Monthly Economic Indicators

THE TREASURY
Kaitohutohu Kaupapa Rawa

June 2013

Executive Summary

- **Drought slowed growth in the March quarter and will further restrain it in the June quarter**
- **The current account deficit is expected to remain below 5% throughout 2013**
- **Nervousness in financial markets as they adjust to US monetary policy signals**

The surge in growth recorded in December was reduced in March as the most severe drought in at least 70 years sharply curtailed agricultural production. The drought will further constrain growth in the June quarter and its negative effects may also affect the September quarter. Although the quarterly growth rate will remain moderate in the June quarter, other indicators of growth released over the month, including business and consumer confidence, showed domestic demand continued to strengthen. These developments are likely to see growth accelerate as the drought impacts fade over the second half of the year.

The annual current account deficit narrowed to 4.8% of GDP in the March quarter, mainly owing to a larger goods surplus. The outlook is for the deficit to remain around its current level over 2013. However, the deficit is expected to widen thereafter as the ongoing economic recovery and the Canterbury rebuild generate increased demand for imported investment goods and higher profit outflows from foreign-owned firms operating in New Zealand.

June was characterised by general nervousness in global financial markets owing to less accommodative signals from the Federal Reserve (Fed), and despite positive economic data. The economic recovery is becoming more evident in the developed world, although emerging economies are experiencing slower growth. The fall in asset prices does not suggest any deterioration in economic conditions, but reflects the market adjusting to the new Fed policy stance.

The first of the Special Topics in this release looks at the relationship between employment and GDP in New Zealand and evaluates its recent behaviour. The second Special Topic outlines current fiscal policy and its impact on the economy.

New Zealand Government

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Analysis

The surge in growth recorded in December was reduced in March as the most severe drought in at least 70 years sharply curtailed agricultural production. The drought will further constrain growth in the June quarter and its negative effects may also affect the September quarter. All up, the Treasury estimates that the drought will reduce growth by around 0.7 percentage points over 2013. Although the quarterly growth rate will remain moderate in June, other indicators of growth released over the month, including business and consumer confidence, showed domestic demand continued to strengthen. These developments are likely to see growth accelerate as the drought impacts fade over the second half of the year, as in the Budget forecasts. Developments offshore continued to set the tone for financial markets, with news out of the US and China adding further impetus to the realignment in the NZ dollar and other financial markets that began in May.

Drought slows growth in March...

Growth was expected to moderate in the March quarter not least because December's 1.5% growth rate was exceptional, but also because the most severe drought in at least 70 years had curtailed agricultural production. However, the 0.3% growth rate in the March quarter was weaker than the Treasury and other forecasters expected, although revisions to prior quarters meant that growth of 2.5% for the year ending March was in line with expectations.

The decline in agricultural production reduced GDP growth by 0.3%-points (Table 1). At the same time, destocking of farmland meant the country's meat works were operating at full capacity, which provided a partial offset. Hydro-electricity generation was also reduced, although weak demand from the energy intensive aluminium smelting industry also played a role. Overall, the net effect of the drought appears to have been to reduce growth by 0.2 to 0.3%-points in the quarter.

The positive impact of the Canterbury rebuild was evident in the construction industry and in the broad professional, scientific, technical, administrative, and support services industry, which included significant growth in architectural and engineering services (Table 1).

Table 1: Key contributors to real GDP growth

GDP (production) by industry	%-age point contribution
Agriculture, Forestry and Fishing	-0.3
Mining	0.1
Manufacturing	0.0
Electricity, Gas, Water & Waste Services	-0.1
Construction	0.3
Prof, Scientific, Technical, Admin, & Support Services	0.4
Retail Trade	0.1
Other industries*	-0.2
GDP	**0.3**

* includes unallocated and balancing item
Source: Statistics NZ

Expenditure on GDP also advanced 0.3% in the quarter, and grew 2.9% in the year ending March 2013. Household consumption and residential investment spending continued to expand, contributing 0.2 and 0.4%-points respectively to March quarter growth. Excluding residential investment, investment fell in the quarter, reducing growth by 0.3%-points. The main driver of this fall was decreased plant and machinery investment. However, with business confidence remaining firm, further progress in the Canterbury rebuild, and inventories of capital goods rising sharply in recent quarters, a rebound in investment is anticipated in coming quarters.

Dairy exports rose in March, despite the drought, as did exports of other primary produce, helping lift total goods exports. Services exports experienced their largest quarterly gain in over a decade, up 7% in the quarter as international visitors increased their spending. Overall, goods and services volumes rose 2.5%, more than offsetting a 2.3% rise in imports of goods and services. The negative effects of the drought on meat and dairy export volumes, which make up over 36% of total goods exports, are expected to become increasingly evident in coming quarters as inventories are reduced. Some indication of this is evident in trade figures from April and May, which show meat and dairy export volumes tracking below March quarter levels.

