Monthly Economic Indicators

THE TREASURY
Kaitohutohu Kaupapa Rawa

June 2010

Executive Summary

- **The economy has been growing for a year but recovery more gradual than in the past**
- **Economic expansion is set to continue but recent data suggest that growth over 2010 may be slightly weaker than expected**
- **Global sentiment remains volatile and downside risks have increased relative to Budget**
- **External indebtedness likely to increase despite recent declines in current account deficit and favourable terms of trade**

The New Zealand economy expanded throughout the 2010 March year, with real GDP increasing 0.6% in the March quarter. This was slightly weaker than forecast, but the level of nominal GDP was in line with forecast. Growth in the March quarter came from the primary industries and non-food manufacturing, with services flat. On an expenditure basis, growth was relatively weak in private consumption and investment, but stronger in exports.

The recovery is expected to continue to be relatively gradual, with the level of real GDP per capita still 4% below its pre-recession level. This reflects a more cautious approach by households given high debt levels, changed perceptions about the riskiness of high debt levels and a reduction in credit availability at the more speculative end of the investment spectrum. Deteriorated fiscal positions internationally, necessitating large-scale fiscal consolidation in many countries, are also likely to constrain future growth in the global economy. European fiscal consolidation is the focus of this month's special topic.

Early indicators of growth for the June quarter, including retail sales, suggest continued weakness in private consumption, while exports are likely to ease on the back of reduced dairy exports. Factors such as these suggest growth will be a little weaker than forecast. However, both business and consumer confidence measures point to continued growth, even with business sentiment easing a little in June. Record increases in the terms of trade over the last couple of quarters, with further gains likely in the near term, represent positive (albeit largely anticipated) influences for the New Zealand economy and incomes.

The higher terms of trade, along with a falling investment income deficit, have contributed to a sizable narrowing in the annual current account deficit to 2.4% of GDP. However, future trends are likely to see the current account deficit expand and the level of New Zealand's international indebtedness continue to increase - a feature which makes the New Zealand economy vulnerable to shifts in investor confidence in a world less tolerant to risk. To stabilise New Zealand's net international liabilities around current levels of GDP would require sustained surpluses on the combined goods and services balance of between 1¼% and 2¼% of GDP, well above the average of the past decade of 0%. Even with the favourable terms of trade, it is unlikely that New Zealand will achieve such surpluses without a substantial change in economic behaviour.

Overall, international and domestic developments over June lead us to believe the economy will continue its relatively gradual recovery over the year ahead. Our view as to the most likely path the economy will take remains consistent with the Budget Forecasts. However, downside risks are significantly higher and near term growth likely to be a little weaker than forecast.

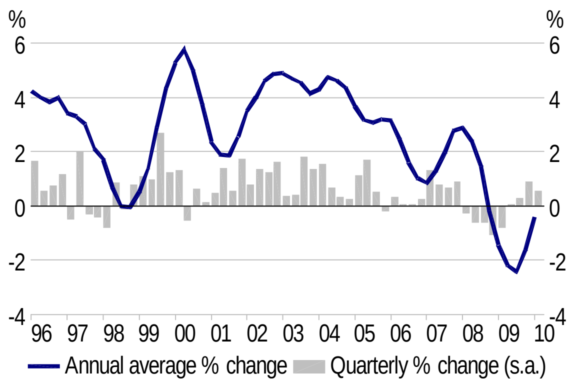
Analysis

Data released over June helps us assess the current state of the New Zealand economy. March quarter GDP and balance of payments data also provide useful platforms from which to consider a couple of the major issues facing the economy, namely the outlook for growth and the risks associated with imbalances such as New Zealand's high level of net international liabilities. Given renewed nervousness in financial markets about global economic growth, there is increased risk associated with high levels of external debt, particularly in an environment in which investor sentiment can change rapidly.

Economic recovery continues…

Real production GDP rose 0.6% in the March 2010 quarter, the fourth consecutive quarter of expansion (Figure 1). This was slightly weaker than the 0.8% growth in the Budget Forecasts. The pace of growth was also lower than the 0.9% recorded in the December quarter.

Figure 1 – Real GDP



Sources: Statistics NZ, the Treasury

… despite weak services sector

A key driver of this moderation was the service sector, which recorded no growth in the March quarter, the weakest result in a year. With services flat, growth was driven by primary and manufacturing industries. Although the impact was large in some regions, the national impact of drought was small as agriculture production rose 0.8% in the quarter, including a rise in dairy production. Some drought impact may be felt in the June quarter or next season.

Recession impacts linger, with activity still below pre-recession levels

The recession saw real GDP fall 3.4% below its December 2007 level by March 2009. Over the past year the economy has clawed back just over half of this reduction with real GDP now 1.6% below the December 2007 level. However, this underplays the impact of the downturn on the economy as part of this recovery reflects population growth. In per person terms, real GDP fell 4.8% below its December 2007 peak by June 2009 and has to date recovered about one sixth of this, with the level of real GDP per capita still around 4% below its December 2007 level.

The current recovery is not expected to be as strong as was experienced after the 1997/98 downturn. This reflects a more cautious approach by consumers given high debt levels in an environment which views debt as more risky, significantly deteriorated fiscal positions in a large number of economies necessitating relatively large-scale fiscal consolidation, and a reduction in credit availability at the more speculative end of the investment spectrum. This expectation of a more muted recovery appears to be playing out. Real GDP increased by 5.7% in the first four consecutive quarters of growth following the 1997/98 downturn, but only 1.9% in the latest recovery.

