Monthly Economic Indicators

THE TREASURY
Kaitohutohu Kaupapa Rawa

June 2012

Executive Summary

- **Risks stemming from the European debt crisis have increased as the focus shifts from Greece to Spain.**
- **However on the back of strong March quarter GDP, domestic data point to further modest gains in the June quarter.**
- **Global developments in June have dragged down consumer and business confidence as well as the export sector.**
- **Overall, with the established growth momentum and the earthquake rebuild picking up, we expect annual growth to increase over the next year.**

The growth outlook for our major trading partners deteriorated in June and risks associated with the euro debt crisis increased. Improving sentiment following the positive outcome of the second Greek election was short-lived as the focus of the crisis shifted quickly from Greece to Spain. Spain's euro area partners provided funds to support its ailing banking sector, but the move had little effect with interest rates on government debt rising further.

Against the backdrop of a worsening global outlook, a strong real GDP outturn for the March 2012 quarter provided welcome local relief. Annual average growth in the year to March 2012 of 1.7% was close to the 1.6% *Budget 2012* forecast and the 1.8% *Budget 2011* forecast.

Domestic data, particularly housing sales activity, show that momentum has continued into the June quarter. Household electronic card spending posted solid gains in April and May, indicating that household consumption is bouncing back following a post Rugby World Cup slowdown. Moreover, service and manufacturing data indicated expanding sector output. Reflecting this improving activity, core Crown tax revenue in the ten months to April 2012 came in above *Budget 2012* forecasts.

However, global developments dragged down household and business sentiment in June. In addition, the export sector is already reflecting weaker trading partner growth with the terms of trade falling and the current account deficit widening in the March quarter.

Overall, with the established growth momentum and the earthquake rebuild expected to quicken in pace in the second half of the year, we expect annual growth to increase over the next year. However, global developments will mean that while the general direction for growth is up, there will be ups and downs along the way.

New Zealand Government

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Analysis

While euro crisis headlines have weighed on household and business confidence in June, modest momentum in the domestic economy continues to build. Annual average GDP growth increased to 1.7% in the March quarter from 1.4% in December. Indicators to date, including core Crown tax revenue running ahead of forecast, point to further modest gains in the June quarter. Global developments, particularly in the euro zone, will ensure that the road ahead remains bumpy, although the expected quickening in pace of the Christchurch rebuild in the second half of the year will provide some positive offset.

Risks increase in the global economy, particularly in Europe...

The growth outlook for our major trading partners deteriorated in June and risks associated with the euro debt crisis have increased despite the positive outcome of the second Greek election. New Democracy took the largest share of the vote and formed a coalition with its traditional rival socialist party and a small left-wing party. While the outcome was positive, Greece's fundamental problems of an unsustainable debt burden and poorly-performing economy remain. Greek banks are under pressure, the government is likely to run short of cash in the next month and under the existing programme it is expected to find further fiscal savings. The new government accepts the bailout programme but wants to renegotiate some of the terms.

...as the focus shifts from Greece to Spain

The focus of the crisis shifted from Greece to Spain in the past month as its government and banking sector came under increasing pressure. Spain's euro area partners undertook to provide €100 billion of funds to support its ailing banking sector, but the move had little effect with interest rates on government debt rising further, in part because existing debt would be subordinated to any bailout funds. Spain's problems are three-fold: its economy is in recession, its government finances are weak and its banks are under-capitalised after suffering losses from a large fall in house prices. In addition, there is an inter-dependency between bank and sovereign debt. Credit ratings for both have been downgraded.

It is widely expected that Spain will shortly apply for an EU/ECB/IMF support programme. Cyprus has already requested support for its banks, which are exposed to the Greek financial sector, and concerns are increasing about the sustainability of Italy's position as its bond yields rise.

No resolution to euro debt crisis in sight

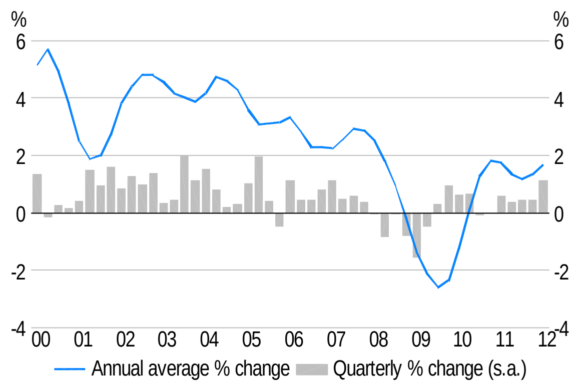
As the month passed, there was increasing speculation about the outcome of the EU Summit being held on 28-29 June. Leaders of the four central euro area organisations put forward a plan for the future of the economic and monetary union which involves further centralisation based on greater financial, fiscal, economic and political integration. However, Germany, the nation which would be called upon to support weaker members of the area, is opposed to some of the proposals.