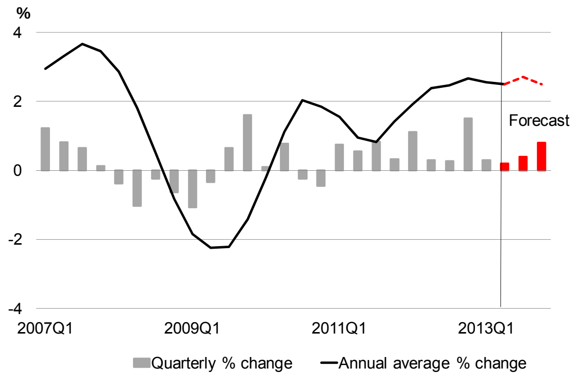
...and will impact further in June

The Treasury expects the drought effects to be even larger in the June quarter. Milk production contracted further in the June quarter and meat processing volumes have retreated from their elevated March quarter levels, although increased hydro-electricity generation may provide an offset.

The net impact of this is expected to be a reduction in growth of between 0.3 and 0.4%-points. However, other manufacturing industries appear to have performed well in the quarter and consumer and services industry sentiment have remained at elevated levels, which should more than offset the negative drought effects and enable the economy to expand at a similar pace to March.

To date, the drought effects have been largely as anticipated in the Budget forecasts, which estimated that the drought would reduce real annual average GDP growth by around 0.7%-points over 2013. Most of that impact has already occurred, but some small negative effects are expected to persist into the September quarter. Fading drought impacts, combined with the positive influence of the Canterbury rebuild and low interest rates, see growth accelerate over the second half of the year (Figure 1).

Figure 1: Quarterly GDP growth accelerates in the second half of 2013



Sources: Statistics NZ, the Treasury

The continuing economic recovery is expected to feed through into higher employment as discussed in Special Topic 1: A jobless recovery?

Revisions swell the size of the economy

With the drought impacts in March largely as anticipated, the main explanation for the weaker-than-expected growth lies in upward revisions to growth in prior quarters. Revisions boosted both the production and expenditure measures of GDP growth by 0.2%-points to 2.7% and 3.2% respectively for the year ending December 2012. These revisions meant that output in the economy was greater than initially estimated and so had to grow by less to reach the size it was expected to be.

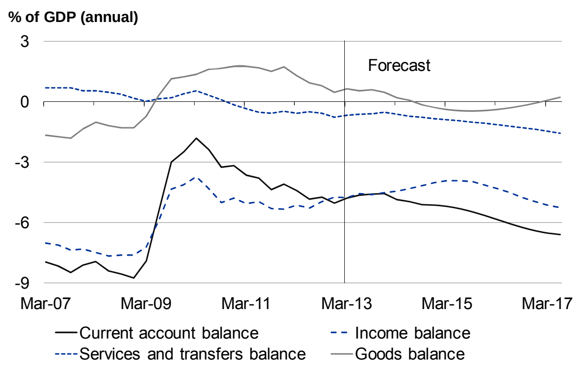
For the Treasury, the size of the economy is critical for two reasons. First, the level of output, in conjunction with the unobserved "potential" output, informs the Treasury's view of how much spare capacity the economy is operating with. This feeds through to our fiscal policy advice, for example, when considering the impact of fiscal adjustment on the economy (see Special Topic 2: Recapping New Zealand's recent fiscal policy). Second, the level of output is a key determinant of the tax base. The other key determinant of the tax base is the price level (technically the implicit GDP price deflator), which rebounded in the quarter, rising 2.1% on a stronger terms of trade. This boosted growth in the current price measure of GDP to 2.7% for the year ending March, in line with the Budget forecast and broadly consistent with trends in tax revenue.

In the ten months ending April, core crown tax revenue was 1.0% ahead of the Budget forecast. Just over half this variance arose from higher corporate profitability, partly owing to the strength of international equity markets. These gains may not be well captured by measures of GDP, or reflected in the Balance of Payments statistics, as both of these are based on transactions rather than changes in market value. With regard to the Balance of Payments, it is notable that a significant portion of the $2.7 billion fall in the net international debt position was attributable to increases in the market value of offshore assets. These increases can generate tax liabilities even though the investor does not make a transaction that would generate a flow of income.

Current account deficit falls below 5%...

The current account deficit in the year ending March narrowed to 4.8% of GDP from 5.0% in December (Figure 2).

Figure 2: Current account deficit remains around current levels over 2013, but then widens



Sources: Statistics NZ, the Treasury

A larger goods surplus accounted for most of the lower current account deficit in the year. The income deficit, the largest component of the current account deficit, continued to benefit from lower interest outflows, which fell to their lowest level since 2004. Dividend income earned by foreign portfolio investors also fell. A decrease in profits from New Zealand-owned companies overseas offset the lower outflows, keeping the income balance flat.

...and is expected to remain there over 2013

The Treasury's Budget forecast is for the current account deficit to remain around current levels of 4.8% of GDP over the coming year. Beyond that, the economic recovery and the Canterbury rebuild are expected to lead to increased demand for imported investment goods and to higher profit outflows from foreign-owned firms, widening the current account deficit to around 6.5% to GDP. Recent falls in the New Zealand dollar, if sustained, could moderate this widening trend, principally through its positive impact on goods and services exports, although a much larger currency adjustment is required to achieve any meaningful shift in the trend.