Export growth was stronger than anticipated but consumption weaker

Real expenditure GDP also increased 0.6% in the March 2010 quarter. The increase in expenditure GDP was led by a 3.4% increase in goods exports, with log exports and non-primary manufacturing key factors. This was partially offset by lower services exports, driven by a fall in overseas visitor spending. Imports increased 1.8% in the quarter, boosted by the acquisition of the HMNZS Otago, but were still 15% lower than their peak in mid-2008. Net exports made a slightly larger contribution to March quarter growth than was anticipated in the Budget Forecasts.

On the other hand, real private consumption and investment growth was weaker than we anticipated. Real private consumption grew 0.2% in the March quarter following increases of 0.8% in the previous quarter and 0.9% in the September 2009 quarter. Residential investment rose only 0.5% after a 4.7% increase in the previous quarter. Public consumption rose 1.7% boosted by the acquisition of HMNZS Otago.

Muted consumption continues in June quarter…

Relatively weak private consumption growth looks to have continued in the June quarter based on indicators such as retail sales and electronic card transactions. Total retail sales fell 0.3% in the month of April, while retail transactions on electronic cards recovered just 0.4% in May following a 2.2% decline in April. These data point to subdued consumer spending in the June quarter as a whole, although lower food prices in April and May will cushion the impact on volumes to some degree.

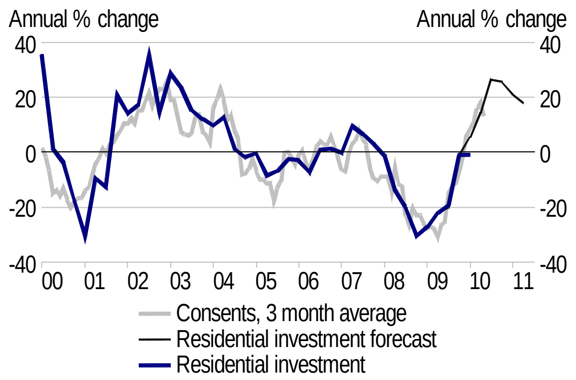
… but higher confidence should eventually flow through to spending

Consumer confidence figures point to a pick-up in consumer spending later in the year. The Westpac McDermott Miller measure of consumer confidence increased from 114.7 in March to 119.3 in June. Consumers remain more upbeat about future conditions relative to the here and now, although most of the improvement in the June quarter related to present conditions.

Housing data remain weak

Data relating to the housing market remain weak. The number of house sales slipped back by 3.6% in May (seasonally adjusted). Sales levels remain low, although seasonally adjusted sales for the June quarter as a whole should be above the weak March quarter figure. The time taken to sell a house also crept up over the three months to May, while prices eased slightly.

Figure 2 – Consents and residential investment



Sources: Statistics NZ, the Treasury

Building consents for new dwellings (excluding apartments) eased 9.5% in May. Consents data are volatile on a monthly basis but recent developments imply downside risk to our residential investment forecast (Figure 2).

Slowing migration will also affect the demand for housing. Net migration gains slowed in the year to May, reflecting fewer arrivals and a pick-up in departures (particularly to Australia), continuing a development that has occurred since January this year. The annual net gain from permanent and long-term migration in the year to May was close to 18,000, down from a recent peak of 22,600 in the year to January.

Weaker consumption growth and stronger exports relative to the Budget Forecasts indicate slightly more rebalancing in the economy than was anticipated. The recent consolidation by households is also apparent in credit data. Consumer credit contracted by 2.5% in the twelve months to May, with the rate of growth in housing credit also remaining weak. At this stage, the rebalancing in the economy is only slight and is yet to be sustained for any length of time.

More cautious behaviour from households, including slower residential investment, is pointing to slightly weaker near-term growth than was expected in the Budget Forecasts. However, in the absence of significant external shocks, further economic recovery can be expected.

Economic recovery set to continue over 2010

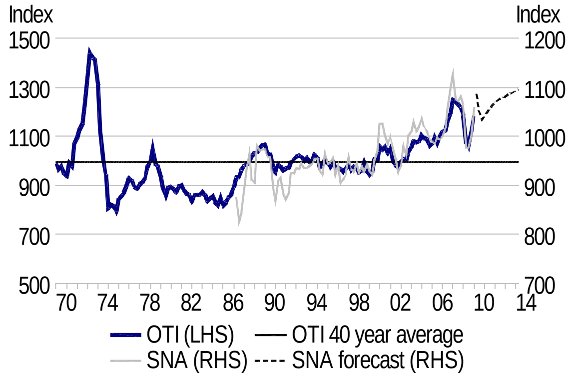
The National Bank's Business Outlook points to continuing economic recovery over the year ahead. Associated with this rise in activity should be an increase in employment. The level of business confidence and expectations of firms' own activity levels remain elevated. However, consistent with much of the latest data, a degree of caution was apparent, with expectations slipping back relative to earlier highs. This was the case across most of the survey measures, including overall confidence, investment intentions, employment and profits.

