



# BERL Economic Update

## September 2009

*prepared by BERL for Taupo Moana Funds Ltd*

- Quarterly GDP growth will return to positive this September quarter. However, this growth is set to compound medium to longer term imbalances facing the New Zealand economy.
- The immediate short-term outlook is more positive than it was earlier this year. Unemployment is no longer set to reach double-digits, business confidence is higher, log exports to China are increasing, meat export receipts have recovered, and kiwifruit and wine exports are building on sustained industry growth.
- The medium term picture is not great as an export lead recovery is not on the horizon. The outlook for processed forestry products over the medium term is muted, export volumes from the meat industry remain static, tourism numbers are down, and manufacturing exports are struggling.
- The collapse in business investment is sobering. The prospects for a quick U-turn are unlikely, as businesses look to replenish cash flow and bank lending remains constrained. Our forecasts are now relying on domestic spending to underpin weak growth.
- Assisted by a slight reduction in participation rates, we are forecasting unemployment to peak at just over 7.3% in mid-2011. Job growth will return earlier than this but will be weak. This means jobless numbers won't start to decline until the latter half of the forecast horizon.
- Our projection for GDP growth in the March 2010 year is -1.0%. This is equivalent to 0.2% per quarter growth for the remainder of the year. Thereafter, we expect GDP growth to creep towards the 0.5% per quarter mark and so register close to 2%pa for the March 2011 and 2012 years.

# Economic update – Forecast summary and comparisons

## KEY INDICATORS : FORECAST SUMMARY AND COMPARISONS

	2007	2008	2009	2010	2011	2012
<b>Real GDP</b>						
<i>March year average % change</i>						
BERL	1.8	3.1	-1.0	-1.0	1.2	2.1
Reserve Bank	1.8	3.1	-1	-0.9	3.1	3.4
Treasury	1.5	3.1	-0.9	-1.7	1.8	2.9
<b>Unemployment rate</b>						
<i>March quarter %</i>						
BERL	3.8	3.8	5.0	6.5	7.2	6.7
Reserve Bank	3.7	3.8	5	6.8	6.5	5.9
Treasury	3.7	3.7	5	7.5	7.5	6.3
<b>Current Account Balance</b>						
<i>March year % of GDP</i>						
BERL	-8.3	-8.0	-8.5	-8.4	-8.0	-7.7
Reserve Bank	-8.3	-8	-8.4	-5.8	-7	-7
Treasury	-8.2	-8	-8.6	-6.9	-5.4	-5.5
<b>Employment FTE growth</b>						
<i>March year average % change</i>						
BERL	2.3	0.6	0.8	-0.7	0.1	0.7
Reserve Bank	2	-0.3	0.8	-1.1	0.8	1.7
Treasury	2	0.8	0.7	-3.4	-2.2	1.8
<b>Export volume growth</b>						
<i>March year average % change</i>						
BERL	3.1	2.9	-3.3	-5.1	0.2	2.6
Reserve Bank	3.1	2.9	-3.3	-1.2	4.3	7.1
Treasury	3.1	2.9	-4.2	-1.5	2.4	4.1

Reserve Bank : Monetary Policy Statement, September 2009

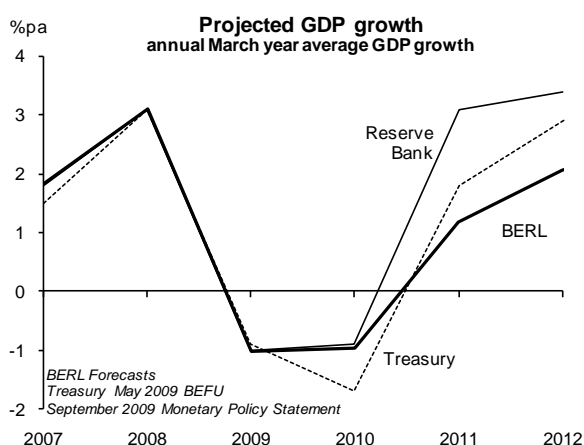
Treasury : Budget Economic and Fiscal Update, May 2009

# Our assessment

compiled by Ganesh Nana

With global stock markets recovering lost ground, New Zealand house prices and house sales numbers turning up, the prospect of stable interest rates for another six months or so, rising net migration, and Australia, Germany and France recording positive GDP growth, many are suggesting the recession is past.

From a technical sense, these suggestions are correct in that quarterly growth in New Zealand's GDP will have returned to positive this quarter.



However, the evolving composition of this positive growth leaves us feeling very uneasy. Of course, much depends on time horizons. The outlook can be summarised as follows:

- short term – the next year will be better than last year.
- medium term – the two years following next year are unlikely to be better than the two years preceding last year.
- long term – the quest for a high-wage export-based economy with productivity advances will remain elusive.

Without doubt, the immediate short-term outlook is more positive than it was earlier this year. With unemployment no longer set to reach double-digits (although we were not amongst those suggesting such a blowout) and resurgent business confidence the climate of 'fear' has abated. Furthermore, the export contribution from forestry (logs to China), meat (receipts if not volumes), and kiwifruit and wine (ongoing industry growth) have added to the feeling that the worst may have passed.

Nevertheless, monthly indicators suggest that activity is still well below year-earlier levels across many sectors. While the rate of decline may have eased, new residential building consents are still more than 20% below those of a year ago. Similarly, the slight pick-up in retail sales turnover, with the latest three months being 2.6% up on year-earlier, suggests sales volumes remain flat.

**SELECTED MONTHLY INDICATORS**  
3 month total % change on same period previous year

Month	Car registrations	Retail sales (exc mv's)	New dwellg permits	Intermediate imports (excl oil)	Visitor arrivals	Mach & eqmpt expts	NBNZ Survey business confidence#
Jul 08	-21.3	2.0	-36.7	30.1	-0.1	-2.9	-43.2
Aug 08	-24.7	1.5	-42.8	28.3	-0.6	0.1	-20.5
Sep 08	-24.7	1.7	-33.9	32.6	-2.1	-2.1	1.6
Oct 08	-22.2	2.1	-37.2	32.3	-3.8	3.3	-42.3
Nov 08	-23.2	2.1	-36.5	35.5	-4.6	5.1	-43.0
Dec 08	-25.9	2.0	-42.3	30.4	-1.5	1.3	-35.0
Jan 09	-31.8	1.4	-45.2	18.9	-1.8	-5.1	na
Feb 09	-35.0	0.4	-44.0	9.3	-3.3	-11.3	-41.2
Mar 09	-38.0	0.5	-42.9	8.1	-7.4	-4.1	-39.3
Apr 09	-39.5	0.7	-45.7	3.0	-4.5	-5.1	-14.5
May 09	-35.7	2.5	-40.3	-4.6	-1.1	-4.7	1.9
Jun 09	-34.7	2.7	-38.1	-19.9	2.3	-15.0	5.5
Jul 09	-26.7	2.6	-20.5	-24.1	-1.2	-13.9	18.7
Aug 09	-21.7						34.2