Net liability position improves

The net international liability position fell to 69.3% of GDP from 71.4% in December. Rising overseas share prices and a large increase in purchases of overseas debt securities contributed to a $3 billion rise in New Zealand's overseas assets. There was little change in liabilities in the quarter, although net errors and omissions in the financial account were large, and the net liability position decreased to $146.6 billion from $149.6 billion in December.

The fall in the net international liability position is likely to be temporary given the ongoing rundown of outstanding international reinsurance claims from the Canterbury earthquakes, which are recorded as overseas assets. Settlements of international reinsurance claims in the March quarter were estimated at $1.0 billion, down from an average of $1.4 billion in previous quarters. A total of $9.2 billion in claims have been settled, leaving $9.5 billion outstanding.

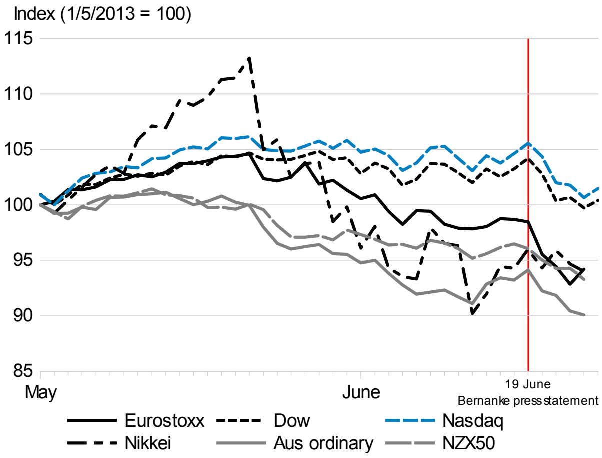
Global markets adjusting as economic recovery becomes more evident

June was characterised by general nervousness in global financial markets owing to less accommodative signals from the Federal Reserve (Fed), and despite positive economic data. Economic recovery is becoming more evident in the developed world, although emerging economies are experiencing slower growth. The fall in asset prices does not suggest any deterioration in economic conditions, but reflects the market adjusting to the new Fed policy stance.

Volatility persists in financial markets...

Global financial markets continue to be highly volatile, and sensitive to data and policy developments. Equities fell broadly during the month (Figure 3), as the market was surprised by the Fed announcement of the imminent tapering of quantitative easing (QE). Figure 3 shows the S&P and the Dow declining over the month, while the Nikkei and the Stoxx600 experienced even sharper falls, as stock prices corrected from their QE-inflated levels. Chinese equities plummeted 17.7% during the month, chiefly owing to a liquidity squeeze and soft economic data.

Figure 3: Global equities



Source: Haver

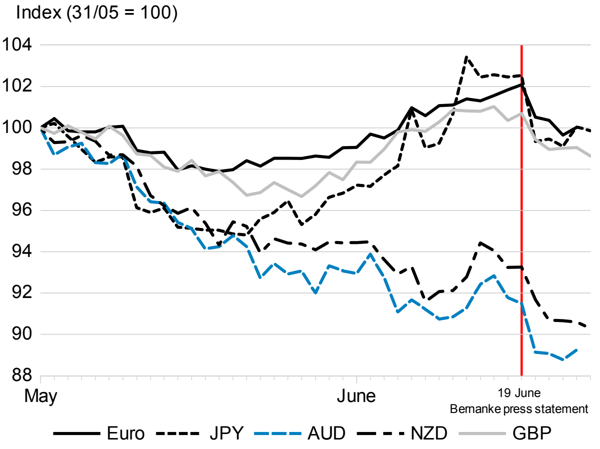
Global interest rates rose as the market increasingly expects tighter monetary conditions. Yields on 10-year UK and US Treasury bonds climbed by nearly 50 basis points (bps), while the average yield for 10-year euro area government bonds rose by 30 bps. Japanese yields remained flat, as stimulatory measures by the BoJ offset the upward pressure on yields. NZ yields were also pushed up by prospective Fed moves. The 5-year and 10-year government bond rates both rose by around 50 bps during the month, to 3.42% and 4.21% respectively.

...driven by less supportive monetary policy...

Falling asset prices were the product of increasingly less accommodative signals from the Fed. Chairman Bernanke revealed his plans to begin reducing asset purchases in late 2013, and to end purchases by mid 2014, assuming no significant deterioration in activity. The Fed also hinted that the current low rates of inflation will be given less weight in its conduct of monetary policy in the near future. This less supportive stance surprised market participants.

The less dovish Fed stance led to a broad strengthening of the USD. Figure 4 shows the depreciation of the other majors against the USD resuming in the middle of the month, following an earlier reversal. In the last two weeks, the euro fell by 2.3% against the USD, the yen by 2.6%, and the pound by 1.9%.

Figure 4: Currency moves against the USD



Source: Haver

The ECB is also being perceived as overly cautious in stimulating growth, having made only one policy rate cut since mid-2012 despite the euro area's economic downturn. The People's Bank of China (PBoC) delayed injecting liquidity into the banking sector until late in June, bringing a liquidity squeeze that led to a 6.3% one-day fall in Chinese equities.