The outlook remains broadly consistent with our assumption in the *Budget* that European leaders would manage their way through the crisis, but stresses are increasing and the stakes are becoming larger as the crisis spreads to the bigger economies of Spain and Italy.

NZ March GDP surprise provides local relief...

Against the backdrop of a worsening global outlook, the 1.1% increase in real production GDP over the March 2012 quarter (Figure 1) provided welcome relief, albeit temporary. The quarterly increase was stronger than our *Budget* forecasts and market expectations (both 0.5%).

Figure 1 – Real production GDP



Source: Statistics New Zealand

...with annual activity in line with *Budget* forecasts

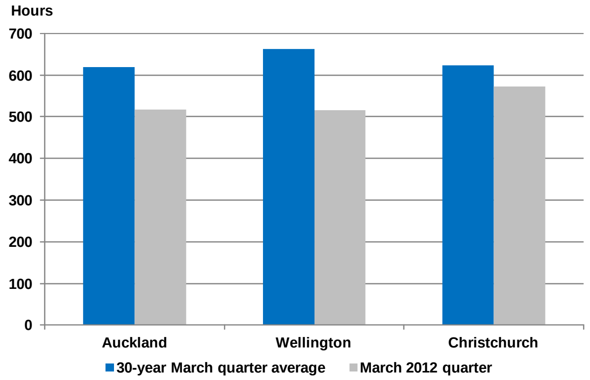
Getting a feel for the momentum in the economy is difficult with one-offs such as the Rugby World Cup, the excellent growing conditions (which may not be repeated next season) as well as the May revisions to GDP data. However, combining the

0.4% from the December quarter and March quarter's 1.1% growth, we get 1.5% or average quarterly growth of 0.75%. Annual average growth in the year to March of 1.7% was close to the 1.6% *Budget 2012* forecast and the 1.8% *Budget 2011* forecast. Hence, the overall pace of the economic growth over the past year appears in line with our expectations.

Increased agricultural production was the silver lining to the wet summer holidays

The wet summer holiday weather (Figure 2) was partially offset, at least in an economic sense, by excellent pastoral growing conditions, resulting in increased milk production and a 2.1% rise in the agriculture, forestry and fishing industry. In turn, this production flowed through to a 3.2% increase in food processing, and contributed to a 1.8% increase in total manufacturing activity.

Figure 2 – Sunshine hours, main centres



Source: NIWA

Real expenditure GDP rose 0.8% in the March quarter compared to our 0.5% *Budget* pick. Relative to our forecasts net exports, which subtracted 1.9% points from growth, were weaker than expected, but the negative contribution was offset by a run-up in inventories. We expected slightly stronger business and residential investment, although a large balancing item accounted for most of the divergence from forecast.

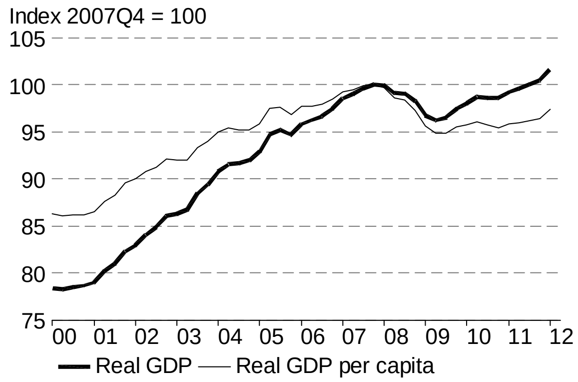
The service industry grew faster than the rest of the economy over the March year

The service industry grew faster than the primary and goods producing industries (manufacturing, utilities and construction) and contributed 0.7 percentage points of the 1.7% annual increase in GDP. Leading the rise in services industries, the professional, scientific, technical, administrative, and support services category increased 2.0%, its fifth consecutive quarterly rise, to be up 7.8% in the year ending March. This group includes businesses that would have experienced increased activity from rising house sales, the Rugby World Cup and the Canterbury earthquakes.

