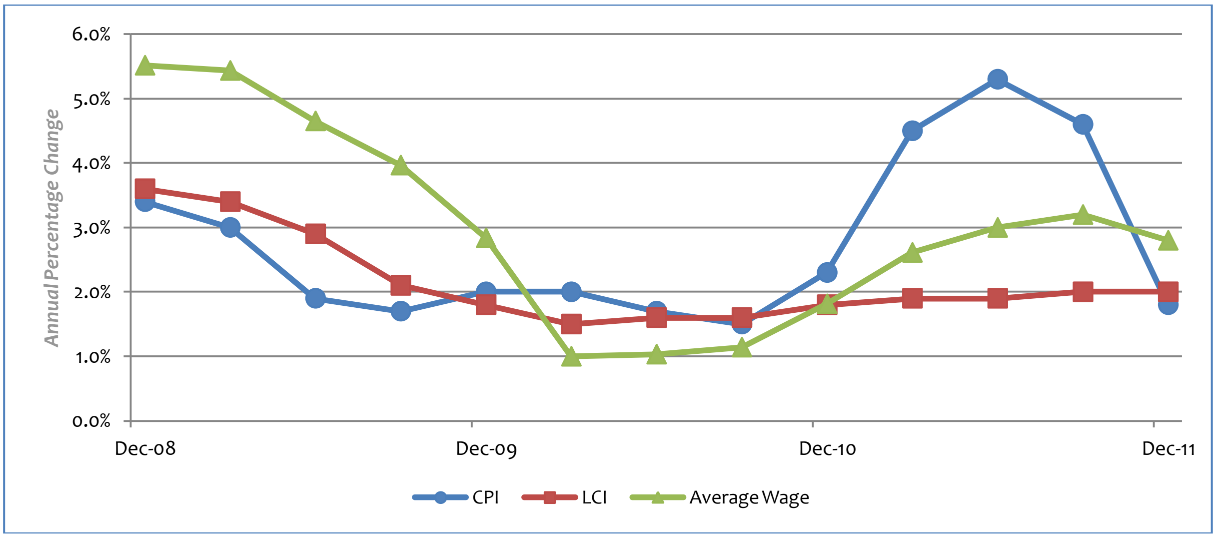
- ★ For the month of January 2012, Overseas Merchandise Trade recorded a seasonally adjusted $103m deficit – 2.5 percent of the value of exports for the quarter. It was strongly affected by the importation of a large aircraft, without which there would have been a small surplus. Increases in exports were led by milk powder and by China. Increases in imports were led by oil products and the aircraft, and by the US. For the year to January 2012, New Zealand recorded a trade surplus of $646 million (1.3 percent of exports). China became New Zealand's largest source of imports for the year, passing Australia, but Australia is still easily our largest export destination although exports to China are rising more quickly.
- ★ The Performance of Manufacturing Index for January 2012 fell to 50.5[1] off its sharp rise to 51.6 in December. The employment sub-index also fell: to 51.2 from 52.8 in December.
- ★ The Performance of Services Index for January 2012 was 53.6[1], a rise from 50.9 in December. The employment sub-index also rose: to 54.2 from 52.7 in December.
- ★ The Retail Trade Survey for December 2011 found retail sales were up 2.2 percent by volume and 2.0 percent by value between the September and December 2011 quarters. Volumes for core retailing, which excludes vehicle-related industries, rose 2.9 percent, the largest seasonally adjusted increase since the series began in 1995. Both the Rugby World Cup and the delayed timing of school holidays were likely influences. Retail sales were up 6.6 percent by volume and 8.0 percent by value compared to the December quarter in 2010.
- ○ On 8 December 2011 and 26 January 2012 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be on 8 March 2012 and will include a Monetary Policy Statement.
- ★ The REINZ Housing Price Index recorded a 1.4 percent fall in house prices for the month of January 2012 after a 0.1 percent fall in December, and the median house price was static at $355,000 compared to December. The House Price Index was up 4.3 percent for the year to January.