...and a slowdown in emerging economies

Growth is slowing in the emerging economies, particularly China. China's HSBC manufacturing PMI has fallen for two consecutive months to 48.3 in June, indicating below-trend growth. Industrial production (IP) growth in May was below market expectation, coming in at 9.2% on a year ago. Commodity markets reacted negatively to the ongoing softness, with iron ore and crude oil prices retreating in recent months. The commodity-based currencies, including the AUD, CAD and NZD, fell heavily against the USD during the month, driven primarily by weaker growth in China and also by the Fed announcements.

For Australia, falling commodity prices coincided with the likely peak of mining investment in the March quarter, suggesting weaker momentum for growth in 2013. The non-mining sectors of the economy do not appear to be picking up; the AIG manufacturing PMI was at 43.8 in May and the services PMI at 44.1 in April, both reflecting significant contraction. However, the recent fall in the AUD should provide some support to manufacturing and maintain the profitability of mining.

However, data convey underlying economic recovery in the US...

While Wall Street may be nervous, US data continue to point to underlying economic recovery, despite a downward revision to the March quarter GDP growth. Solid growth in non-farm payrolls (average of 155,000 per month from March to May) and the downward trend in the unemployment rate show sustained recovery in the labour market. Momentum is also evident in the housing market: housing starts were up 29.0% on a year ago in May, new permits were up 20.8% on a year ago, and the Case-Shiller house price index rose 12.1% on a year ago in April.

...and improvement in the euro area...

The euro area exhibited some improvement in recent weeks. The manufacturing PMI and the services PMI sat at 48.7 and 48.6 in June, respectively, up by 2.0 points and 1.6 points on their April lows, although both indices still indicated contraction. IP rose 0.4% in April, representing the third consecutive monthly gain. However, general economic conditions remain weak, and a disparity between Germany and the peripheral countries is evident. Negatively, the unemployment rate ticked up 0.1% points to 12.2%, driven largely by rising unemployment in peripheral countries.

...and stimulus-led pickup in Japan...

Japanese growth in the March quarter was revised up 0.1% points to 1.0%. Activity appears strong: the manufacturing PMI rose in May (+0.4 points to 51.5), as did the services PMI (+3.1 points to 54.8), while IP expanded in April (0.9%). The two major household sentiment indicators are at 6- and 7-year highs, reflecting sustained enthusiasm surrounding the BoJ's stimulatory policies. However, the pickup is partly on the basis of short-term fiscal stimulus by the Abe government in late 2012, while structural reforms and growth targets recently revealed by the government have so far not impressed the market.

...suggesting recovery in the developed world

Economic recovery in the developed world, led by the US and reinforced by more positive signs elsewhere, is becoming more evident, despite the current nervousness in financial markets. The depreciation of other currencies against the USD will support manufacturing and other tradables output in the rest of the world.

The recent decline in equity prices does not reflect any deterioration in economic fundamentals, but that stock prices had been lifted to historically high levels by QE stimulus. The financial markets are adjusting as this stimulus is expected to be gradually unwound. The longer-term outlook for equities should be positive as sustainable growth takes over from stimulatory monetary conditions as a market driver.

NZD revaluation is expected to continue

Developments in the past month have led to a revaluation of the NZD. Expectations of the Fed tapering QE, the falls in commodity prices, and the slowdown of growth in China and Australia led to a steady depreciation of the NZD. The NZD/USD rate has fallen to around 77 US cents, from 86 cents in mid-April, although the NZD/AUD rate rose slightly, as falling ore prices and the manufacturing slowdown in China produced a greater drag on the AUD. The fall in the NZD is earlier than expected in the Budget forecasts, which forecast the TWI to decline in 2014. The fall in the exchange rate will make NZ tradables more competitive, lending support to manufacturing and strengthening the returns to exporters more broadly.

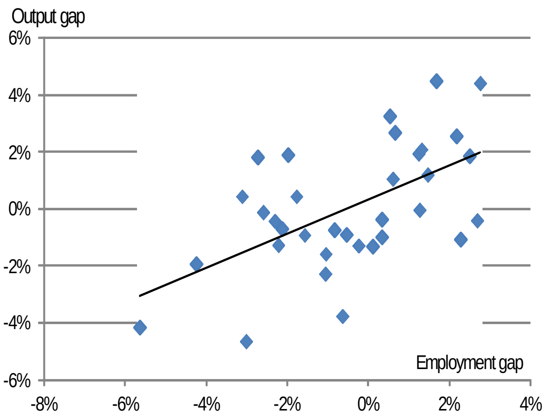
Special Topic 1: A jobless recovery?

One of the reasons economists and policymakers care about economic growth is that it is a source of jobs. When unemployment is high for a sustained period, such as at present, it is common to see statements that unemployment is structural rather than cyclical; a variant of this is to say the economy is experiencing a "jobless recovery" – such a situation would be a concern. The aim of this special topic is to see if the current relationship between employment and GDP in New Zealand is atypical in the historical context; if so, this may imply unemployment is more structural.

