

BUSINESS MATTERS

Kiwibank Business Banking wants to help Kiwi businesses succeed. We've teamed up with Business and Economic Research Limited (BERL Economics) to bring you this economic update.



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The post-election fiscal outlook

In general, there are a number of positive economic factors on the medium term horizon. But the gloom of the Euro-zone debt crisis is a heavy cloud that is likely to dampen the near term recovery. This means the new government has some difficult choices to navigate.

On the positive side, the Christchurch rebuild is gaining momentum, and high export commodity prices are buoying export revenues and incomes.

The re-elected National government remains committed to reining in government spending, which will continue to fall as a percentage of GDP out to 2016. With the commitment to increasing public sector efficiency, programmes such as Whanau Ora will come under scrutiny. The OECD's recent report on social cohesion and economic development noted social programmes should be "affordable and sustainable". The scrutiny of Whanau Ora – and other programmes – should examine whether it passes this test or not.

We believe that Treasury anticipates the positive impacts from the rebuild of Christchurch too early and has not put enough weight on the negative impacts of the on-going European debt crisis. That crisis poses a risk to the positive outlook, and the tax revenue and employment associated with it. If the European debt crisis causes growth in China to slow, then world agricultural commodity prices are likely to soften, which will hit our exporters in the pocket – and the government's coffers.

We believe these two influences will delay the major drivers of the recovery and means the recovery will occur over a longer timespan. This will leave unemployment and welfare payments higher for longer. We expect nominal GDP to grow by just under 4% in the next year, after removing the effects of inflation, we expect output to grow (in real terms) by around 1% in 2012. This would still leave unemployment at between 6 and 7% out to 2013. This is well above the rates experienced before the Global Financial Crisis.

With softer growth (and tax revenue) and higher welfare expenditure, the government's accounts are likely to stay in the red out to 2015/2016.

It is unclear how the government would handle any delay to getting its books back into the black (and the debt it builds in the meantime). The latest OECD global economic outlook warns New Zealand that "further fiscal slippage and renewed widening of the current account deficit could provoke sharply increased international funding costs, jeopardising growth prospects and increasing debt service burdens."

Is this the end of the road for the Euro?

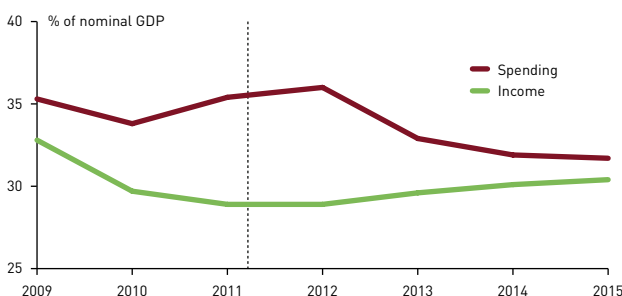
With the Eurozone markets lurching from one crisis to another, are we seeing the death throes of the Euro, or will the new technocrat governments in Greece and Italy right the ship?

November saw the resignation of the Greek Prime Minister George Papandreou and the Italian Prime Minister Silvio Berlusconi. The lack of progress on their countries' sovereign debt crisis spelt the end for both men. New Prime Ministers Mario Monti (Italy) and Lucas Papademos (Greece) now have the important jobs of pushing through economic reforms and reassuring the global financial markets that, under their temporary leaderships, their respective economies will be stable and investment in government bonds will be safe.

These events occurred shortly after a three-part deal was reached by the European Union and banks holding Greek debt in late October. This deal aimed to stabilise the debt crisis in Greece. In this deal, EU member countries agreed to increase the size of the European Financial Stability Facility (EFSF) to one trillion Euros while banks holding Greek bonds agreed to write off 50% of their holdings. The third part of the deal will then see banks increasing their capitalisation by 106 billion Euros by June 2012.

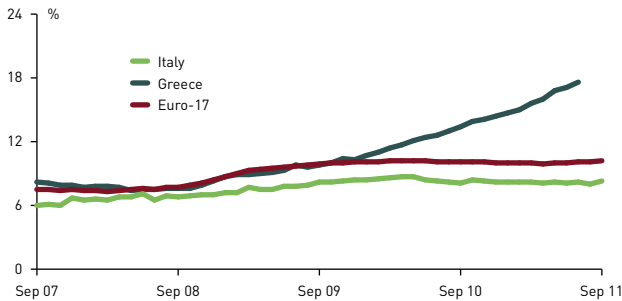
Govt income and spending (BERL Forecast)

Treasury, BERL



**Unemployment rate
% of labour force**

Eurostat



Global financial markets are watching to see if Prime Ministers Monti and Papademos have the political willpower to push through the measures demanded in exchange for much needed bailout cash.