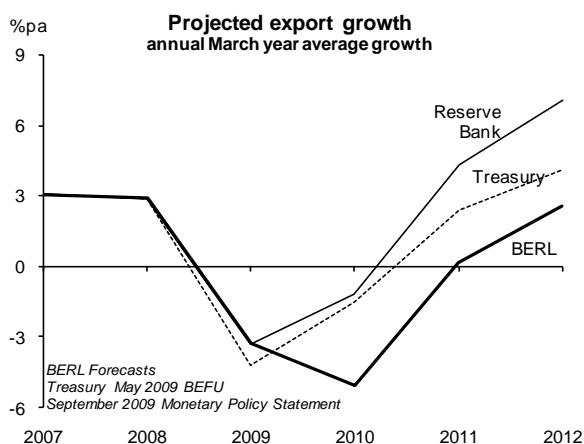
Statistics NZ; NBNZ # net expecting improvement

Looking ahead, our projection for GDP growth in the March 2010 year is -1.0%.

While this number looks worse than now, it is consistent with a quarterly profile of growth beginning from the June 2009 quarter. But the weakness of the recovery – barely 0.2% per quarter – ensures annual growth remains negative in the March 2010 year. Thereafter, we expect GDP growth to creep towards the 0.5% per quarter mark and register close to 2%pa for the March 2011 and 2012 years.

We are noticeably less optimistic than either of the Reserve Bank's or Treasury's latest forecasts of a quick rebound to a 3% growth trajectory. In this context, we remain unconvinced by the 'green shoots' argument. While we won't see a repeat of the 'shocks' from abroad, as we have had over the past year, the recurrence of additional isolated shocks cannot be discounted.

In addition, we have difficulty seeing a rapid recovery from the export sector. The forestry industry is making a contribution via increased log exports, but the prospects for any significant surge in processed products over the medium term is low. Further, export volumes from the meat industry remain static with cattle and sheep slaughtering totals for the year 7% down on the previous year.



Manufacturing has now shrunk for three out of the last four March years.

Consequently, the \$18bn contribution to GDP (in 1996\$s) from this sector in the year to March 2009 is equivalent to its contribution in the year to March 2003. That's six years of standing still! And export volumes from machinery and transport equipment in the year to June 2009 were over 9% down on the previous June year.

Meanwhile, the tourism industry has been saved (for the day) courtesy of the Australian government's largesse via the nation's ski slopes.

In behind this sad and sorry export tale is the exchange rate that defies any relationship to fundamentals. It is a story that will not be rectified unless the relative price signals between the tradable and non-tradable sector are similarly rectified.

Much as BERL has been critical of many Reserve Bank of New Zealand (RBNZ) actions over the past 20 years, we have to come to the RBNZ's defence on these matters. Under the RBNZ Act 1989, the prevention of inflation is its single responsibility and variation of the OCR has been chosen as its only instrument. As we have argued throughout, inflation was always and still is more than just a monetary problem and influencing interest rates at the short end was never an adequate method of managing the monetary component. So it's not the RBNZ's fault, or at least its current management's, that it has been given an impossible job to do and a useless instrument for the purpose.

In the meantime, the appreciation of the NZ\$ has continued, although at a slower rate. We believe the TWI is now near its top.

This is in contrast with the current market view that the US dollar has considerably further to fall. This could be true for the near term. But, taking a longer-term view, we note that financial authorities in general, and particularly in the

US, are already considering the “claw-back” of government provided liquidity to major banks.

We believe stimulus packages may soon begin to improve investment conditions in their respective real domestic economies. Thus we could have a concurrence of reduced liquidity and increased investment demand in major markets, both of which would tend to reduce capital outflow and therefore the demand for foreign currencies such as the Kiwi.

We doubt however that the TWI would fall to a level low enough to generate sustained export-led growth. As long as major currencies manage their currencies downward, it is inevitable that currencies not so managed will tend to be over-valued. If, as we believe, a TWI in the mid-50s is the natural rate required for such growth, it would follow that the actual TWI delivered by the market will fluctuate around a higher level, such as 60.

This is our longer term forecast of the TWI, but we would hesitate to guess when the decline is likely to occur.

Our concern for the medium to longer term is further heightened by the picture for private sector investment. The collapse in the March 2009 quarter (down 9.2%) means real investment spending by businesses in the year to March was 5% below that of the previous year. The prospects for a quick U-turn here are also unlikely, as businesses look to replenish cash flows and bank lending remains constrained.

And while short-term productivity numbers are set to look good, given reduced labour inputs,

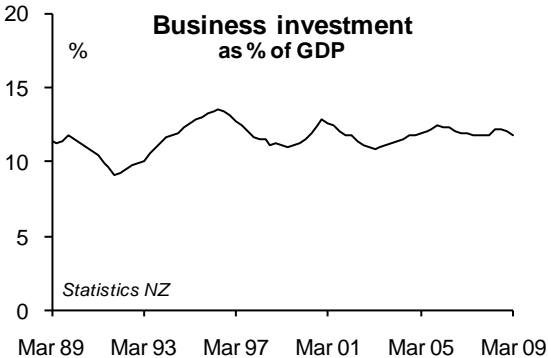
the prospects of longer-term sustainable productivity growth are not bright if business investment continues under pressure.

Therein lies our concerns as to the composition of economic activity. Consequently, our forecasts are tending towards yet another domestic spending base for the re-establishment of growth.

Despite the ‘technical’ end of the recession, a belated impact on employment numbers and numerous other labour market indicators is now being felt. While jobless numbers rose through last year, it wasn’t until the June quarter that employment growth turned negative coupled with an easing in participation rates.

We expect various labour market indicators to continue to lag behind overall economic activity. Businesses have not shed staff as quickly as in earlier recessions. Consequently, the return to positive growth as measured by GDP numbers this year will not be reflected in growth in employment numbers until later next year. But with such growth being muted, at best, unemployment numbers are set to remain high for some time.

Assisted by a slight reduction in participation rates, we are forecasting unemployment to peak at just over 7.3% in mid-2011. While well below some forecasts promulgated by others earlier this year, this is still a sobering number, representing over 170,000 officially unemployed. This represents a lengthy period of relatively high unemployment. So, while the recession may be technically over, the damage to economic performance and social conditions will continue well into the medium term.



# Feature: BERL's Submission to the Parliamentary Banking Inquiry

by Ganesh Nana

Over recent years *BERL Forecasts* have consistently argued that monetary conditions and settings (and expectations of policy changes) have unnecessarily hindered the development of the New Zealand economy. In particular, the pursuit of the primary target of inflation control has continued, while impacts on other economic targets have been relegated to side issues.