GDP is now above pre-recession levels...

The seasonal adjusted quarterly level of real GDP is now higher than its pre-recession peak. However, we will have to wait a while longer for per capita GDP to surpass its pre-recession peak; based on the March outturn and *Budget* growth forecasts from June onwards, we expect this to happen mid-2013.

Figure 3 – Real GDP levels



Source: Statistics New Zealand

...while core Crown tax revenue is ahead of forecast despite weaker nominal GDP

Nominal expenditure GDP grew 3.1% in the year ending March 2012, down from 4.8% in March 2011. The GDP deflator (economy-wide prices) rose 2.1% in the 2012 year, down from a 4.6% rise in the 2011 year, and accounted for the fall. Despite the weakening nominal GDP, core Crown tax revenue in the ten months to April 2012 was around $800 million (1.7%) above *Budget* forecasts.

Current account deficit widens as goods and services exports fall...

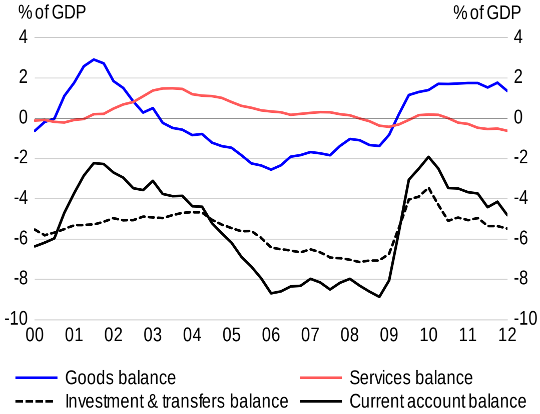
The annual current account deficit widened to 4.8% of GDP in the year ending March, up from 4.2% in December and 3.7% in March 2011. The goods surplus for the year ending March fell to $2.7 billion (1.4% of GDP) from $3.6 billion in the year to December. Falling dairy and fruit prices and lower crude oil exports were the main contributors to a fall in export values in the quarter. Imports of crude oil spiked in the March quarter and drove the increase in quarterly goods values.

The annual services deficit rose to $1.3 billion, the largest deficit since 1998, and was almost entirely owing to increased services imports. Services exports were largely flat, despite the RWC, but hosting and broadcasting fees associated with the Cup contributed to a rise in imports. Other import contributions came from increased insurance premiums and increased overseas travel by New Zealanders.

...and the income deficit widens...

The income deficit for the year grew to $10.8 billion, up $1.0 billion from March 2011. The rise in the annual deficit reflects the increase in bank profits over the year – the major banks reported large profit gains late in 2011 – partly offset by an increase in returns on New Zealand investments overseas.

Figure 4 – Annual Current Account Deficit



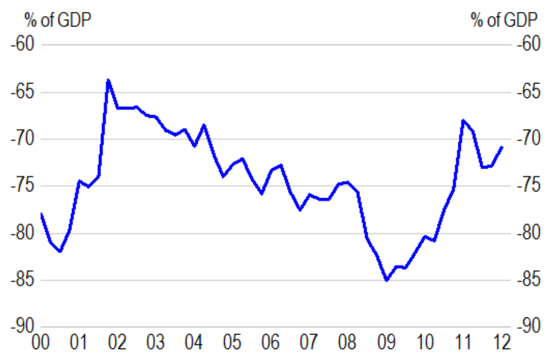
Source: Statistics New Zealand

We expect the current account to widen further over the year ahead, as commodity prices retreat further and the exchange rate remains elevated. Recent revisions to nominal GDP have increased the current account deficit to GDP ratio by around 0.2 percentage points, which combined with the March 2012 outturn points to a current account deficit of over 5% by March 2013, compared to the 4.6% forecast in the Budget.

...but net international liabilities fall

While the current account deficit widened, valuation changes decreased New Zealand's net international liabilities. As at 31 March, New Zealand's net international liabilities were $143 billion or 71% of GDP, decreasing 2% points from 73% in December 2011 (Figure 5). The appreciation of the exchange rate reduced overseas liabilities by $1.6 billion, while increased overseas equities prices increased overseas held assets by $1.0 billion.