Employment



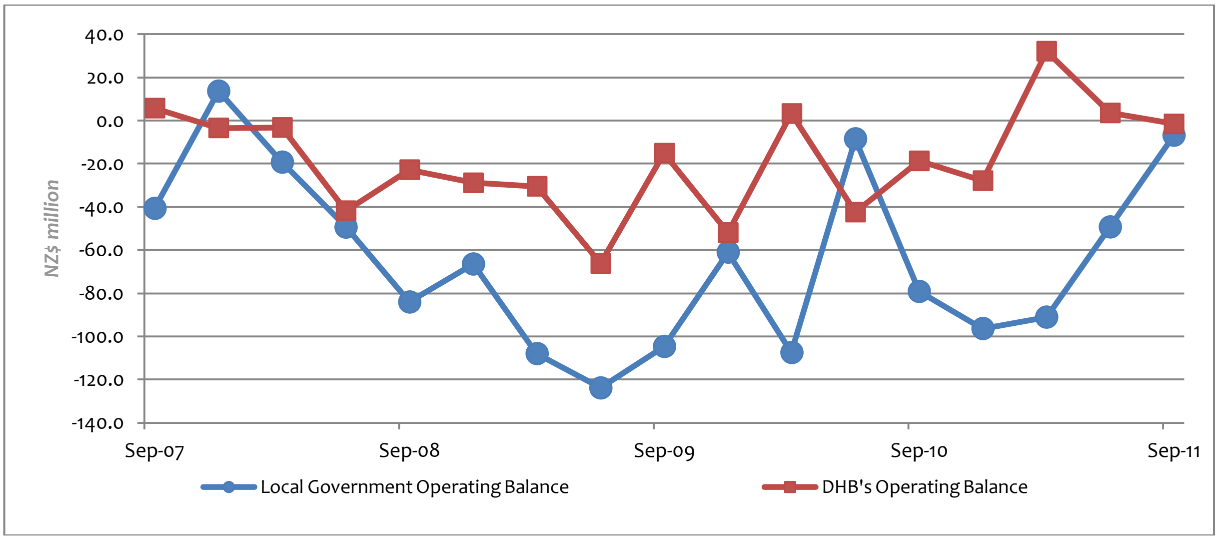
- ★ According to the Household Labour Force Survey the unemployment rate in the December 2011 quarter was 6.3 percent, down from 6.6 percent in the September quarter. The participation rate was 68.2 percent – down 0.2 percentage points on September. There are 150,000 people unemployed. Māori unemployment was 13.4 percent (up from a revised value of 13.1 percent), Pacific unemployment was 13.8 percent, Asian unemployment was 9.1 percent and European/Pakeha unemployment was 4.7 percent. Youth unemployment (15-19 year olds) was 24.2 percent (up from a revised 23.4 percent).
- ⭘ At the end of December 2011 there were 59,964 working age people on an Unemployment Benefit, an increase of 5,481, or 10.1 percent, from 54,483 in November 2011. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)
- ★ In December 2011, Job Vacancies Online rose by 0.7 percent for all vacancies and 0.5 percent for skilled jobs in seasonally adjusted terms.
- ★ International Travel and Migration figures show 6,970 permanent and long-term arrivals to New Zealand in December 2011 and 7,954 departures. There was a net loss of 1,855 migrants in the year to December 2011. Net migration to Australia in the year to December was 36,868 departures. There was an increase of 14,024 permanent and long-term departures from New Zealand nationally for the year to December 2011 compared to the year to December 2010, the increase more than accounted for by Australia.