In its June Monetary Policy Statement, the Reserve Bank increased the Official Cash Rate to 2.75% from 2.5%, the first change since April 2009. This reflects a view that the need for unusually supportive monetary policy is reducing as the economy enters its second year of recovery.

Rising commodity prices boost incomes

Rising commodity prices played a key role in the largest increase in the merchandise terms of trade since 1976, as measured by the Overseas Trade Indexes (OTI). The merchandise terms of trade increased 5.9% in the March quarter, following a similar 5.8% increase in December 2009.

Figure 3 – Merchandise terms of trade



*SNA measure is the measure used in the GDP data.

Sources: Statistics NZ, the Treasury

While still a little below the 2008 level, the merchandise terms of trade is significantly higher than over most of the period since the mid-1970s (Figure 3). Despite a slight 1.2% decline in world commodity prices in the month of June, the ANZ commodity price series remains near record highs, suggesting further increases in the terms of trade are likely. A high terms of trade is an important factor supporting incomes, including government taxation revenue.

Nominal GDP in line with forecast

Consistent with the OTI data, a large increase in the goods terms of trade was recorded in the GDP data and this drove the increase in the GDP deflator. A 1.8% increase in the GDP deflator, together with the 0.6% increase in real expenditure GDP, meant nominal GDP increased 2.5%. The level of seasonally adjusted nominal GDP matched the Budget forecast.

Lower food prices and a higher exchange rate dampen the inflation outlook slightly

Domestically, price developments have been reasonably weak in the June quarter. Lower food prices suggest that consumer price inflation is likely to be lower than the 0.7% quarterly increase predicted in the Budget Forecasts. With the dampening impact that a higher than anticipated exchange rate will have on tradables inflation, there is a reasonable chance that annual inflation will peak below the 5.9% figure in the forecasts. Nevertheless, a peak well in excess of 5% is still considered likely.

Current account deficit smallest in 2 decades

The annual current account deficit narrowed to 2.4% of GDP in March 2010 from 2.9% in December 2009. The main driver of this reduction was a fall in the investment income deficit due to lower profits of foreign-owned firms operating in New Zealand and higher profits from New Zealand-owned firms operating abroad. Higher dairy prices contributed to a larger goods surplus.

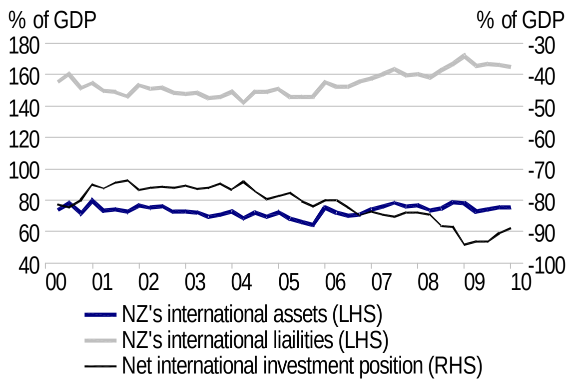
The reduction in the current account deficit was broadly in line with the 2.6% current account deficit forecast in the Budget Forecasts. We still expect the current account deficit to widen from here, with the deficit to exceed 4% of GDP in the second half of 2010, before rising further. This rise will partly reflect the one-off nature of the bank tax cases with IRD, which will begin to fall out of the annual calculations from the June 2010 quarter. However, it will also reflect a recovery in the New Zealand economy. A rise in import volumes and investment income is expected as domestic demand continues to recover (albeit slowly).

Taking the April and May merchandise trade data for the June quarter as a whole suggests a fall-back in dairy export volumes in the quarter (possibly drought related). This contributes to a slightly weaker outlook for goods export volumes as a whole, although growth in nominal goods exports is likely to be similar to forecast owing to slightly more positive prices. Import growth for the June quarter looks a little weaker, partly reflective of subdued domestic demand. These differences from forecast are likely to be relatively small and therefore do not substantially change our view as to the likely path taken by the current account deficit.

High net foreign liabilities remain a risk…

As of 31 March, New Zealand's net international liabilities stood at $166.7 billion or 88.9% of GDP (ie, international liabilities exceed international assets). This, however, represents the second quarter in a row that net international liabilities have declined. In December 2009 New Zealand had net international liabilities of 90.6% of GDP, down from 93.3% in September 2009. These changes reflect valuation changes and therefore are unlikely to continue over a sustained period.

Figure 4 – International assets and liabilities

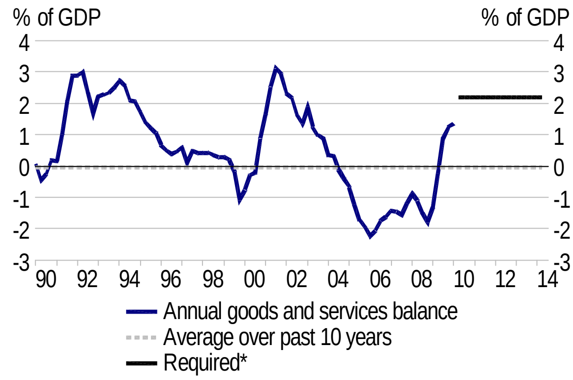


Sources: Statistics NZ, the Treasury

… and are likely to trend higher

Valuation changes aside, countries running consistent current account deficits will see their net international liabilities increase over time. In the current global economic climate, greater attention is being paid to such imbalances. To stabilise New Zealand's net international investment position (as a percentage of GDP) would require continued surpluses in the combined goods and services balance in the order of 1¼ to 2¼ percent of nominal GDP. This contrasts to an average 0% (ie approximate balance) over the past decade.