Figure 5 – Net international liabilities



Source: Statistics New Zealand

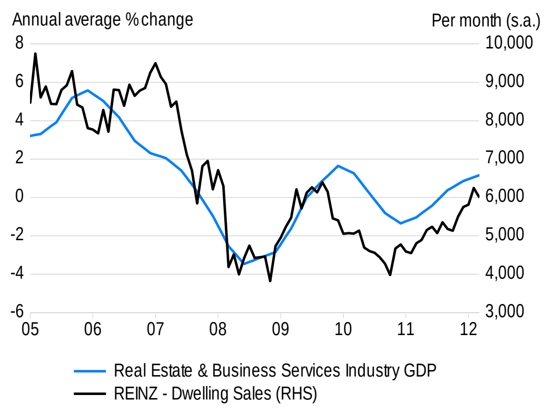
Low interest rates interest are encouraging more home buyers

Low interest rates are encouraging home buyers and translating into more activity as the housing market continues to recover off its lows. REINZ house sales rose 24.4% in May 2012 compared to May 2011; sales were the highest for the month of May since 2007. The REINZ house price index also rose a seasonally adjusted 1.3% in May, with annual growth of 6.4%; the index now stands 0.3% above the previous peak in November 2007.

At this stage, increased buyer interest is mainly translating into higher sales volumes. While buyers appear more motivated than in the recent past, they remain unwilling to over-commit as income growth is subdued and prospects uncertain. This will keep a lid on house price growth, although prices will continue their drift upwards from previous lows.

Higher sales volumes will benefit the real estate industry. Accordingly, we expect real estate and business services industry to contribute further to GDP growth over the year ahead (Figure 6).

Figure 6 – House sales and real estate & business services industry GDP

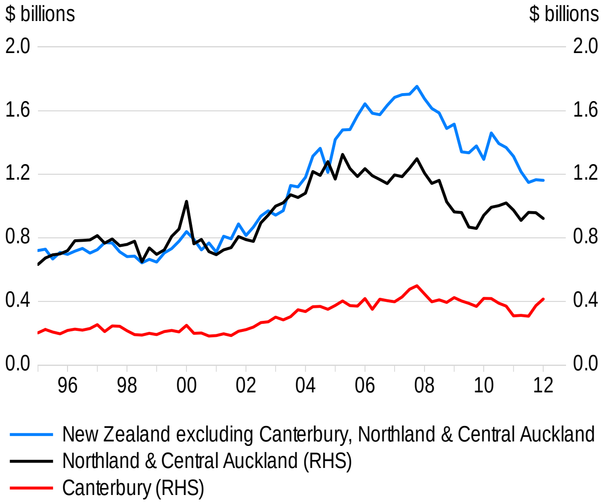


Sources: REINZ, Statistics New Zealand

Canterbury construction hints at pick-up, but nationally construction remains flat...

The pick-up in house sales and a 27% increase in residential building consents in April 2012 compared to April 2011 have yet to translate into increased residential investment as we would normally expect. In Canterbury, mostly non-residential construction has driven a 34% increase in total building work put in place in the March 2012 quarter compared to the same quarter a year ago (Figure 7). However, construction in the rest of the country, including Auckland, has been flat over the last few quarters.

Figure 7 – Value of building work



Source: Statistics New Zealand

...while manufacturing and service industry data point to continued expansion

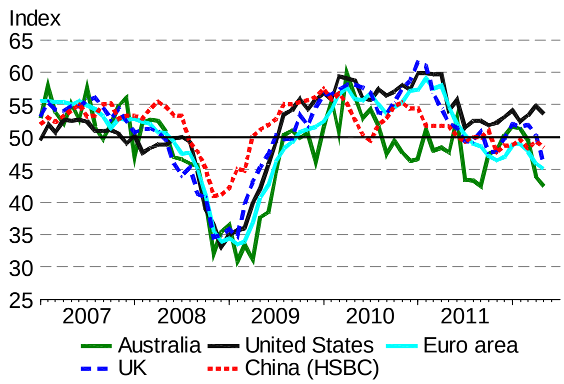
The May Performance of Manufacturing Index (PMI) reading of 55.7 indicates that manufacturing activity kicked on following the 1.8% increase in (GDP) activity over the March quarter. The May reading returned to a similar level to February and March (a figure above 50 indicates expansion), and indicated that April's fall was a blip.

Similarly, the service industry appears poised for further expansion in the June quarter. The seasonally adjusted Performance of Services Index for May stood at 56.8, largely unchanged from the April result (56.7), and the highest result since November 2011. This builds on the 2.2% annual average expansion in the service industry GDP for the year ended March 2012.