The Official Cash Rate (OCR) is implicitly accepted as the only tool to manage monetary conditions. But we would argue that it is unable to manage monetary conditions to the benefit of the New Zealand productive economy.

## Our contention

BERL's primary contention is that the breakdown in the "pass through of OCR cuts to variable interest rates" is a symptom of attempting to manage a modern open economy through periodic changes in a single instrument. The breakdown of the OCR's ability to influence monetary conditions occurred well before the onset of the global financial crisis.

During the upswing between 2004 and 2007, increases in the OCR singularly failed to rein in the expansion in NZ credit. As was reported at the time, this expansion in credit supply made its way into NZ residential property prices, which was met with even more futile increases in the OCR.

During the downswing and recession, the OCR has failed to provide the necessary easing of monetary conditions, as its influence over the cost of wholesale funds has diminished.

Furthermore, during times of up and downswing, the burden of adjustment imposed by the inappropriate use of the OCR has fallen relatively more heavily on the productive and, in particular, tradable sectors.

The impact on the business sector has been relatively larger, as seen by the more than doubling in the gap between the OCR and the business base lending rate. This gap has risen from an average of 3.3 percentage points over the nine years to April 2008 to 7.4 percentage points now. In comparison, the gap between the OCR and variable mortgage interest rates has risen from an average 2.2 percentage points over the nine years to April 2008 to 3.9 percentage points now.

## Our submission

We would argue, therefore, that recent events have provided further evidence of the need for the adoption of more pragmatic policy tools to complement the OCR. These tools should be used to provide an environment whereby the workings of the New Zealand banking industry and consequent monetary conditions serve the needs of the productive sectors of the New Zealand economy.

In particular, while money supply control has ceased to be effective as more sophisticated forms of credit have been developed, the basic concept that the volume of liquidity must be managed remains true. Clear management of the volume of liquidity must be established so that monetary authorities can successfully impose the necessary monetary conditions. To this end the RBNZ should be given explicit powers to modify Basel II ratios to meet New Zealand's circumstances, such as higher reserve requirements for mortgages to finance

purchases of existing assets and to finance consumption.

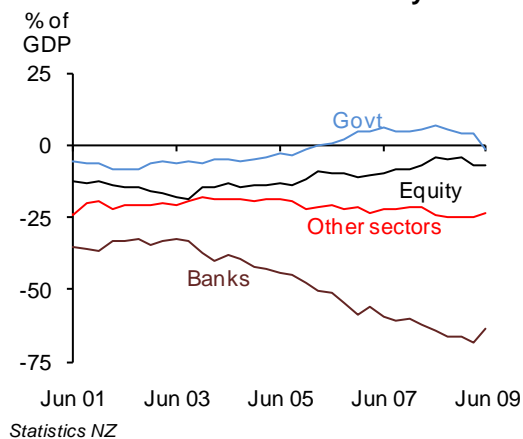
International capital account inflows should be managed by sterilized intervention to a level which is justified by levels of domestic investment. The RBNZ should also be required to prevent further deterioration of the New Zealand international debt position in light of our already high vulnerability.

This will, undoubtedly, result in a more regulated banking sector. This is the price we should be prepared to pay to obtain a banking sector that serves the needs of the productive New Zealand economy.

### Conclusion

New Zealand's net debt has worsened from 76% to 95% of annual GDP over the past eight years. More illuminating though, is the composition of this deterioration. As shown below, the net position attributable to the banking sector has deteriorated from 37% to 70% of annual GDP – accounting for more than all of the worsening over this period.

**NZ's Net International Assets by sector**



In essence, over the previous upswing, the banking sector has accommodated the inflow of funds attracted by the workings of our OCR mechanism.

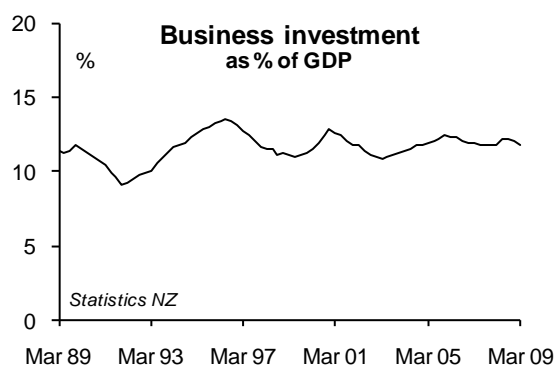
Without appropriate changes to the monetary framework, concern is likely to continue as to

the lack of OCR “pass through” to variable interest rates.

An even more pressing issue, however, is the inability of the OCR to manage monetary conditions in the widest sense. This would leave us in a situation best summed up by an excerpt from the latest OECD survey of the New Zealand economy:

*“New Zealand is paradoxically at the forefront of the OECD in adopting policies in many areas that have been shown to lead to high per capita income, and yet it still ranks toward the bottom end of the OECD’s productivity league. .... But, the root of the problem is a structural deficiency in the capacity to produce tradable goods and services.”*

We have done what we’ve been told to do by putting in place policies that have worked elsewhere, but that hasn’t solved our productivity problems. While the OECD may remain mystified as to the paradox, we are in little doubt that the “structural deficiency” is closely related to the lack of business investment, shown in the figure below.



And this lack of investment is, in turn, closely related to the burden placed on the productive, tradable sector – relative to that on the property, non-tradable, sector – by the inappropriate use of the OCR mechanism. Presumably the newly established Productivity Taskforce will also investigate these matters.

# Labour market

compiled by Fiona Stokes

## LABOUR MARKET INDICATORS 000s people

June quarter	2007	2008	2009	2010	2011	2012
Full-time employment	1,670	1,677	1,652	1,652	1,656	1,681
Part-time employment	497	507	514	514	518	523
<b>Total employment</b>	<b>2,166</b>	<b>2,184</b>	<b>2,166</b>	<b>2,166</b>	<b>2,174</b>	<b>2,204</b>
FTE employment growth %	0.8	0.6	-1.2	0.0	0.3	1.5
<b>Unemployment</b>	<b>80</b>	<b>88</b>	<b>134</b>	<b>160</b>	<b>171</b>	<b>156</b>
Official unemployment rate %	3.6	3.9	5.8	6.9	7.3	6.6
<b>Labour force</b>	<b>2,246</b>	<b>2,272</b>	<b>2,300</b>	<b>2,326</b>	<b>2,345</b>	<b>2,360</b>
Participation rate %	68.2	68.2	68.2	68.1	67.7	67.2
Not in labour force	1,046	1,059	1,073	1,090	1,119	1,152
Working age population	3,292	3,330	3,372	3,416	3,464	3,512

Statistics NZ and BERL calculations

BERL Forecasts

The recession is now making a belated impact on employment numbers and numerous other labour market indicators. While jobless numbers rose through last year, it wasn't until the June quarter that employment growth turned negative coupled with an easing in rising participation rates.