Figure 5 – Goods and services balance to stabilise net international liabilities (as % of GDP)



*assumes 5% per annum nominal GDP growth, 8% return on net international liabilities, and a transfers surplus of 0.4% of GDP per annum

Sources: Statistics NZ, the Treasury

Over the past decade, the current account deficit has largely been the result of private sector savings being insufficient to fund private sector investment. Government surpluses meant that from a savings and investment perspective the government sector was having an offsetting impact. This is no longer the case.

Even stabilising New Zealand's net liabilities is a substantial task

Achieving consistent goods and services surpluses of the magnitudes referred to above would require a significant change in economic behaviour and a marked departure from past trends. Part of this behaviour change would need to manifest itself in a substantial and sustained increase in national savings. Periods when a combined goods and services surplus of the magnitude required have been achieved have been associated with a low exchange rate. A supportive global economic climate also assists. However the risks associated with the world economy have increased. Global economic sentiment has been volatile and subject to significant swings. This volatility is likely to remain a feature of the financial and economic landscape for some time.

Financial contagion fears ease...

Worries that the debt problems experienced by Greece will spread to other European and major economies eased somewhat in June. Sovereign funding worries have partially subsided after European countries, including Portugal, Spain, Ireland and Italy, had relatively successful government bond auctions, with some risk appetite returning to markets. The major beneficiaries have been commodities and "risk currencies". Oil prices have rebounded from their $US68 per barrel low towards the end of May to an eight-week high over $US78 and the New Zealand and Australian dollars have risen over 4% against the United States dollar (USD) from May's lows.

.... but global slowdown worries rise

Germany, France, Japan and the UK all announced major austerity measures to cut their significant fiscal deficits. While these measures will be positive in the long run, by improving global imbalances and government finances, there will likely be a short-run negative effect on world growth. In addition, US data releases have led to doubts over the sustainability of the US recovery. March quarter GDP and May non-farm payrolls were weaker than expected. The US housing market is also showing signs of renewed weakness, although this may be a temporary effect from the expiry of home-buyer tax credits.

At the end of June worries about the global recovery intensified due to a run of poor data on the USA, Japan and China. This led to large falls in equities, commodities and "risk currencies".

These concerns have resulted in "safe-haven" demand for gold, as well as US and German government bonds. Gold recently hit a record high, and US two-year and German ten-year bond yields record lows. New Zealand Government interest rates have also eased noticeably over the last couple of months, with 10-year bond rates falling from 5.9% in early May to around 5.5% throughout June, indicating that New Zealand is not seen as a high risk sovereign borrower by markets.

International announcements grab headlines...

China announced the end of a 23-month peg of the Yuan to the USD. The CNY/USD will be reset each morning, allowed to move +/-0.5% within each day and will be referenced against a basket of currencies rather than just the USD, allowing for a slow rise against the USD over time. Markets interpreted this as positive for global rebalancing and a sign of the strength of the global recovery. The announcement was aimed at increasing the flexibility in the exchange rate as a way of limiting currency speculation and relieving political tensions ahead of the G20 summit in late June. The Yuan fluctuated against the USD following the announcement, but has appreciated about 0.5% in the subsequent week.

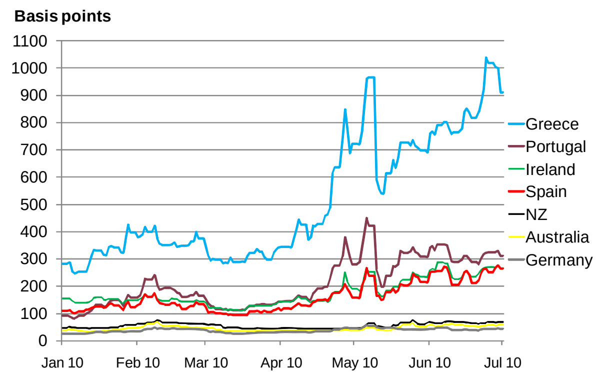
World leaders agreed at the G20 summit to reduce government deficits in most developed economies by 2013. In addition, the Bank for International Settlements called for monetary tightening to avoid distortions and risks to financial and monetary stability. This month's special topic examines the implications for New Zealand of fiscal consolidation in Europe.

The US Congress approved a financial reform bill, which included a ban on most proprietary (banks trading for own profit on their own account) and derivative trading. The bill was less restrictive on banks than expected, which eased worries about financial regulation slowing the global recovery.

...and Greece came back into focus

Greece's €110b bailout package announced in May somewhat relieved Greek funding worries. Recently, however, these concerns have reappeared and their five-year sovereign CDS spread (the cost of insuring against default on government bonds) has risen back to record highs, suggesting markets do not believe the package and austerity measures announced will fix their solvency problem.

Figure 6 – Sovereign 5-year CDS spreads



Source: Bloomberg

Banking sector worries heighten...

A number of European banks have had their credit ratings downgraded in June, while many are relying on funding from the European Central Bank (ECB) for liquidity. This has resulted in increased banking sector fears, with the three-month Euro area interbank interest rate (EURIBOR) hitting a nine-month high and the US LIBOR-OIS spread (a measure of banking sector risk) continuing to increase.