International data disappoint in latest period

International economic data took a softer turn in June, with the exception of Australia. PMIs declined further in most of our major trading partners and are below 50, indicating a decline in manufacturing output and below-trend growth in the case of China (Figure 8). June *Consensus* forecasts for our trading partner growth were revised down to 3.8% for 2013, the same as our Budget forecast; the forecast for 2012 was unchanged at 3.5%, just above our 3.4%.

Figure 8 – Purchasing Managers' Indices (PMIs)



Source: Datastream

US data weaker...

In the US, jobs growth in May was less than half what was expected at 69,000 with downward revisions to previous months; industrial production declined slightly in May and factory orders fell, pointing to continued weakness. Retail sales fell in May, mainly because of lower petrol prices, and consumer confidence declined in June. There were some signs of a housing market recovery with single-unit permits and house starts rising 3-4% in May and prices up marginally in April.

...and a significant slowdown in Europe...

Uncertainty arising from the debt crisis is beginning to affect output levels in Europe. Industrial production (IP) fell 0.8% in April, to be down 2.3% for the year; the weakness is beginning to affect Germany with a 2.0% monthly decline in IP. Euro-wide unemployment reached 11.0% in April and is more than twice that in some of the peripheral economies, but only half that in Germany. Euro retail sales fell 1.0% in April, down 2.5% annually.

...as China also slows...

May's economic data from China also showed slower growth: annual industrial production growth was 9.6%, well down from 15% mid last year; retail sales growth eased from 14.1% in April to 13.8% in May. On the positive side, exports were up more than expected and lending growth was above expectation.

...but Australia surprises

March quarter output in Australia increased 1.3%, double the rate expected and taking growth from a year ago to 4.3%. Growth was concentrated in private consumption and business investment, particularly mining investment; residential investment and exports were weak. There are signs of more general weakness as consumer and business confidence remain low, but mining investment is expected to support growth.

Central banks ready to act...

Inflation has eased in most major economies, partly because of lower oil prices, which are a sign of weakness in the global economy. Lower inflation gives central banks more room to support demand. China lowered its policy rates for all maturities and introduced some flexibility in the setting of rates. The Reserve Bank of Australia also reduced its policy rate 25 basis points to 3.5%. The US Federal Reserve extended "Operation Twist" (an attempt to reduce longer–term rates), reaffirming its intention to hold its policy rate low until late 2014. And, the European Central Bank has indicated that it may reduce its policy rate in July.

...but the Reserve Bank remains on hold

The Reserve Bank left the Official Cash Rate unchanged at 2.5% at the June Monetary Policy Statement. The Reserve Bank noted that New Zealand's trading partner outlook had weakened recently as well as growing risks that conditions deteriorate markedly in the euro area. Weighing these considerations against an improving domestic growth outlook next year, the Reserve Bank stated that "it remains appropriate for monetary policy to remain stimulatory."

Global pessimism spreads to Kiwi businesses and households...

The deteriorating situation in Europe led to a fall in business and consumer confidence in New Zealand in June. The June National Bank Business Outlook showed that a net 13 percent expect business conditions to improve over the year ahead, down from a net 27 percent last month. Similarly, consumer confidence fell in May, undoing much of the previous rise in confidence. After posting five consecutive rises, the seasonally adjusted ANZ-Roy Morgan consumer confidence fell 2.0% points in May and a further 6.1% points in June.

The falls in both surveys coincided with the worst headlines from Europe, including when the initial Greek election failed to produce a government.

...and weakens the merchandise trade balance

The deteriorating global outlook was also reflected in an increase in the annual merchandise trade deficit for the May year. The deficit was $805 million, widening $249 million from the year to April. Export values fell in May to be down 4% from May 2011, despite a rise in dairy and meat export volumes and values. A pick-up in crude oil and plant and machinery imports, drove a rise in the value of merchandise imports for the month to be up 1% compared to the same month a year ago.

Overall, with the established growth momentum and the earthquake rebuild expected to quicken in pace in the second half of the year, we expect annual growth to improve over the next year. We forecast annual real GDP growth to increase to 2.6% in the year to March 2013. However, global developments will mean that while the general direction for growth is up, there will be ups and downs along the way.