We expect various labour market indicators to continue to lag behind those of overall economic activity. Businesses have not shed staff as quickly as in earlier recessions. Consequently, positive growth as measured by GDP numbers this year will not be reflected in growth in employment numbers until later next year. But with such growth being muted, at best, unemployment numbers are set to remain high for some time.

Assisted by a slight reduction in participation rates, we are forecasting unemployment to peak at just over 7.3% in mid-2011. While well below some forecasts promulgated by others earlier this year, this is still a sobering number, representing over 170,000 officially unemployed. This represents a lengthy period of relatively high unemployment. So, while the recession may be technically over, the damage to economic performance and social conditions will continue over the medium term.

Total employment in June 2009 was 2,166,100, 18,200 less than in June 2008.

This decrease was due to a decline in the number of people employed full-time between June 2008 and June 2009. During this period, full-time employment declined 25,000 while part-time employment grew by 7,000.

It is no surprise to see that the largest fall in full-time employment occurred in the personal and household goods retailing sector, down 9.5%, while the largest fall in part-time employment was in the food retailing sector.

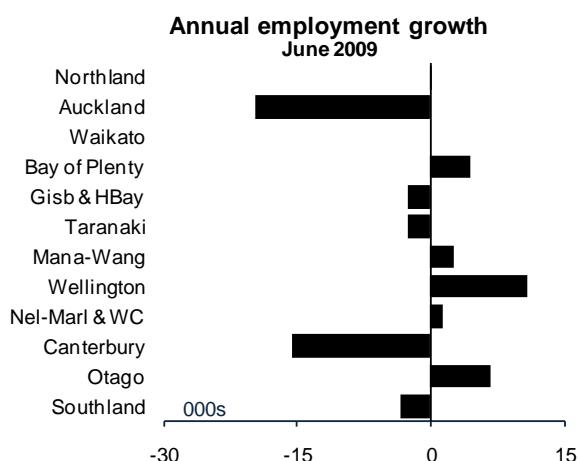
Total employment in the food retailing sector fell 10.1%, due to large decreases in part-time employment. Communication services also saw a 7.6% decline in total employment, largely due to a 5.8% decrease in full-time employment. Most of these job losses occurred within the telecommunication services sector of this industry due to changes within the network infrastructure of Telecom. With households reassessing their budgets, the sport and recreation sector has also seen job losses with total employment down 6.7% year-on-year, and an even split between losses in full and part-time employment.

This sentiment is reflected in the personal services industry. Full-time employment declined by 7.3% in the personal services sector between June 2008 and June 2009, while part-time employment grew 2.7%. Overall, total employment in this sector was

down by 4.6%. People employed in this sector provide services such as hairdressing, dry-cleaning, and hire personal goods and equipment such as videos and domestic appliances.

Overall service sector activity has continued to contract throughout 2009. Over the last three months the BNZ Capital – Business NZ Performance of Services Index (PSI) has averaged 47.1 and the employment index has been recording a three monthly average in the 45 range.

Previously we have discussed the two parts to the economy: the Auckland region with fairly strong employment decline, and the rest of the country that has continued to grow reasonably well. Annual changes in employment figures now indicate the impact on Canterbury employment of a decline in manufacturing.



Full-time employment in the printing, publishing and recorded media sector fell 6.8% between June 2008 and June 2009, followed by a 4.2% decline in full-time employment in wood and paper product manufacturing, 4.2% decline in

other manufacturing, 2.7% decline in metal product manufacturing, and 1.9% decline in textile, clothing and footwear manufacturing.

However, each of these industries had small increases in part-time employment year-on-year. Wood and paper product manufacturing lead the way with a 1.1% increase in part-time employment. The decline in full-time employment reflects restructuring within this sector that has resulted in the closure of mills. But, some mills have decreased the number of shifts they operate and have shifted to reduced operating hours to remain open and keep people in employment.

### Migration

The net inflow of migrants has now crept up from the 5,000 in the year ending July 2008 to 14,500 in the year ending July 2009. This net inflow predominantly consists of a decline in the number of people leaving for Australia. We would expect this trend to continue throughout 2009 and into mid 2010.

The net inflow of migrants from Asia has remained fairly stable over the last 12 months while the inflow of migrants from the Americas and Europe has slowly increased.

In our last forecast we discussed how the first four months of the year had seen the net flow lift to an annual rate of over 9,000 for the year ending April 2009. This increase in the last three months concurs with our belief that flows in the 20-30,000 range will be seen by the middle of 2010. In terms of outflows, we expect these to decline from 75,000 seen in the year ending June 2009 to 67,000 by mid 2010.

### PERMANENT AND LONG-TERM MIGRATION 000s people

Year ended June	2007	2008	2009	2010	2011	2012
Gross migrant inflow	82.7	85.2	88.3	94.0	98.0	105.0
Gross migrant outflow	72.6	80.5	75.7	67.5	71.0	76.0
Net migrant inflow	10.1	4.7	12.5	26.5	27.0	29.0

Statistics NZ

BERL Forecasts

## Māori in the labour market

As mentioned in our previous update, Statistics New Zealand's latest rebasing of the labour market data series (along with amended definitions of ethnicity) has made comparisons of employment numbers with earlier periods complex. Nevertheless, with some manipulation of the data, we can derive a picture of long-term trends in the Māori labour market.

As illustrated below, the latest set of data shows a significant fall in employment numbers and a matching rise in unemployment. Changes in the labour force and working age population are, unsurprisingly, more stable and in-line with longer-term trends.

Clearly, of considerable concern is the rapid deterioration of the job market. However, the table shows that this deterioration has occurred across the total market. The 11,400 increase in Māori unemployed over the past year is against the backdrop of a 46,000 increase in total unemployed.

Worryingly, the gap between the Māori unemployment rate and the national average appears to be increasing again. A year ago,

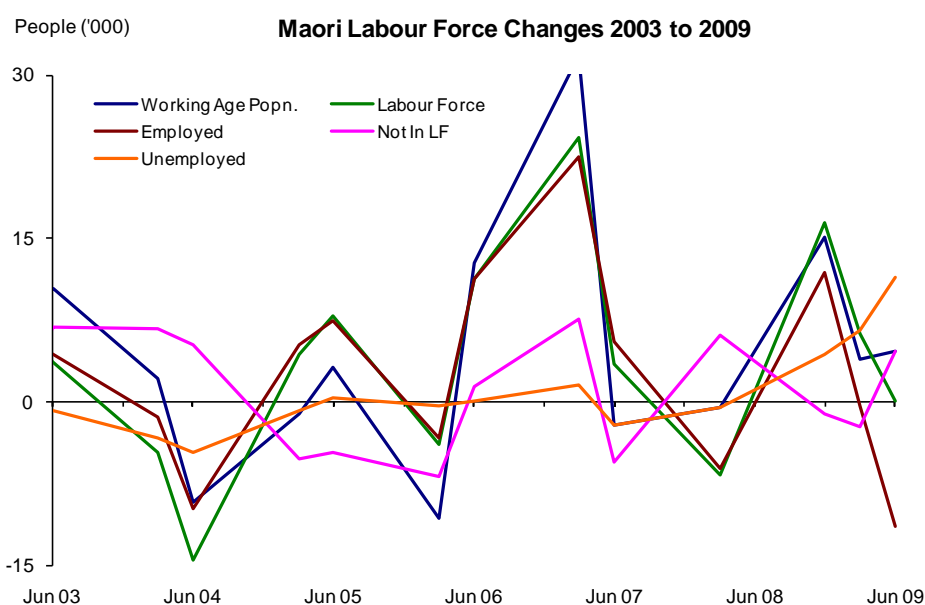
change from June 2008 to June 2009		
000s people	Maori	Total NZ
Employment	-11.4	-18.2
Unemployment	11.4	46.0
Labour force	0.0	27.8
Not in labour force	4.7	14.1
Working age population	4.7	41.9