... highlighting a risk for New Zealand...

New Zealand's floating exchange rate, independent monetary policy, relatively low levels of government debt, and the strong Australasian banking system place New Zealand in a much stronger position than embattled economies such as Greece and Portugal.

The biggest risk to New Zealand from the sovereign debt crisis is through the banking sector and financial markets. If banking sector worries spread to the rest of the world, New Zealand banks may find it harder to raise money on foreign wholesale markets, which make up a large part of their funding. If funding costs rise worldwide, higher interest rates will be passed on to New Zealand borrowers. The result may be credit constraints and higher debt servicing costs, dampening the ongoing recovery.

...although direct economic risks are small

Europe makes up a relatively small part of New Zealand's trade (around 12% of New Zealand's exports), so any slowdown in the region will not have a major direct impact on the New Zealand economy. European problems could indirectly affect New Zealand through our other trading partners. New Zealand's biggest export destinations are Australia and emerging Asia, which continue to lead the world recovery with strong economic data outturns, although there are concerns about weaker growth in China in the second half of 2010.

Overall, international and domestic developments over June lead us to believe the economy will continue its relatively gradual recovery over the year ahead. Our view as to the most likely path the economy will take remains consistent with the Budget Forecasts. Nevertheless, downside risks have increased significantly and near term growth may be a little weaker than forecast.

Special Topic: European fiscal consolidation and implications for New Zealand

As the world has begun to emerge from the worst of the recession, attention is shifting to the increased fiscal challenges facing many developed economies in the aftermath. In an effort to reassure the markets in the wake of the sovereign debt crisis, many European governments have announced measures to address fiscal sustainability. This article provides a brief summary of some of the major consolidation developments announced in Europe in recent weeks and the context in which debate about fiscal policy is occurring. It then considers the economic implications and risks associated with these consolidation moves.

An accelerated pace of consolidation ...

The intensification of Greece's debt crisis during the last week of April, which left Greece unable to issue government bonds, the sharp rises in bond yields and the sovereign credit rating downgrades of Greece, Portugal and Spain have all prompted their governments to act swiftly to try to restore confidence and address fiscal sustainability. The new European Stabilisation Fund was an important complement to these fiscal adjustment efforts, designed to minimise the risk of other European countries facing a crisis like Greece's.

In May 2010, as part of an IMF-EU support programme, Greece announced an ambitious reform programme, entailing not just putting its public finances in order but also liberalising its economy. The government pledged to make fiscal cuts totalling 11% of GDP to reduce the fiscal deficit from its current level of 13.6% to below the EU maximum of 3% of GDP by 2014. If achieved, this would be one of the largest fiscal consolidations in so short a time. Soon after that, Italy and Spain announced a series of corrective measures - totalling €24bn (1.6% of GDP) for Italy and €65bn (6.5% of GDP) for Spain - as the market increased its attention on their large fiscal imbalances. Portugal also announced a new plan to reduce its deficit faster.

The fiscal consolidation momentum has now spread to other "core" European states, which had not faced immediate adverse market pressures. On 7 June, the German government announced an €80bn (3% of GDP) savings package by 2014. France also announced plans to cut its deficit by €100bn (5% of GDP) of which €42bn will be delivered through spending cuts. Underlying banking sector vulnerabilities in core Europe, and the risk that further state support may yet be needed, are an important part of the backdrop to the European fiscal adjustment.

On 22 June, the new UK government introduced an emergency Budget aimed at delivering fiscal savings of around £128bn (8% of GDP) by 2014/15. Many of the specifics have still to be announced. At a global level, there has also been a shift towards fiscal consolidation. At the G20 summit in late June, leaders endorsed some non-binding targets that envisage material reductions in deficits over the next three years.

... but will it suppress global growth?

International fiscal consolidation is occurring against a difficult backdrop. On the one hand, countries need to preserve access to funding markets and do not want to leave consolidation so long as to be forced into panicked adjustments under extreme market pressure. On the other hand, the recovery from the recession appears quite fragile, and the huge overhang of private debt left over from the boom years makes it difficult to envisage a strong and sustained recovery in private demand.

While fiscal concerns themselves are far from allayed, investors are now focusing on increasing signs of the fragility of the recovery and worrying that simultaneous fiscal consolidation across a wide range of larger countries could further undermine the fledgling global economic recovery.

While the move by many European governments to put their fiscal positions on a more sustainable footing will benefit the global economy over the longer term, the reduction in demand in the near term is likely to have a negative impact on growth in these economies. However, the growth impacts are likely to vary across countries. Countries with floating exchange rates and independent monetary policy (such as New Zealand) are likely to experience reduced impacts as a result of any fiscal consolidation measures undertaken by their governments. This is because a floating exchange rate enables nominal currency depreciation and therefore increased competitiveness and reallocation of resources to the tradable sector, with this assisting recovery.

Impact may not be as great as expected …

The impact of the fiscal cuts may be less than it first appears. The value of tightening is equal to 5.5% of GDP in Greece, 2.2% in Spain, 2.1% in Portugal and 3.2% in Ireland in 2010. However, these are fairly small economies in the Euro-zone, together accounting for less than one-fifth of the region's economy. Thus, their fiscal consolidation will have a correspondingly small effect on the euro-zone economy.