When financial markets perceive that the risk of default on government's bonds is increasing, they demand higher interest rates to counter this risk. This in turn makes it more expensive for a country to finance its debts, and can push it closer to default. This occurred in Italy where the yields on its government 10 year bonds steadily increased from 5% in August to 7.25% on 9 November. To stop this, financial markets need to be reassured that Italian – and Greek – government bonds are safe investments.

So far, Prime Minister Monti has unveiled a 30 billion Euro austerity package. It includes raising both sales and property taxes and lifting eligibility age for the pension. This package comes as European leaders meet in December in Brussels to plan on how to stabilise the currency bloc.

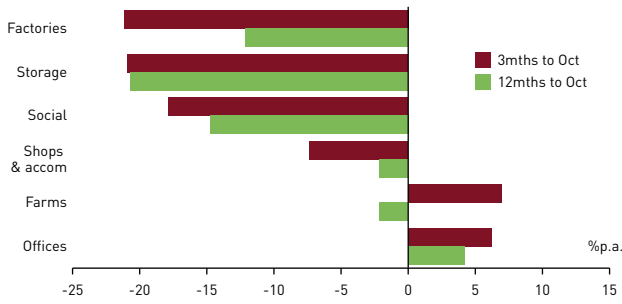
The effect of the latest debt crisis on New Zealand's economy is a story of 'watch and wait'.

Downturn continues in building construction and manufacturing

The 12-month running total for non-residential building consents sat at 12,630 in October. This means when we compare the last 12 months with the previous 12 month period, non-residential building consents were down 6.6%.

**Non-residential building consents growth
% change on year ago**

Statistics NZ

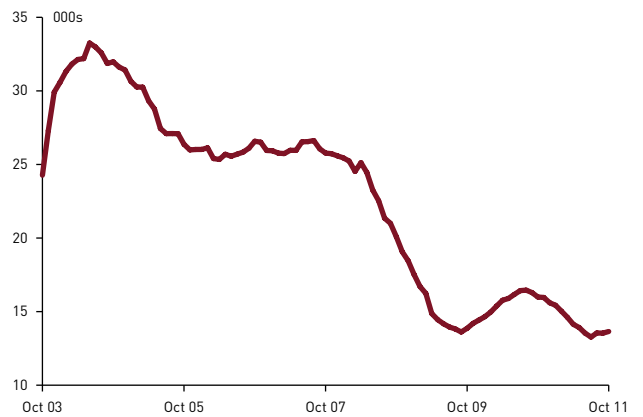


Comparing the three months to September with the same period last year, the biggest changes come from a 21% decline in the number of consents for factories and storage buildings, and an 18% decline in consents for social buildings (hospitals, education, religious and cultural buildings).

Residential consents for new buildings in the October 2011 quarter relative to the same quarter a year ago were down in the lower North Island: -30% in Taranaki, -23% in Manawatu-Wanganui, -15% in Hawke's Bay and -23% in Wellington. At the other end of the scale, consents in Auckland, Waikato, Gisborne, and Bay of Plenty were all up.

**Residential building consents
annualised totals**

Statistics NZ



The downsizing of the construction industry seems to be slowing, but there are 20,000 fewer people employed in this industry now than in 2007 – a whopping 10% difference. The occupation data shows that most of these losses are in the building and related trades, and professional engineers. This picture is a reflection of migration data, and will become more of a concern when the tortuous Christchurch process finally gets to the point of re-construction.

Looking ahead, we are forecasting that the 12-month running total for residential building consents will sit at 19,200 in October 2012 before moving towards 23,500 in October 2013.

Global uncertainty and subdued building construction activity is also showing through in the employment data and sentiments of the manufacturing surveys that we monitor.