Economists observe a relationship between unemployment and output...

The relationship between output and unemployment is called Okun's Law – although it is really more of a rule of thumb. There are a number of variants of this law but we will focus on one, the relationship between the output gap (actual output less potential output) and the employment gap (actual employment less trend employment).[1]

Figure 5: Output and the employment gap



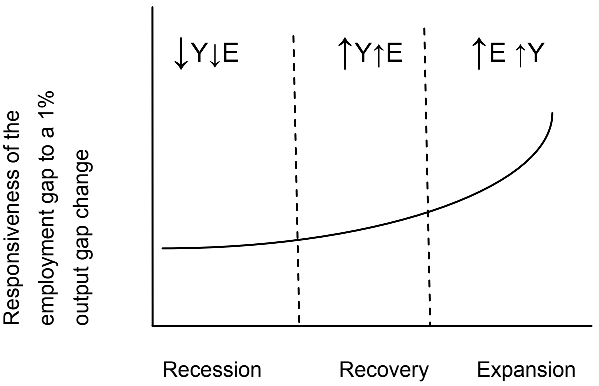
Source: Treasury

Figure 5 plots the relationship between the employment gap and the lag of the output gap for New Zealand for the period 1979 to 2012 and shows there is a strong positive relationship. We lag the output gap because it is commonly accepted the labour market lags output.

... and there are reasons the relationship maybe time-varying

Given firms tend to over-hire in the later stages of expansions, one would expect a change in output to have an increasing employment response at the end an expansion. Conversely, during a recession labour hoarding means that the employment response to the negative output gap is low (i.e., employment does not fall as much as output). In the recovery phase we see low (positive) employment growth relative to (positive) output growth as firms use existing staff to expand output rather than hire new staff (Figure 6).

Figure 6: Output and the employment gap



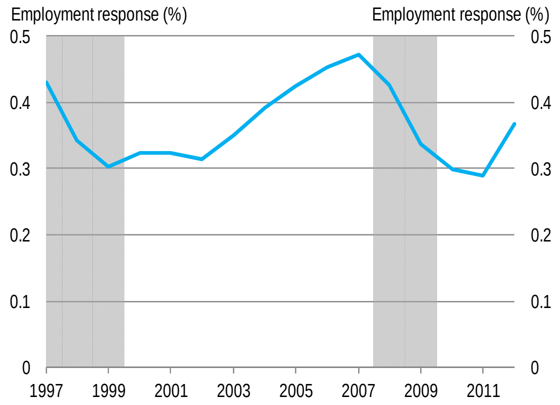
Source: Treasury

Figure 7 shows that generally the last cycle (1999-2007) matches our stylised facts with the employment response low during the recession and then rising post recession, reaching its apex at the end of the expansion in 2007.[2]

[1] We report only the employment gap for brevity - our conclusions are the same for the unemployment gap or employment growth. Trend employment is calculated by HP filtering (λ=100) the employment series; the output gap series is based on Treasury's measure used in its forecasts.

[2] We do not report any further back in history as the analysis is complicated by structural reforms in the 1980s and early 1990s.

Figure 7: The coefficient of the employment gap to a 1% change in the output gap[3]

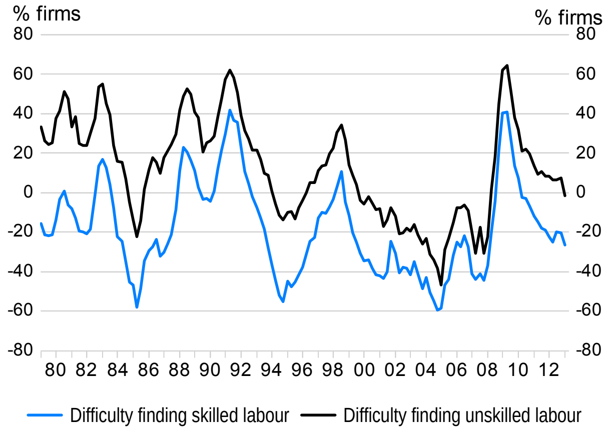


Source: Treasury

There is little evidence something structural is at play...

If there was some structural change in the New Zealand labour market at present we would expect the employment response to GDP to be unusually high (a larger negative employment gap for a given negative output gap). However Figure 7 shows that the employment response in the2008/09 recession was similar to the previous recession and its path post recession is also similar – an indication that the current relationship is not abnormal and therefore evidence against the structural hypothesis. The conclusion that the elevated level of unemployment is related to the slow output recovery rather than something structural in the labour market is consistent with Craigie et al (2012).[4]

Figure 8: Difficulty finding labour



Source: NZIER

Another indicator we can look at is the QSBO survey of the difficulty firms have in finding skilled and unskilled labour (Figure 8). After being elevated in 2009 (relatively easy to find labour), both these indices are returning to somewhere near average, i.e. firms are finding it harder to find labour. This dynamic is exactly what you would expect to see in a normal recovery. In a "jobless recovery" it would remain easy to find labour and therefore the index would remain high.