the national unemployment rate was 3.9%, with unemployment amongst Māori standing at 7.4%. Now, the national rate has risen to 5.7% and the Māori unemployment rate has jumped to 11.6%, or 31,400 people.

Similarly, the labour force participation rate amongst Māori has slipped back over the past year to 67.1%.

Clearly, the recession will mean a somewhat subdued job market is likely over the near term. The potential for a relatively greater impact on Māori – in particular, given the weakness of manufacturing and some areas of construction – is already apparent.

This reinforces the importance of ongoing investment in Māori asset bases in order to underpin the long-term development and future of the Māori economy.



# GDP growth

compiled by Ganesh Nana

Real GDP growth has now been negative for the fifth quarter running, with a fall in economic activity of 1.0% recorded in the March 2009 quarter.

On the production side, the fall in GDP was led by a disheartening 7.1% fall in manufacturing activity. This followed falls of 3.9% in the December 2008 quarter and 3.2% in the September 2008 quarter.

Consequently, manufacturing industry GDP in the year to March 2009 was 5.6% down on the previous year. This means that manufacturing has shrunk for three out of the last four March years. Within manufacturing, the latest quarter's contraction has seen a large 4.8% decline in activity in the food and beverage sector (consistent with meat processing numbers). In addition, the 11.8% fall in the machinery and equipment sector and the 16.1% decline in metal product manufacturing cast serious doubt on the probability of any export-led recovery being imminent.

Other noticeable falls in the March quarter were registered in the export-related transport sector (down 5.6%); with wholesale trade down 3.7% and retail trade down 2.9%.

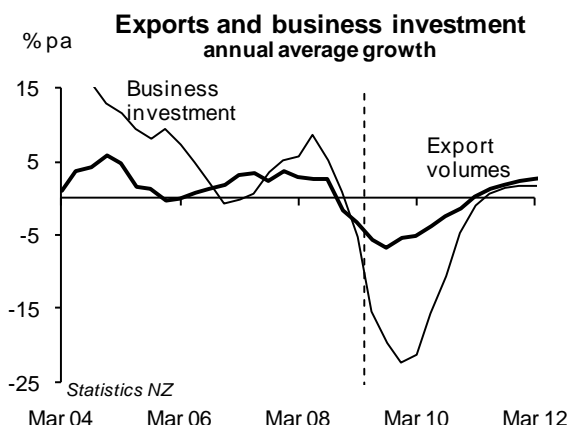
On the expenditure side, the fall in GDP was measured as only 0.7%. This decline was heavily driven by a large collapse in business investment – down 9.2%. This follows falls of 3.7% in the December 2008 quarter and 11.5% in the September 2008 quarter. Consequently, business investment in the year to March 2009 was 5.1% down on the previous March year. Needless to say, this lack of investment now does not bode well for the much-needed future productivity boost that we are awaiting.

The March quarter also saw a 1.3% contraction in consumer spending. In line with the fall in consumer and investment spending, import volumes were also down in the quarter. The 8.6% fall in this category took imports for

the March year to 4.2% below those of a year earlier. While there was a small 0.6% rise in export volumes over the quarter, the year to March was a disappointing 3.3% down on the year earlier. These numbers reinforce earlier comments as to the prospects for an export-led recovery.

Looking ahead, our projection for GDP growth in the March 2010 year is -1.0%, with the expenditure measure recording a smaller 0.5% decline as the arithmetic deals with the statistical errors between the two measures.

While these numbers look bad, these are consistent with a quarterly profile of growth beginning from the June 2009 quarter. Thus, technically anyway, the recession can be claimed to be over.



But the weakness of the recovery – barely 0.2% per quarter – ensures annual growth remains negative in the March 2010 year. Thereafter, we expect GDP growth to creep towards the 0.5% per quarter mark and so register close to 2%pa for the March 2011 and 2012 years.

We are noticeably less optimistic than either of the Reserve Bank's or Treasury's latest forecasts of a quick rebound to a 3% growth trajectory. In this context, we remain unconvinced by the 'green shoots' argument

and have difficulty seeing a rapid recovery from the export sector.

Our picture for private sector investment is also significantly negative as businesses replenish cash flows and bank lending remains constrained.

Consequently, our forecasts are tending towards yet another domestic spending base for the re-establishment of growth. That is, precisely the type of recovery that is extremely unhelpful given the long-term imbalances in the New Zealand economy that remain to be tackled.

#### GDP EXPENDITURE annual average % change

Year ended March	2007	2008	2009	2010	2011	2011
Private consumption	2.8	3.2	-0.7	-1.5	1.3	1.9
Housing investment	-2.3	4.6	-22.9	-10.0	1.1	1.6
Other investment	-0.2	5.7	-5.1	-21.2	-1.1	1.7
Govt investment	0.1	1.1	-4.6	-0.9	3.2	3.5
Government consumption	4.4	4.0	3.3	1.8	1.1	1.5
Gross National Expenditure GNE	1.5	4.3	-2.3	-4.3	1.2	1.9
Exports	3.1	2.9	-3.3	-5.1	0.2	2.6
Imports	-1.5	9.5	-4.2	-16.5	0.3	2.2
<b>Gross Domestic Product GDP</b>	<b>2.9</b>	<b>2.4</b>	<b>-1.7</b>	<b>-0.5</b>	<b>1.2</b>	<b>2.1</b>

Statistics NZ

BERL Forecasts

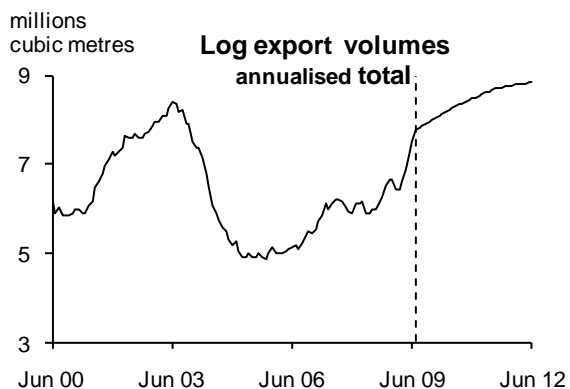
# Forestry

compiled by David Norman

Total forestry exports are up, but this hides inverse fortunes for logs and pulp. While log exports are up 58% year on year, high electricity prices and continued strength in the NZ\$ are battering pulp exports.