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

28 June 2012

Quarterly Indicators

		2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2
Gross Domestic Product (GDP)								
Real production GDP	qtr % chg(1)	-0.0	0.6	0.4	0.4	0.4	1.1	...
	ann ave % chg	1.8	1.7	1.3	1.2	1.4	1.7	...
Real private consumption	qtr % chg(1)	-0.4	0.2	0.9	1.5	0.1	0.1	...
	ann ave % chg	2.3	1.6	0.8	1.0	1.5	2.0	...
Real public consumption	qtr % chg(1)	0.6	0.1	0.1	0.5	-0.7	0.5	...
	ann ave % chg	0.6	0.3	0.0	0.3	0.2	0.3	...
Real residential investment	qtr % chg(1)	-6.5	-2.2	-8.4	1.0	4.2	-0.5	...
	ann ave % chg	3.8	3.8	-4.9	-11.1	-11.7	-11.9	...
Real non-residential investment	qtr % chg(1)	4.8	1.4	-2.7	-0.7	0.7	2.1	...
	ann ave % chg	1.7	6.9	10.6	10.0	5.8	2.4	...
Export volumes	qtr % chg(1)	-0.5	1.5	-0.5	0.7	2.9	-1.7	...
	ann ave % chg	3.2	2.1	1.3	1.2	2.0	1.9	...
Import volumes	qtr % chg(1)	7.2	-2.8	2.0	2.8	-2.2	4.1	...
	ann ave % chg	10.6	11.1	11.0	10.3	6.4	6.0	...
Nominal GDP - expenditure basis	ann ave % chg	5.0	4.8	4.9	4.6	3.4	3.1	...
Real GDP per capita	ann ave % chg	0.6	0.5	0.2	0.1	0.4	0.8	...
Real Gross National Disposable Income	ann ave % chg	2.9	2.5	2.9	3.0	2.1	1.7	...
External Trade								
Current account balance (annual)	NZ$ millions	-6787	-7196	-7396	-8827	-8338	-9738	...
	% of GDP	-3.5	-3.7	-3.7	-4.4	-4.2	-4.8	...
Income balance (annual)	NZ$ millions	-9538	-9649	-9501	-10363	-10405	-10633	...
Merchandise terms of trade	qtr % chg	0.8	0.8	2.4	-0.6	-1.5	-2.3	...
	ann % chg	12.3	6.7	7.1	3.4	1.0	-2.1	...
Prices								
CPI inflation	qtr % chg	2.3	0.8	1.0	0.4	-0.3	0.5	...
	ann % chg	4.0	4.5	5.3	4.6	1.8	1.6	...
Tradable inflation	ann % chg	3.3	3.7	5.5	4.6	1.1	0.3	...
Non-tradable inflation	ann % chg	4.6	5.2	5.2	4.5	2.5	2.5	...
GDP deflator	ann % chg	7.0	4.3	4.5	3.1	0.6	0.5	...
Consumption deflator	ann % chg	3.3	3.6	4.6	3.7	1.7	1.4	...
Labour Market								
Employment (HLFS)	qtr % chg(1)	-0.3	1.1	0.1	0.2	0.2	0.4	...
	ann % chg(1)	1.3	1.7	2.0	1.1	1.6	0.9	...
Unemployment rate	%(1)	6.7	6.6	6.5	6.6	6.4	6.7	...
Participation rate	%(1)	68.0	68.6	68.4	68.4	68.2	68.8	...
LCI salary and wages - total (adjusted)(5)	qtr % chg	0.5	0.4	0.5	0.6	0.6	0.4	...
	ann % chg	1.7	1.8	1.9	2.0	2.0	2.0	...
QES average hourly earnings - total(5)	qtr % chg	0.5	0.4	1.1	1.2	0.1	1.4	...
	ann % chg	1.8	2.6	3.0	3.2	2.8	3.8	...
Labour productivity(6)	ann ave % chg	0.3	-0.3	-0.7	-0.8	-0.1	0.2	...
Retail Sales								
Core retail sales volume	qtr % chg(1)	-0.3	1.4	1.0	2.6	2.2	-1.4	...
	ann % chg	0.3	1.4	1.9	4.5	7.3	4.3	...
Total retail sales volume	qtr % chg(1)	-0.6	1.4	0.9	2.3	1.6	-0.6	...
	ann % chg	-0.1	0.7	1.1	3.9	6.4	4.2	...
Confidence Indicators/Surveys								
WMM - consumer confidence(3)	Index	108	98	112	112	101	102	100
QSBO - general business situation(4)	net %	9.7	-15.7	24.9	11.8	4.8	23.4	...
QSBO - own activity outlook(4)	net %	18.2	5.7	17.5	15.6	18.0	25.1	...