[3] This is estimated on annual data using the Kalman filter where: employment gap = $\alpha+\beta$output gap(-1)+η_t is the signal equation and $\beta_t= \beta_{t-1}+\varepsilon_t$ is the state equation.

[4] "Not a jobless recovery, just a slow one", RBNZ Analytical Note 2012/6.

Special Topic 2: Recapping New Zealand's Recent Fiscal Policy

The recent Budget 2013 provides an opportune time to recap the recent and prospective path of fiscal policy and its impacts on the economy.

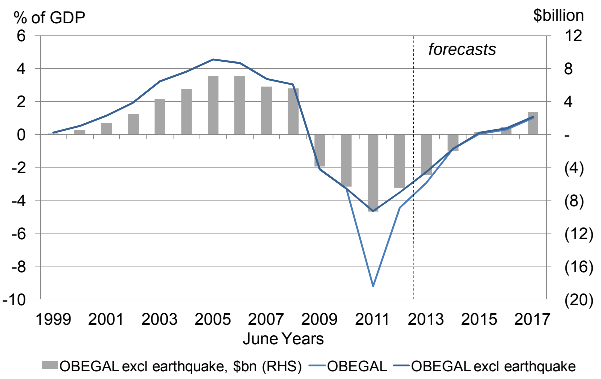
The recession saw the fiscal position move into structural deficit...

Over 2008 and the first half of 2009, New Zealand – along with much of the world – experienced a decline in economic activity. The severity and nature of the downturn and subsequent slow recovery had structural impacts on the fiscal balance. The potential growth path of the economy appears permanently lower, and tax revenue with it. Tax reductions in 2008 and 2009 also reduced the tax take.

At the same time, expenses rose due to greater uptake of unemployment and welfare benefits. However, as other expenses such as health and defence are not as closely linked to economic activity, they remained largely on their pre-recession path.

The combination of these factors saw the balance of revenues to expenses reverse, from fiscal surplus to deficit. Its structural nature meant that from late 2008 forecasts showed the Government's operating balance before gains and losses (OBEGAL) remaining in deficit for the foreseeable future. Costs from the Christchurch earthquakes further added to expenses. Ultimately the OBEGAL deficit reached 9.2% of GDP in 2011, or 4.6% of GDP excluding earthquake expenses (Figure 9).

Figure 9: Total Crown OBEGAL



Source: the Treasury

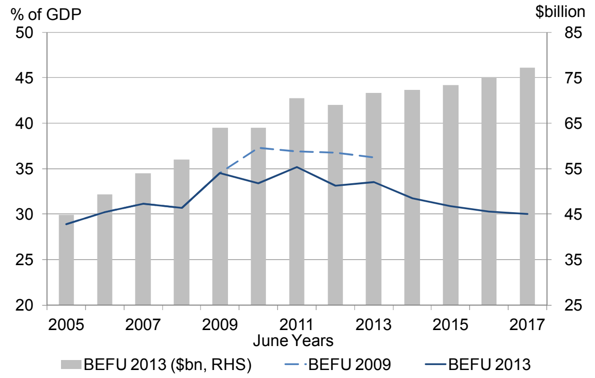
...necessitating a policy response...

In response to the prospect of ongoing deficits, the Government announced a series of policy adjustments in successive budgets since 2009, aimed at returning the fiscal balance to surplus. It has focussed these adjustments mainly on the expenditure side. Measures have included:

- Reducing the amount of new spending each year.
- Changes to entitlements, e.g. KiwiSaver, student loans, and welfare schemes.
- Seeking efficiency savings across the state sector, including through constraining growth in public sector wages.

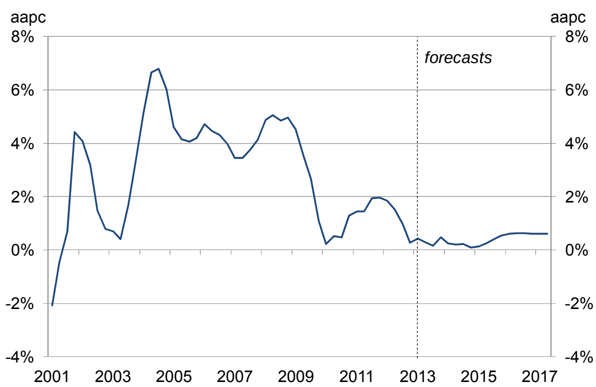
The policy changes have generally slowed the growth rate of expenses rather than reduced the dollar amount. Government expenditure has been growing and will continue to do so (Figures 10 and 11). However, by slowing the rate of growth to lower than that of GDP, core Crown expenses are forecast to fall back to around 30% of GDP, similar to the level seen prior to the fiscal expansion in the late 2000s.