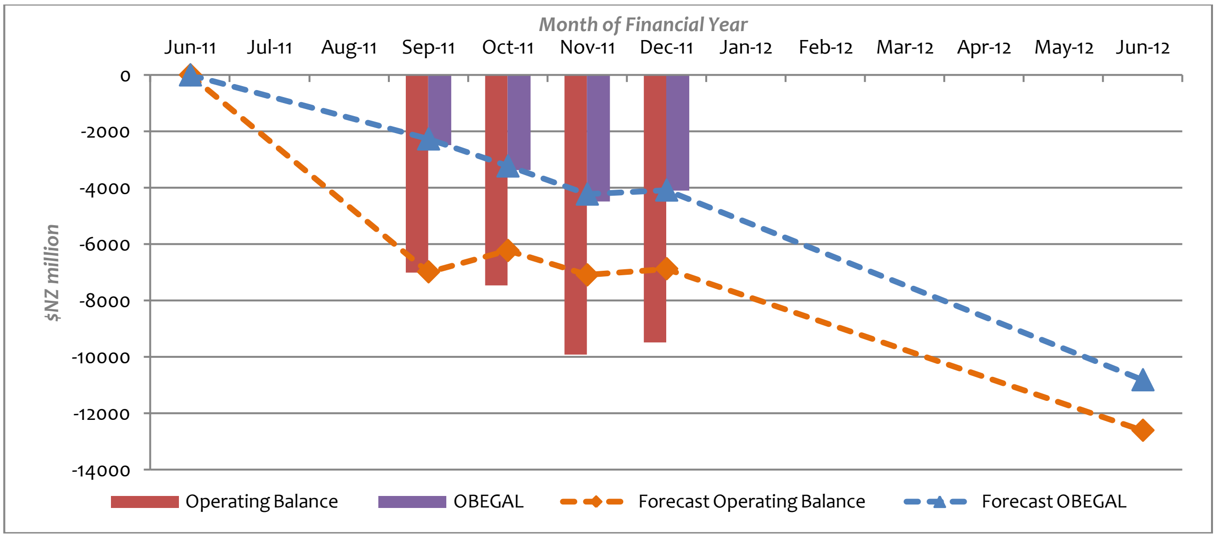
Wages



- ★ The Labour Cost Index (Wage and Salary Rates) (LCI) rose 2.0 percent for the year to December 2011 and 0.6 percent for the December quarter for salary and ordinary time rates. It rose 1.8 percent in the public sector and 2.0 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 December 2011 Quarterly Employment Survey found the average hourly earnings for ordinary-time work was $26.56, up 0.1 percent on the September quarter and 2.8 percent over the year. The average ordinary-time wage was $24.53 in the private sector (up 0.0 percent in the quarter and 2.8 percent in the year) and $33.82 in the public sector (up 0.9 percent in the quarter and 3.4 percent in the year). Female workers (at $24.60) earned 87.1 percent of what male workers earned (at $28.24) for average ordinary time hourly earnings.
- ⭘ The Consumer Price Index for the December 2011 quarter fell 0.3 percent, but rose 1.8 percent for the year to December. This is the first quarter since September 2010 which has not been affected by the October 2010 GST increase. For the quarter, food costs were down 2.2 percent, communication prices fell 3.5 percent, while transport costs rose 1.4 percent.
- ★ The Food Price Index did not change in the month of January 2012 compared to December 2011, and there was a 1.0 percent increase in food prices between January 2011 and January 2012. Between December and January, Fruit and Vegetable prices rose 3.6 percent, Grocery food fell 0.2 percent, Meat, Poultry and Fish fell 1.8 percent, Non-alcoholic Beverages fell 0.9 percent, and Restaurant Meals and Ready-to-eat food prices rose 0.2 percent.

Public Sector





- ★ According to Treasury's Financial Statements of the Government of New Zealand for the six months ended December 2011, government revenue was down $743m (2.5 percent) on the forecast in the 2011 Pre-Election Economic and Fiscal Update (PREFU), mainly due to tax revenue being down $296m in source deductions (PAYE) and $234m in GST, and expenditure was down $887m (2.5 percent) on forecast, mainly due to costs associated with child support penalties ($268m) and a reduction in the carbon price relating to the Emissions Trading Scheme ($178m). The operating deficit before gains and losses (OBEGAL) was $4.1bn, $3m worse than forecast. The operating deficit was $9.5bn, $2.6bn worse than forecast due to $1.0bn in unforecast actuarial losses in the GSF, $753m in actuarial losses on ACC's liability for outstanding claims due to a decrease in the discount rate, and a $779m fall in valuations of investments, mainly held by ACC, the New Zealand Superannuation fund and EQC. The Government's net debt is 24.7 percent of GDP, 0.2 percentage points better than budgeted in the PREFU.
- District Health Boards recorded an operating deficit of $1.6m for the September 2011 quarter compared to a deficit in the June 2011 quarter of $3.5m. Employment costs were $1.23bn, down 1.2 percent for the September quarter, compared to total expenses of $3.35bn, up 0.6 percent.

- Local Government recorded a 4.6 percent increase in operating income and a 2.3 percent increase in operating expenditure for the September 2011 quarter compared to June, resulting in an operating deficit for the quarter of $7m, all in seasonally adjusted terms. Without seasonal adjustment, their deficit for the September 2011 quarter was $34m, compared to a $81m deficit in the September 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/economicbulletin132.
For further information contact Bill Rosenberg.