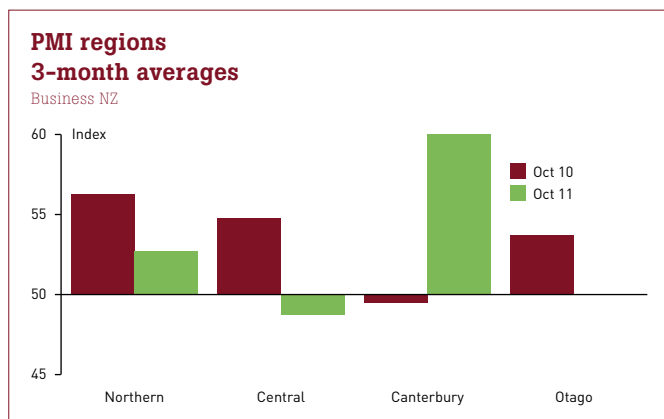
The Household Labour Force Survey indicates that in the September 2011 quarter manufacturing employment was down 0.4% compared to the same quarter in 2010. During this period full-time employment in areas such as food product manufacturing and wood product manufacturing fell, while employment in fabricated metal product manufacturing and machinery and equipment manufacturing grew.

These surveys indicate that underlying uncertainty in regards to the global economy, and in particular our markets beyond Australia and China, continues to hold back expansion. On-going frustration in Canterbury in terms of the rebuild is also leading to a decline in net confidence among businesses.

The New Zealand Manufacturers and Exporters Association Survey of Business Conditions indicate that domestic manufacturing sales decreased by 15.4% in October 2011 compared to October 2010, while manufacturing export sales increased by 23.7%. Overall, total sales decreased by 1.5% year-on-year and net confidence among the businesses surveyed was down.

The BNZ-Business NZ seasonally adjusted Performance of Manufacturing Index (PMI) stood at 46.5 in October, indicating that manufacturing activity has eased after remaining above 50 throughout 2011. Each of the indices that make up the PMI was below 50 in October, with the highest being – surprisingly – employment sitting at a measly 48.6. In regards to three-monthly averages, the PMI stood at 51.6 in the three months to October, and production, employment and new orders were also all sitting above 50.

At a regional level, this downturn in activity can also be seen through a comparison of the three-monthly average year-on-year.



Europe’s debt crisis also continues to impact on the international manufacturing surveys we monitor. JPMorgan Global Manufacturing and Services PMI sat at 50 in October 2011, a slight increase from the 49.8 seen in September 2011. Global manufacturing activity remained stagnant in October with production levels and new orders falling. As mentioned in previous editions, global manufacturing is currently lop-sided with manufacturing in the United States largely stagnant while in the Eurozone manufacturing levels are contracting.

Retail trade swells with RWC visitors, but NZ consumers remain cautious

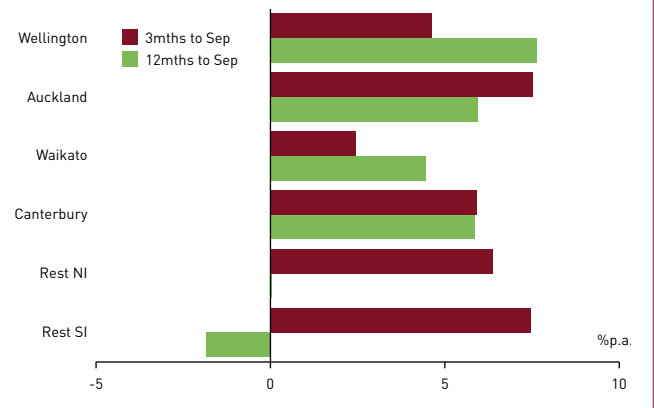
The Rugby World Cup 2011 provided a lot of the impetus to boost retail sales. Statistics New Zealand estimated that 80,000 people came to New Zealand for the RWC. This is the equivalent of temporarily adding 1.9% to the New Zealand population. While we cannot clearly isolate this impact, the increases are of a similar magnitude: seasonally adjusted retail sales – in real terms – climbed in the September quarter by 2.2%.

The rises in retail sales were also in the sorts of industry where we would expect them. Accommodation rose by 8.7%, food retailing by 6.4%, non-store retailing (which covers internet retailing, mobile food retailing and vending machines) by 4.2% and supermarkets and grocery stores were up 4.1%. Liquor retailing (3.3%) and pharmaceutical sales (3.8%) – perhaps not surprisingly – increased by similar proportions.