Figure 10: Core Crown expenses



Source: the Treasury, Statistics NZ

Figure 11: Real government consumption growth



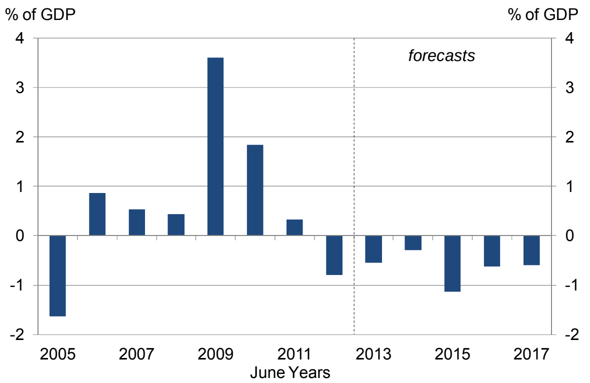
Source: the Treasury, Statistics NZ

...that will play out over time

Although policy changes have been announced, much of the actual fiscal adjustment is still to occur. The measured pace of New Zealand's fiscal adjustment is highlighted when we look at domestic forecasts for the next five years, as well as the experiences of international peers.

Domestically, one way to illustrate the gradual pace of adjustment is the fiscal impulse measure (Figure 12).

Figure 12: Fiscal impulse*



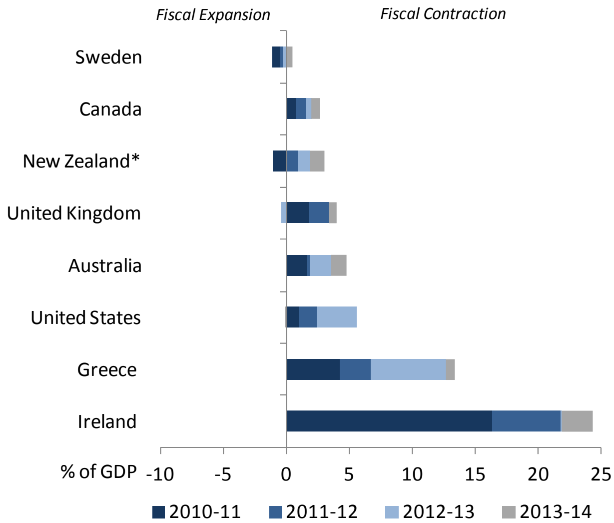
*Core Crown plus Crown entities fiscal impulse, excluding EQC and Southern Response payments[5]

Source: the Treasury

The fiscal impulse combines cash-based spending (operating and capital) and tax information to provide a summary guide to the impact of fiscal policy on demand in the economy. It measures the annual change in the fiscal balance as a percentage of GDP, abstracting from the effects of the economic cycle. This shows that in the recession and the initial years of the recovery fiscal policy provided support to the economy. This stance continued until the June 2012 year, when the impulse turned negative. It is expected to remain negative throughout the forecast period, as measures introduced over recent budgets restrain expenditure growth. It is worth reiterating that this indicates the Government's contribution to economic activity will gradually decline in each year of the forecasts, rather than the level of government spending itself falling.

International comparisons also highlight the gradual nature of New Zealand's fiscal adjustment. Figure 13 shows the phasing of fiscal adjustment across a number of countries, as illustrated by the annual change in each country's cyclically-adjusted fiscal balance from 2010 to 2012 and forecasts for 2013 and 2014. The cyclically-adjusted balance estimates the underlying fiscal position – i.e. the part expected to remain once economic activity has returned to its sustainable growth path.

Figure 13: Change in cyclically-adjusted fiscal balance, % of GDP*



*Cyclically-adjusted balance estimates from OECD Economic Outlook 93, with the exception of New Zealand. New Zealand estimates are Treasury's, from *BEFU 2013,* and exclude Canterbury earthquake expenses.

Source: OECD, Treasury

The figure illustrates a range of experiences. In Eurozone countries such as Ireland and Greece, pressures from financial markets (as well as from the IMF and ECB for "programme" countries) have led to front-loaded adjustment, with the vast majority of total 2010-14 adjustment in these countries already having occurred. US fiscal adjustment remained relatively gradual over 2010-12, until the "sequester" changes earlier this year brought about a faster pace. Meanwhile, countries such as New Zealand, Sweden and Canada have implemented a more gradual adjustment, with over a quarter of the total adjustment between 2010 and 2014 in these countries expected to occur in the coming year. These more back-loaded approaches have been permitted by strong initial fiscal positions, more favourable economic conditions, and the early signalling of credible adjustment paths all helping to alleviate market concerns.

[5] For more information on the fiscal impulse and the cyclically-adjusted balance, see the *Budget Economic and Fiscal Update 2013 Additional Information* on the Treasury website.

Adjustment will likely have a small impact on economic activity...

Assessing the impact of fiscal policy on the macro economy is not straightforward and requires assessment of a range of indicators and tools – all of which have limitations – as well as contextual information relating to the broader economic environment.

One commonly used measure is the fiscal impulse already mentioned. This shows fiscal policy withdrawing on average 0.5% of GDP annually from aggregate demand over the next five years. However, this measure should be used with caution. It does not attempt to take account of the composition of fiscal policy changes (e.g. some government spending has higher import components, or affects groups with different propensities to consume) or how a change in fiscal policy will be transmitted through the economy via secondary effects and behavioural responses.