Monthly Indicators

		2011M12	2012M01	2012M02	2012M03	2012M04	2012M05	2012M06
External Sector								
Merchandise trade - exports	mth % chg(1)	5.8	-1.7	-10.6	1.8	-1.1	-1.2	...
	ann % chg(1)	11.9	12.7	-6.3	-8.9	-17.4	-4.4	...
Merchandise trade - imports	mth % chg(1)	-5.9	9.0	-12.0	8.1	-3.5	0.8	...
	ann % chg(1)	-1.6	17.9	-7.3	-0.4	0.2	1.1	...
Merchandise trade balance (12 month total)	NZ$ million	806	637	663	266	-557	-805	...
Visitor arrivals	number(1)	219,990	213,520	203,850	210,710	212,680	210,610	...
Visitor departures	number(1)	220,180	218,880	215,120	209,060	218,350	205,810	...
Housing								
Dwelling consents - dwellings	mth % chg(1)	2.3	9.2	-6.2	19.6	-7.2	...	...
	ann % chg(1)	17.8	19.7	20.8	46.7	34.5	...	...
House sales - dwellings	mth % chg(1)	4.6	1.0	7.4	-3.7	-8.0	14.8	...
	ann % chg(1)	20.6	26.7	37.3	25.2	13.2	23.5	...
REINZ - house price index	mth % chg	-0.1	-1.4	0.8	1.9	-0.3	1.7	...
	ann % chg	3.1	4.3	2.7	4.2	2.7	6.4	...
Private Consumption								
Electronic card transactions - total retail	mth % chg(1)	-0.2	1.1	-0.6	0.3	1.0	0.9	...
	ann % chg	7.2	4.7	8.2	5.6	1.2	6.1	...
New car registrations	mth % chg(1)	3.8	1.9	-1.9	-3.3	3.4	3.4	...
	ann % chg	4.2	4.5	2.3	-1.0	8.6	10.3	...
Migration								
Permanent & long-term arrivals	number(1)	6700	6600	7180	7540	6430	7050	...
Permanent and long-term departures	number(1)	7250	7240	7560	7290	7230	6890	...
Net PLT migration (12 month total)	number	-1855	-3134	-4068	-3383	-4006	-3653	...
Commodity Prices								
Brent oil price	US$/Barrel	108.19	110.45	119.43	125.38	120.08	110.24	*95.47*
WTI oil price	US$/Barrel	98.57	100.24	102.25	106.19	103.33	94.70	*82.52*
ANZ NZ commodity price index	mth % chg	-0.5	-2.8	-4.1	-0.2	-4.0	0.8	...
	ann % chg	0.7	-4.7	-11.1	-17.9	-17.6	-15.8	...
ANZ world commodity price index	mth % chg	-0.6	1.2	-0.1	-1.7	-4.5	-4.2	...
	ann % chg	2.6	-0.2	-2.9	-8.9	-13.9	-17.3	...
Financial Markets								
NZD/USD	$(2)	0.7697	0.8007	0.8343	0.8208	0.8190	0.7762	*0.7790*
NZD/AUD	$(2)	0.7604	0.7691	0.7780	0.7779	0.7908	0.7766	*0.7809*
Trade weighted index (TWI)	June 1979 = 100(2)	68.61	71.23	73.36	73.00	73.00	70.04	*70.76*
Official cash rate (OCR)	%	2.50	2.50	2.50	2.50	2.50	2.50	*2.50*
90 day bank bill rate	%(2)	2.69	2.74	2.75	2.74	2.74	2.59	*2.58*
10 year govt bond rate	%(2)	3.91	3.87	3.99	4.17	3.98	3.66	*3.42*
Confidence Indicators/Surveys								
National Bank - business confidence	net%	16.9	...	28.0	33.8	35.8	27.1	12.6
National Bank - activity outlook	net%	25.7	...	31.2	38.8	36.1	34.9	20.8
ANZ-Roy Morgan - consumer confidence	net%	108.4	116.1	113.3	110.2	114.0	113.9	105.8

qtr % chg	quarterly percent change	(1)	Seasonally adjusted
mth % chg	monthly percent change	(2)	Average (11am)
ann % chg	annual percent change	(3)	Westpac McDermott Miller
ann ave % chg	annual average percent change	(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, One News Colmar Brunton