Other programmes, especially in the larger EU countries, are scheduled to occur over a longer period. Germany's €80bn cuts will be made over the next four years, while the UK's plan will be over five years. Most of the savings are concentrated in later years when projections suggest that the pick-up in underlying growth will be more robust. In 2011, the consolidation will amount to only €11.2bn in Germany, less than 0.5% of GDP.

The wider global situation is also mixed. In the US, the Administration is resisting early consolidation, although in Congress and at state and local government levels, some material consolidation is already becoming apparent. In emerging economies, which now make up a larger share of world activity than previously, the overall stance of policy appears to remain relatively accommodating.

Taking into account both the demand and confidence effects, Credit Suisse[1] estimated output in the Euro area would be reduced by half the amount of the fiscal consolidation, e.g. fiscal cuts of 1% of GDP would lower GDP by only 0.5% (Table 1).

Table 1: Budget cuts and impact on growth

	Budget cuts (% of GDP)		Impact on GDP (%)*	% of NZ export values
	2010 (f)	2011 (f)	2011 (f)	
France	-0.4	0.6	-0.3	1.3
Germany	-2.3	0.5	-0.3	2.0
Greece	5.5	1.6	-0.8	0.2
Ireland	3.2	1.2	-0.6	0.1
Italy	0.2	1.0	-0.5	1.1
Portugal	2.1	2.6	-1.3	0.1
Spain	2.2	3.2	-1.6	0.7
UK	0.5	1.0	-0.5	4.1
OECD	-0.5	1.4	-0.7	59.9

Sources: UK Budget, Barclays Capital, Statistics NZ; Treasury estimate for OECD;
* A multiplier of 0.5 is assumed.

[1] Global Equity Strategy, 18 June 2010

… and there are some offsetting factors

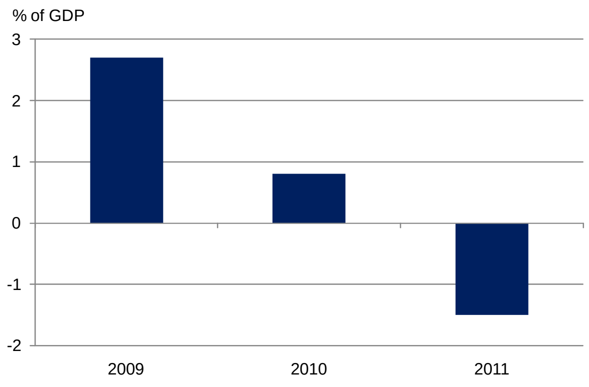
Governments have tried to design policies that will promote growth in the long run. For example, in the UK three-quarters of the savings will come from spending restraint. This approach is consistent with the IMF and OECD research which suggests that fiscal adjustments which rely primarily on spending cuts are more likely to promote growth than those based on tax increases.

In the short to medium term, growth will also receive support from continued expansionary monetary policy. Recent concerns related to the sovereign debt crisis have seen the Federal Reserve and ECB maintain their interest rates at low levels. The Bank of England has also said that it regards fiscal consolidation as a top priority, and will facilitate it by keeping monetary policy expansionary. There is also increasing speculation on the possibility of additional quantitative easing to help support aggregate demand and facilitate the fiscal adjustment that clearly needs to occur over the next few years.

Rebalancing necessary for long-term growth

An accelerated pace of fiscal consolidation is needed to reduce the substantial structural imbalances in many economies. Over the last couple of years, governments have increased fiscal deficits to offset reduced private sector demand (Figure 8), but the ability of many governments to provide ongoing support is now coming to an end due to high and rapidly rising levels of government debt and large primary budget deficits.

Figure 7: Change in cyclically-adjusted primary balance for G20 countries



Source: IMF

The consolidation programme may dampen growth for affected economies, especially in the Euro-zone and the UK, in the short term. If the global recovery is already beginning to lose momentum (and markets are increasingly concerned that it is), it could make for a difficult period in the next year or two. However, there is little choice but to begin the fiscal consolidation process, and - done well - such consolidation should help support a more sustainable economic recovery in the longer term.

Implications for New Zealand’s growth

As a small open economy, New Zealand is significantly influenced by global developments. New Zealand also has very high levels of private external debt and a relatively large cyclically-adjusted fiscal deficit, reinforcing our exposure to international developments. Concerted fiscal consolidation policies can impact on New Zealand’s economic growth if its main trading partners’ growth is depressed. This could translate into lower volumes and values of New Zealand’s exports, worsening our terms of trade and thereby undermining domestic spending growth.

Despite expected slower growth in the Euro-zone, New Zealand’s increasing links to faster-growing economies in Asia mean that the external stimulus remains relatively strong. June Consensus forecasts revised up New Zealand’s trading partner growth by 0.1% point from May to 3.9% for 2010 while 2011 remained unchanged at 3.5%. These revisions imply that New Zealand’s economic growth, at least in the short run, will continue to benefit from a strong rebound in Asia and Australia, which together account for more than 60% of our merchandise exports. There are, however, signs that the strength of the recovery in China may be beginning to ease, partly as the authorities reduce their support measures.