The rises were spread across the country, with an average increase in dollar terms of 4.4% in the North Island and 2.1% in the South Island. The swell in the South Island, was mainly outside of Canterbury. Canterbury experienced the lowest growth in the county, at 0.5%, but still managed to add almost \$9 million of sales in the three months to September.

Growth in retail sales by region – total % change cf year earlier

Statistics NZ



Inflation in the retail trade sector has been restrained, overall. According to the retail trade deflator index, retail trade prices rose by only 0.2% overall in the September quarter. However, the top-line figure for the quarter disguises some changes for particular industries. The rises came in food retailing (4.0%), accommodation (1.4%), and supermarkets and groceries (1.2%), while the falls were in fuel retailing (-4.1%), electrical and electronic goods retailing (-3.6%) and small changes (-0.2%) for both recreational goods retailing and department stores.

Electronic card transactions also registered a rise in expenditure on durable goods. Sales of these goods – in seasonally adjusted terms – rose by 0.5% during October, and this followed on from a rise of 1% in September. This may be a positive indicator of improving consumer confidence.

New Zealand consumers are also continuing to show some restraint in adding to their debt, despite relatively low interest rates. The share of electronic transactions going onto credit cards has fallen away from its high of 48.2% in early 2008 to 43.2% in October 2011. While this may be a re-balancing of the way people manage their debt – with the purchase going onto the mortgage rather than the credit card – it is a positive sign of moving towards better financial management.

We had been expecting some increase in the hospitality industry as a result of Rugby World Cup 2011, but this did not eventuate. In fact the accommodation and food services industry lost about 6,000 employees, and retail lost a further 3,800 in the year to September 2011. Possibly there will be some increase in employment in these sectors in the December quarter, but we remain cautious in our optimism.

While the ‘new normal’ takes hold

The prevailing sense of uncertainty that has gripped the global economy has resulted in a new normal. For those yearning for a return to ‘business as usual’ à la the mid-2000s, this might come as a surprise. But, uncertainty is a likely feature of the global economic situation for some time to come. As indicated above, the European finance and currency arrangements are unlikely to be settled promptly. And issues with the United States debt situation will re-emerge through next year as the interim deal reached earlier this year frays. In addition, next year has presidential elections in both the United States and France, and federal elections in Germany are due in 2013.

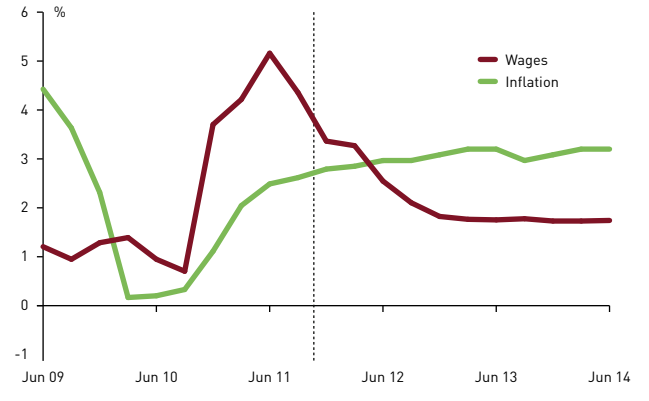
For New Zealand, the concept of an uncertain world is something we must get used to. In the immediate future, the argument that the current level of the Official Cash Rate is 'abnormally' low and must be increased carries less and less weight as the prospect of continuing uncertainty grows. Indeed, assertions that the OCR is currently 'low' are arguably based on a desire to return to previous 'business as usual' levels. But, the on-going consequences of the 2008 financial crisis reinforce the argument that there is no return to the previous 'business as usual'.

Looking ahead, our view of inflation has not changed: uncertainty in the global environment will continue to keep prices in check. This will dampen any enthusiasm resulting from a strengthening New Zealand economy. As a result, the CPI should return sharply to around the 2.3% to 2.5% range from mid 2012.

The uncertainty is likely to see the OCR remain on hold for most of 2012. This watch-and-wait scenario translates into a New Zealand economy that is 'on hold' for most of 2012. The timing of the Christchurch re-building effort could be a circuit breaker that extracts us from this holding pattern. Unfortunately, this is also an area of uncertainty due to planning and regulatory matters as well as concerns regarding the available skills and capacity of the construction industry.

Prices and wages annual % change

Statistics NZ



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