The commercial electricity energy price index suggests that commercial electricity prices dropped 29% in the nine months to March 2009, and are now just 4.1% higher than in mid-2005, but there appears little flow-through of this to higher exports of pulp. This may well be the result of the NZ\$ rising from 52 to 63 on the TWI since February, meaning reductions in the cost of producing pulp have been offset by an overly-strong dollar. This was certainly the reason cited for the Gisborne pulp mill closure in July, with the loss of 65 jobs.

Nevertheless, on the whole things are looking far more positive in the forestry export sector than they have for some time. The total value of forestry exports in the July 2009 year was \$1.75bn, up 13% over the year before.



Pulp contributed nearly 30% of forestry export earnings in 2006, but now accounts for half that share. Timber produced 40% of forestry export earnings in July 2006. Despite China picking up some of the slack created by collapsing demand from the United States, timber now accounts for just 35% of forestry exports. Meanwhile, export earnings from logs have increased dramatically, from 30% in 2006, to 50% in the July 2009 year.

**Log** export values in the July 2009 year were the highest ever recorded, at \$880m, up 58% year-on-year. And the gains were not simply the result of increased volumes. While there was a 29% increase in volumes, to 7.76m m<sup>3</sup>, average annual prices rose 22%, to an eight-year high. At \$113.40/m<sup>3</sup>, this was the highest annual average price since May 2001, when a cubic metre fetched \$115.60. Where is all this demand coming from? The usual suspect – China. Up from just 16% of log export receipts in 2006, the Middle Kingdom now takes almost half (49%) of log exports.

**Timber** exports are up a more sedate 7.0% over the year before, but once again, the increase is the result of both quantity and price increases. Total value exported stood at \$623m for the July 2009 year, up from \$583m the previous year. Prices are rising, up 3.0% in the year, to \$384/m<sup>3</sup>. Export volumes were up 3.8% on the year before, to 1.6 m m<sup>3</sup>. As with logs, China is taking a far bigger share, up from 10% in 2006 to 17% in 2009. At the same time, the collapse of the US housing market has led to plummeting demand from there. The US now takes just 20% of timber exports, down from 36% in mid-2006.

**Pulp** export earnings from pulp have fallen 38% year-on-year. This is the result of New Zealand pulp production becoming less competitive due to higher electricity prices here. Total value of pulp exports was \$251m in the July 2009 year, down from \$407m the year before. And export values continue to head in the wrong direction, with no sign of improvement in the last few months. Export values are lower on account of weaker prices and lower volumes. Prices are 10% lower than a year ago, while volumes are off 31%. Volume exported in the July year stood at 404,000 tonnes, down from 588,000 tonnes the year before.

# Agriculture

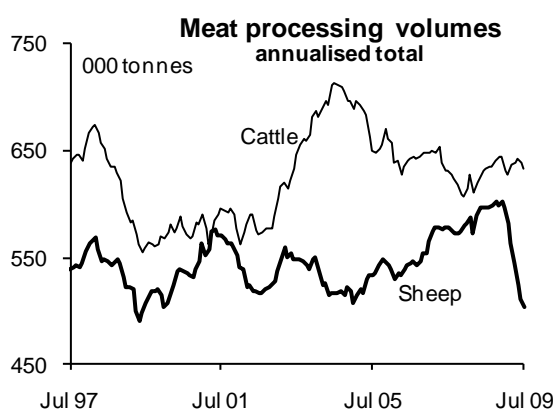
compiled by Michael Webster

## Meat and wool

International demand is increasing as the economies of our trading partners begin to recover. However, farmers are keeping a nervous eye on the volatile exchange rate situation, which could easily erode any potential gains. The situation is so uncertain that Meat and Wool New Zealand provided a range of forecasts for the 2009-10 seasons' farm gate prices, dependant on the movement of the US dollar. This insecurity cannot help but put a damper on any potential export-led recovery.

Beef prices have remained steady over the past three months, with improvements in commodity prices eroded by the strengthening dollar. Prices for lamb remain around 30% higher than the same period last year, primarily due to continued solid commodity prices.

Export meat prices were up 20.7% in June 2009, compared with a year earlier. At the same time volumes were down 1.7%.



On the supply side, farmers are retaining stock to rebuild animal numbers from last year's drought. We expect this retention to lead to an increase in the total number of sheep in New Zealand for the June 2010 year, the first such increase for a number of years. As a result of this higher stock retention, we also expect a drop in sheep processing volumes. For the three months to July 2009, sheep slaughter

numbers have fallen 33% from the same period last year. NZX Agrifax estimates there will be 1 million lambs processed over the last two months of the season, with total slaughter finishing at 22 million (17% below last season).

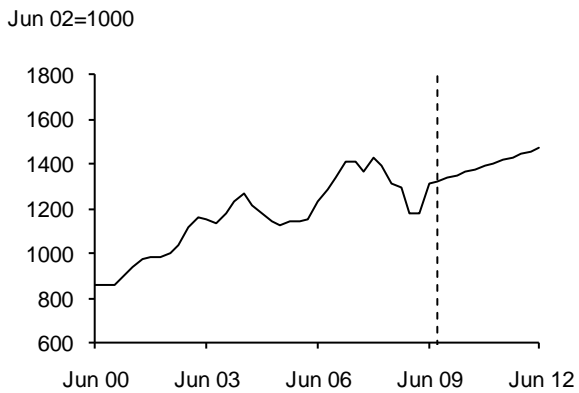
Due to uncertainty around prices and lower supply, our projections for the June 2010 year are relatively muted, with meat prices up 0.5% year-on-year from June 2009, and volumes increasing by 1.0%, leading to an overall increase in value of 1.5%.

Wool prices have remained relatively static over the last few months, with only medium micron grade increasing in price from the same period last year. There has been no sign of recovery for this sector, where export volumes have fallen 13.6% over the July 2009 year and values have fallen 8%. We are projecting no magic wand will appear for this sector - wool volumes will increase by 1% for the June 2010 year, but prices will fall 2%, leading to an overall fall in value of 1%.

There is another straw to grasp for those looking to increase the profitability of the New Zealand meat sector. Silver Fern Farms (SFF), our largest meat processor, and Livestock Improvement (LIC), a major herd improvement organisation, have developed a pilot programme to show the profitability of an integrated meat sector supply chain, 'from plate to pasture'. This programme, which begins this month, will involve around 150 farmers and 150,000 lambs destined for Europe. According to the organisers, this will 'pave the way for an integrated supply chain for red meat that will add significant value to New Zealand's export trade.' Hopefully this will lead to a new way forward for the industry, which has been directionless since proposed mergers between SFF, Alliance and PGG Wrightsons fell through last year.