While a global recovery remains our main forecast, and therefore suggests the New Zealand economy will take a path similar to the Budget Forecasts, downside risks have intensified. Recent developments in Europe have highlighted the underlying weaknesses, not only in sovereign balance sheets but also in the private sector. Indeed, the crisis in the financial sector has not gone away, as the latest problems in the Spanish banking sector and pressures for the publication of Europe-wide bank stress tests have shown.

Sovereign risks remain considerable ...

While most troubled European governments have announced fiscal adjustment plans, in most cases concrete measures have not yet been defined in detail, especially for the outer years. Thus questions have been raised about governments' ability to deliver the extent of adjustment needed, and this is reflected in the high and rising bond spreads for peripheral European countries' sovereign debt.

There are fears that some governments, faced with the difficulties of sustained austerity programmes, and perhaps renewed banking sector stresses, might eventually prefer to default on debt. There is a risk that mounting unease, or a serious default, could trigger a more serious global funding crisis. From New Zealand's perspective, heavily dependent on continued access to international funding markets, the risk of harm from a significant re-intensification of global financial stresses would be much greater than that from a concerted European fiscal consolidation programme in isolation.

Monthly Economic Indicators is a regular report prepared by the Forecasting and Monitoring team of the Treasury.

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New Zealand Key Economic Data

02 July 2010

Quarterly Indicators

		2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2
Gross Domestic Product (GDP)								
Real production GDP	qtr % chg[1]	-1.1	-0.8	0.1	0.3	0.9	0.6	...
	ann ave % chg	-0.2	-1.5	-2.2	-2.4	-1.6	-0.4	...
Real private consumption	qtr % chg[1]	-0.3	-1.0	0.3	0.9	0.8	0.2	...
	ann ave % chg	-0.3	-1.1	-1.4	-1.1	-0.5	0.6	...
Real public consumption	qtr % chg[1]	1.6	0.2	-1.0	0.6	1.1	1.6	...
	ann ave % chg	4.8	4.2	3.0	2.6	1.6	1.4	...
Real residential investment	qtr % chg[1]	-14.4	0.5	-2.2	-3.9	4.7	0.6	...
	ann ave % chg	-18.2	-22.8	-24.4	-23.9	-16.8	-11.5	...
Real non-residential investment	qtr % chg[1]	-2.5	-7.8	2.5	-2.5	-3.0	0.9	...
	ann ave % chg	2.1	-1.2	-6.5	-8.6	-10.3	-8.9	...
Export volumes	qtr % chg[1]	-2.5	0.2	4.5	0.1	-0.7	1.4	...
	ann ave % chg	-1.4	-3.4	-4.1	-3.2	0.0	2.9	...
Import volumes	qtr % chg[1]	-7.4	-7.4	-2.9	1.5	5.8	1.8	...
	ann ave % chg	1.9	-4.7	-12.4	-16.5	-14.9	-9.6	...
Nominal GDP - expenditure basis	ann ave % chg	3.2	1.7	1.2	1.2	1.2	1.7	...
Real GDP per capita	ann ave % chg	-1.1	-2.4	-3.1	-3.4	-2.7	-1.6	...
Real Gross National Disposable Income	ann ave % chg	1.3	-1.0	-1.6	-1.3	-0.9	1.2	...
External Trade								
Current account balance (annual)	NZ$ millions	-15968	-14568	-10371	-5896	-5314	-4457	...
	% of GDP	-8.7	-7.9	-5.6	-3.2	-2.9	-2.4	...
Investment income balance (annual)	NZ$ millions	-13721	-13035	-10793	-8146	-8144	-7628	...
Merchandise terms of trade	qtr % chg	-1	-2.7	-9.4	-1.6	5.8	5.8	...
	ann % chg	1.8	-5	-13.5	-14.1	-8.2	-0.2	...
Prices								
CPI inflation	qtr % chg	-0.5	0.3	0.6	1.3	-0.2	0.4	...
	ann % chg	3.4	3.0	1.9	1.7	2.0	2.0	...
Tradable inflation	ann % chg	2.3	1.7	0.2	-0.1	1.5	2.0	...
Non-tradable inflation	ann % chg	4.3	3.8	3.3	3.0	2.3	2.1	...
GDP deflator	ann % chg	2.6	2.6	3.3	2.5	-0.1	1.0	...
Consumption deflator	ann % chg	4.1	3.9	3.0	2.0	1.3	1.0	...
Labour Market								
Employment (HLFS)	qtr % chg[1]	0.7	-1.3	-0.5	-0.7	0.0	1.0	...
	ann % chg[1]	1.0	0.7	-0.9	-1.8	-2.4	-0.1	...
Unemployment rate	%[1]	4.6	5.1	5.9	6.5	7.1	6.0	...
Participation rate	%[1]	69.0	68.4	68.4	68.0	68.1	68.1	...
LCI salary & wage rates - total (adjusted)[5]	qtr % chg	0.7	0.6	0.3	0.5	0.4	0.3	...
	ann % chg	3.6	3.4	2.9	2.1	1.8	1.5	...
LCI salary & wage rates - total (unadjusted)[5]	qtr % chg	1.4	0.8	0.6	0.9	0.5	0.5	...
	ann % chg	5.6	5.2	4.6	3.8	2.9	2.5	...
QES average hourly earnings - total[5]	qtr % chg	0.9	1.4	0.7	2.1	-0.2	-0.4	...
	ann % chg	5.4	5.3	4.5	5.1	4.0	2.2	...
Labour productivity[6]	ann ave % chg	0.2	-1.8	-1.4	-0.8	0.5	2.2	...
Confidence Indicators/Surveys								
WMM - consumer confidence[3]	Index	101	96	106	120	117	115	119
QSBO - general business situation[4]	net %	-64.4	-64.6	-24.8	35.6	30.7	21.9	...
QSBO - own activity outlook[4]	net %	-40.9	-38.7	-13.1	23.0	10.8	14.5	...

Monthly Indicators

		2009M12	2010M 1	2010M 2	2010M 3	2010M 4	2010M 5	2010M 6
External Sector								
Merchandise trade - exports	mth % chg[1]	4.1	10.9	-4.9	3.8	3.5	-1.1	...
	ann % chg[1]	-11.4	-0.9	-3.5	0.6	8.9	6.6	...
Merchandise trade - imports	mth % chg[1]	7.0	-3.5	5.9	2.0	-4.1	6.0	...
	ann % chg[1]	-18.3	-11.0	1.4	-4.5	-0.6	11.2	...
Merchandise trade balance (12 month total)	NZ$ million	-549	-176	-330	-161	182	91	...
Visitor arrivals	number[1]	216500	210750	206230	207940	204110	206150	...
Visitor departures	number[1]	211850	219410	210310	207240	206880	213560	...
Housing								
Dwelling consents - residential	mth % chg[1]	-3.8	-2.7	6.1	-0.2	8.3	-9.5	...
	ann % chg[1]	22.7	35.2	29.9	33.4	32.0	11.1	...
House sales - dwellings	mth % chg[1]	-0.4	-17.4	10.9	1.4	2.8	-3.6	...
	ann % chg[1]	14.8	-1.0	-3.6	-7.6	-16.8	-16.3	...
REINZ - house price index	mth % chg	-0.9	-1.6	0.4	1.7	-0.4	-1.4	...
	ann % chg	6.4	6.9	5.5	6.8	6.2	2.3	...
Private Consumption								
Core retail sales	mth % chg[1]	-2.0	0.3	-0.7	1.0	-0.2	...	...
	ann % chg[1]	1.5	1.6	0.7	1.4	1.3	...	...
Total retail sales	mth % chg[1]	-0.5	0.7	-0.5	0.5	-0.3	...	...
	ann % chg[1]	1.8	3.6	2.3	3.2	2.4	...	...
New car registrations	mth % chg[1]	6.9	-0.7	0.6	4.8	2.7	-3.7	...
	ann % chg	0.3	15.9	31.4	31.7	40.5	30.5	...
Electronic card transactions - total retail	mth % chg[1]	0.7	0.4	-0.5	2.4	-2.2	0.4	...
	ann % chg	4.7	3.8	3.5	6.1	4.0	2.3	...
Migration								
Permanent & long-term arrivals	number[1]	7050	7100	6660	6810	6530	6370	...
Permanent & long-term departures	number[1]	5360	5260	5660	5870	5800	6120	...
Net PLT migration (12 month total)	number	21253	22588	21618	20973	19954	17967	...
Commodity Prices								
Brent oil price	US$/Barrel	74.79	76.60	73.90	79.52	85.16	76.13	75.24
WTI oil price	US$/Barrel	74.63	78.42	76.31	81.24	84.50	73.84	75.35
ANZ NZ commodity price index	mth % chg	4.2	-1.3	7.8	0.4	4.2	3.5	-0.2
	ann % chg	2.5	5.7	11.7	16.0	24.3	30.3	37.3
ANZ world commodity price index	mth % chg	2.6	0.4	4.0	1.8	5.4	2.8	-1.2
	ann % chg	31.0	37.4	49.8	50.9	55.1	55.0	53.3
Financial Markets								
NZD/USD	$[2]	0.7162	0.7277	0.6974	0.7032	0.7123	0.6992	0.6928
NZD/AUD	$[2]	0.7929	0.7959	0.7868	0.7712	0.7685	0.8019	0.8105
Trade weighted index (TWI)	June 1979 = 100[2]	64.70	66.10	64.60	65.10	66.10	67.00	67.10
Official cash rate (OCR)	%	2.50	2.50	2.50	2.50	2.50	2.50	2.75
90 day bank bill rate	%[2]	2.78	2.78	2.73	2.67	2.69	2.89	3.07
10 year govt bond rate	%[2]	6.02	6.00	5.86	5.86	5.96	5.73	5.51
Confidence Indicators/Surveys								
National Bank - business confidence	net %	38.5	45.7	50.1	42.5	49.5	48.2	40.2
National Bank - activity outlook	net %	36.9	41.0	41.9	38.6	43.0	45.3	38.5
ANZ-Roy Morgan - consumer confidence	net %	118.6	131.4	123.6	121.8	121.9	126	122.0

qtr % chg — quarterly percent change
mth % chg — monthly percent change
ann % chg — annual percent change
ann ave % chg — annual average percent change
Data in italics are provisional

1 Seasonally adjusted
2 Average (11am)
3 Westpac McDermott Miller
4 Quarterly Survey of Business Opinion
5 Ordinary time
6 Production GDP divided by HLFS hours worked

Sources: Statistics New Zealand, Reserve Bank of New Zealand, National Bank of New Zealand, NZIER, ANZ, Datastream, Westpac McDermott Miller