## Dairy

For the June 2009 year, dairy volumes fell 0.4%, while prices rose 2.8%, leading to an increase in value of 2.4%.



While the international dairy market remains volatile, there have been encouraging signs from the last two globalDairyTrade internet dairy auctions, held in August and September, with average prices for whole milk powder increasing from \$1,829 per tonne free alongside ship in July, up to \$2,858 per tonne in September. According to Fonterra, international customers wishing to restock low inventories, coupled with recovering demand, are the main reasons behind these price rises.

We project dairy prices to fall around 0.5% for the June 2010 year, as the record high prices of mid 2008 fall out of the calculation, while volumes increase by 4.0% from drought levels. Therefore the values for dairy product exports are expected to increase 3.5% for the June 2010 year.

On 5 August, Fonterra stated that it would consolidate its port usage in order to increase efficiency in its supply chain. As a result, the volume of dairy products moved through the ports of Taranaki and Timaru will be reduced by 65% and 80% respectively. While obviously bad news for the regional ports, any efficiency gains will equate to dividends to the farmers.

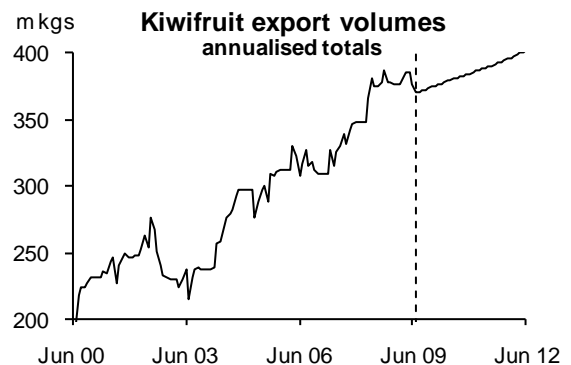
## Horticulture

### Kiwifruit

The 2009 crop has been picked and packed, and around 65% of all products have been shipped. Exports of gold kiwifruit, which historically has an earlier season than green kiwifruit, have been completed and the last shipment bound for Asia headed out in the first week of August.

To forestall lower demand caused by international uncertainty and increasing supply of competing summer fruit, Zespri has embarked on a major international advertising campaign. To date, this campaign and the high quality fruit grown this season have successfully kept up margins for New Zealand kiwifruit in European and Asian markets.

The value of the fruit shipped from April through to July was \$692m, up 13% compared with the same period the year before. Most of this increase in value was caused by higher prices, with only a slight rise in volumes. That said, the season is playing out earlier this year and could lead to a drop in volumes later in the season compared with the previous year.



Looking ahead, we expect an annual increase of 6.4% in kiwifruit values in the June 2010 year. Most of this increase will be from higher prices, up 5.5%, while quantities will remain flat, up 0.9% from June 2009 to June 2010.

## Apples

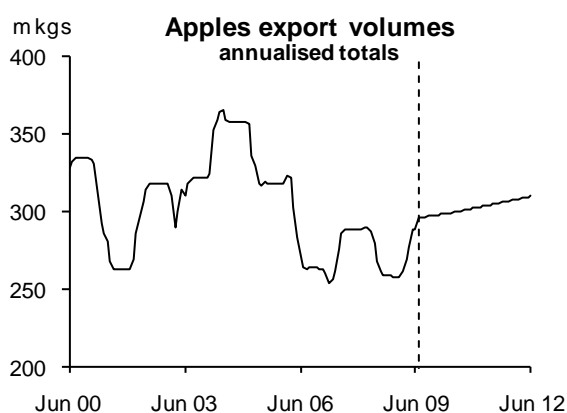
The apple export season is also complete, with most apples shipped by the end of July.

Braeburn volumes and values were much improved from the poor harvest of 2008. Volumes were 18% higher and values were 14% higher in the June 2009 year compared with the June 2008 year. Other varieties that had a strong showing in the June 2009 year were Jazz and the new variety Tentation.

The Jazz variety was extremely popular in Europe in 2009, with increased volumes of 48% for the year. Tentation, a variety first exported in 2006, has made considerable gains, with volumes increasing around 50% on the previous year. Royal gala, our largest export variety, showed no change in volume but a 9% increase in value for the June 2009 year.

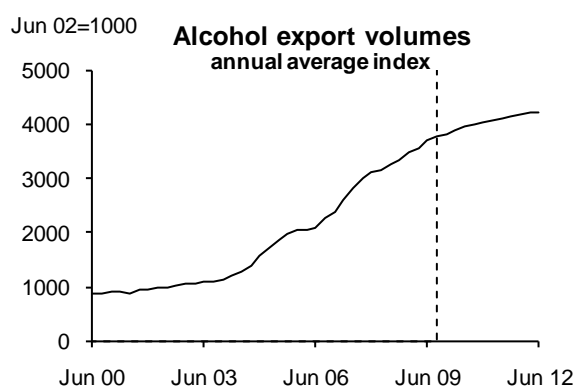
Overall, the quantity of apples exported in the June 2009 year increased by 13.2%, while prices increased by 5.8%. As a result, overall FOB value for apples grew by a solid 19.7% over the year.

We project that in the June 2010 year, apple export values will pass \$400m, increasing by 4.3% for the year. This will be driven mainly by higher quantities shipped in the new season, as exporters take advantage of the increasing market share of New Zealand apples.



## Wine

The wine industry in New Zealand continues to grow, with 58 additional wineries opening in the June 2009 year. Wine exports are also on track to reach the \$1 billion dollar mark for the June 2010 year. For the July 2009 year, annual exports of wine were worth \$983m, 24% higher than the previous year.



According to New Zealand Winegrowers, this growth was due to strong demand in key markets, especially Australia, the UK and USA.

International prices for New Zealand wine have remained high due to the niche, high quality status of this wine, which has allowed exporters a healthy price-point difference despite falling consumer demand.

According to the latest available data from Rabobank, prices have stayed around \$9.00 a litre for the May 2009 year. This is in stark contrast with Australian wine, which is mainly cask and bulk wine of lower quality, and Australian wine export prices have trended downwards since September 2008.

That said, as the wine sector grows, increasing supply and competition could erode profit margins for the 2010 season. Management of supply to export markets will be key in keeping prices high.

# Retail

*compiled by Adrian Slack*

Electronic card transactions (ECTs) are a lead indicator of spending behaviour.

The latest ECT data are another sign that New Zealand consumers are wary of credit, but are not entirely averse to it. Credit card use continued the downward trend of the past two years, dipping to 45.8% of transactions in the year to August 2009. But given the value of seasonally adjusted retail sales has been static over the last year, this means people aren't spending less, but are taking advantage of EFT-POS to use debit cards and cheaper overdraft or revolving credit accounts.

Seasonally adjusted ECTs in the retail industry were relatively static, rising by 0.2% in August. Core retail sales, which exclude motor vehicle-related industries, rose by only 0.1% in August, following a 1.1% increase in July.

Another key retail trade sector indicator is Statistics New Zealand's retail trade survey. The July survey, released this week, reinforces the weak overall picture for this sector.

Seasonally adjusted retail sales in July 2009 fell by 0.5% in the core industries and by 0.4% in the four motor vehicle industries. The biggest changes were a fall in automotive fuel retailing (-2.9%, \$15m) and a rise in motor vehicle retailing (2.1%, \$11m). The strengthening New Zealand dollar will help car importers by making it cheaper to buy in second hand cars from overseas. But fuel retailers will also feel the impact of substantially lower petrol prices, which fell 17% in the year to June 2009.

Sales in recreational goods retailing industries and the accommodation industry rose by \$7m. Sales fell by \$6m for department stores and the 'other' retailing category, which includes industries such as garden supplies, flower

retailing and antique/used goods retailing. Sales in most industries rose or fell by less than \$3.5m.

The regional picture has continued to shift over the past couple of months. Confidence has returned most strongly amongst consumers in the Auckland region.

Nominal retail sales grew by 3.2% in between the June and March 2009 quarters. The latest data for the month of July 2009 show retailers in Auckland rang up \$1,748m in sales, which is \$40m (2.3%) more than the same month a year ago. This level of growth in retail sales values may be consistent with stable or growing sales volumes too, but we lack regional retail inflation data to be able to confirm this.

Nationally, inflation in the retail trade sector was 2.4% over the year to June.

Retail sales values rose by 1.3% in the Waikato region between the June and March 2009 quarters. But the July 2007 level was still 0.8% lower than the same month a year ago. Sales in the Wellington region and the South Island continued to contract over the past quarter.

In a proactive step by the Police, a Crime Prevention Expo held in Tauranga informed retailers about how to protect their profits by reducing the opportunity for criminal activity within their workplace.

Police estimate that retail loss through theft is estimated to be between \$650m to \$1bn annually or between one and one-and-a-half percent of total retail trade turnover. Some retailers report that their loss is as much as 5% of turnover.

# STATE OF THE NEW ZEALAND ECONOMY (SONZE) SEPTEMBER 2009

Indicator	Period	Latest data	Unit	Measure	year ago comparison	+ or - ?			
<b>GENERAL SITUATION</b>	Employment	quarter	Jun 09	number (000s)	2,166	2,184	-		
	growth			% chge on prev yr	-0.8	0.8	-		
	LF participation rate	quarter	Jun 09	%	68.2	68.2	-		
	Net permanent migration	3 month	Jul 09	number	4,126	-1,186	+		
	Business confidence	month	Aug 09	net % optimistic	34.2	-20.5	+		
	Own activity outlook	month	Aug 09	net % optimistic	26.0	4.7	+		
Government OBE GAL	FY to date	May 09	\$m	-1,209	7,269	-			
Government net worth	spot	May 09	\$m	98,985	102,078	-			
<b>EXTERNAL SECTOR</b>	Milk powder, butter & cheese	3 month	Jul 09	tonnes (000s)	561	352	+		
	growth			% chge on prev yr	59.5	-8.0	+		
	Meat	3 month	Jul 09	tonnes (000s)	230	249	-		
	growth			% chge on prev yr	-7.5	9.3	-		
	Logs and timber	3 month	Jul 09	000s m <sup>3</sup>	3,052	2,134	+		
	growth			% chge on prev yr	43.0	4.0	+		
	International visitors	3 month	Jul 09	number (000s)	453	459	-		
	growth			% chge on prev yr	-1.2	-0.1	-		
	Merchandise receipts	3 month	Jul 09	\$m	10,375	10,767	-		
	growth			% chge on prev yr	-3.6	23.3	-		
Merchandise payments	3 month	Jul 09	\$m	9,965	11,949	+			
growth			% chge on prev yr	-16.6	18.9	+			
Current Account Balance of Balance of Payments	annual	Mar 09	% of GDP	-8.5	-8.0	-			
Net international assets	spot	Mar 09	% of annual GDP	-98.3	-86.4	-			
<b>INDUSTRY, INVESTMENT &amp; BUILDING ACTIVITY</b>	Performance of manufacturing index (PMI)	3 month	Jul 09	average index	45.3	46.2	-		
	PMI new orders	3 month	Jul 09	average index	48.3	45.4	+		
	Imports of plant and machinery	3 month	Jul 09	\$m	1,563	1,623	-		
	growth			% chge on prev yr	-3.7	10.6	-		
	Real business investment	quarter	Mar 09	1996\$m	4,509	5,513	-		
	growth			% chge on prev yr	-18.2	6.1	-		
	Non-residential building consents	3 month	Jul 09	number	3,559	4,518	-		
growth			% chge on prev yr	-21.2	-0.5	-			
House building consents	3 month	Jul 09	number	3,552	4,468	-			
growth			% chge on prev yr	-20.5	-36.7	+			
<b>DOMESTIC ACTIVITY</b>	Retail sales (excl mv)	3 month	Jul 09	\$m	11,639	11,339	+		
	growth			% chge on prev yr	2.6	2.0	+		
	Motor vehicle new registrations	3 month	Aug 09	number	30,636	39,114	-		
	growth			% chge on prev yr	-21.7	-24.7	+		
	Guest nights	3 month	Jul 09	number (000s)	5,880	5,905	-		
	growth			% chge on prev yr	-0.4	-0.9	+		
Electricity generation	quarter	Mar 09	GWH	9,545	10,015	-			
growth			% chge on prev yr	-4.7	1.8	-			
Ready-mix concrete production	quarter	Jun 09	000s m <sup>3</sup>	680	918	-			
growth			% chge on prev yr	-25.9	-6.6	-			
<b>FINANCIAL &amp; MONETARY CONDITIONS</b>	Consumer price inflation	quarter	Jun 09	% chge on prev yr	1.9	4.0	+		
	Producer inputs price inflation	quarter	Jun 09	% chge on prev yr	-1.2	12.3	+		
	NZX50 share prices	month	Sep 09	average index	3075	3312	-		
	House sales	3 month	Jul 09	median days on mkt	40.0	53.3	+		
	Credit card balances outstanding	3 month	Jun 09	% of retail sales	99.7	96.5	-		
	Exchange rate TWI	month	Sep 09	average index	63.2	63.8	-		
	90 day interest rate	month	Sep 09	average %	2.70	7.95	+		
	90 day interest rate margin w th Australia	month	Sep 09	basis points difference	-68	67	+		
	<b>SUMMARY</b>				<b>20</b>	<b>+</b>	<b>0</b>	<b>↔</b>	<b>30</b>

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