The effect of fiscal policy on domestic output is likely to be smaller in New Zealand than in some other countries. Of particular note is that monetary policy is not constrained by the zero lower bound of interest rates. This means that, all else equal, a credible and well-signalled fiscal contraction is likely to herald lower interest rates than otherwise, via more accommodative monetary policy, and less pressure on the dollar. This should serve to stimulate aggregate demand and shift resources toward the export-facing sector, softening the impact of fiscal tightening on the economy.

This interaction between fiscal and monetary policy, which reduces the economic impact of adjustment in New Zealand, is supported by recent empirical work. This shows that, all else equal, annual GDP growth can be expected to slow by around 0.3 percentage points in the short-term if government spending is reduced by 1% of GDP.[6] However, these estimates are sensitive to a range of factors, in particular the responsiveness of monetary policy to economic slack and the responsiveness of private demand to both monetary and fiscal policy changes.

...and will be offset by the Canterbury-rebuild

Fiscal adjustment should also be viewed in the wider context of the economic outlook. New Zealand’s planned fiscal adjustment is forecast to subtract from aggregate demand at a time when private sector and earthquake-related spending will be adding to it. It is the balance of these competing influences that will determine the overall path of output going forward. Taking all of these factors into account, Treasury forecasts spare capacity in the economy to be gradually taken up over the coming year and for inflation to settle around the centre of the Reserve Bank’s target range.

Given the lumpiness in both the profile of rebuild activity and fiscal adjustment, it is likely that the path of output will be bumpy, with some volatility in short-run economic outturns. However, overall, the planned fiscal adjustment appears well timed to both minimise its adverse economic impacts and support the recovery by making room for the strengthening of economic recovery.

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[6] Vehbi and Parkyn (2013), “The Effects of Fiscal Policy in New Zealand: Evidence from a VAR Model with Debt Constraints”, Treasury Working Paper 13/02; Murray (forthcoming), “Parameter Uncertainty and the Fiscal Multiplier”, Treasury Working Paper.

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

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New Zealand Key Economic Data

28 June 2013

Quarterly Indicators

		2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Gross Domestic Product (GDP)								
Real production GDP	qtr % chg[1]	0.3	1.1	0.3	0.3	1.5	0.3	...
	ann ave % chg	1.4	1.9	2.4	2.5	2.7	2.5	...
Real private consumption	qtr % chg[1]	0.3	0.6	0.3	0.1	1.5	0.4	...
	ann ave % chg	2.0	2.5	2.7	2.4	2.3	2.2	...
Real public consumption	qtr % chg[1]	0.5	-0.9	1.0	0.3	-0.6	-0.2	...
	ann ave % chg	1.9	1.8	1.6	1.2	0.6	0.6	...
Real residential investment	qtr % chg[1]	5.1	0.7	7.4	5.2	2.2	9.6	...
	ann ave % chg	-11.2	-10.8	-2.2	6.6	12.1	19.2	...
Real non-residential investment	qtr % chg[1]	-0.2	3.4	3.3	-4.3	2.2	-2.2	...
	ann ave % chg	7.6	6.0	5.8	4.5	5.0	3.7	...
Export volumes	qtr % chg[1]	4.2	-2.7	-1.2	4.2	1.4	2.5	...
	ann ave % chg	2.7	2.6	2.4	3.0	2.0	3.4	...
Import volumes	qtr % chg[1]	-1.3	2.8	-2.9	2.1	-0.7	2.3	...
	ann ave % chg	6.5	6.1	3.7	1.5	1.9	0.5	...
Nominal GDP - expenditure basis	ann ave % chg	3.9	3.8	4.1	3.0	2.4	2.7	...
Real GDP per capita	ann ave % chg	0.4	1.0	1.6	1.7	2.0	1.9	...
Real Gross National Disposable Income	ann ave % chg	1.7	2.2	1.4	1.5	1.3	1.0	...
External Trade								
Current account balance (annual)	NZ$ millions	-8,268	-9,033	-10,087	-9,861	-10,486	-10,077	...
	% of GDP	-4.0	-4.4	-4.8	-4.7	-5.0	-4.8	...
Investment income balance (annual)	NZ$ millions	-10,750	-10,443	-10,899	-10,226	-9,824	-10,030	...
Merchandise terms of trade	qtr % chg	-1.5	-2.3	-2.5	-3.2	-1.2	4.2	...
	ann % chg	1.0	-2.1	-6.7	-9.2	-8.9	-2.9	...
Prices								
CPI inflation	qtr % chg	-0.3	0.5	0.3	0.3	-0.2	0.4	...
	ann % chg	1.8	1.6	1.0	0.8	0.9	0.9	...
Tradable inflation	ann % chg	1.1	0.3	-1.1	-1.2	-1.0	-1.1	...
Non-tradable inflation	ann % chg	2.5	2.5	2.4	2.3	2.5	2.4	...
GDP deflator	ann % chg	0.4	-0.2	1.7	-1.5	-2.7	0.9	...
Consumption deflator	ann % chg	1.6	1.3	0.9	0.7	0.5	0.4	...
Labour Market								
Employment (HLFS)	qtr % chg[1]	0.5	0.0	0.0	-0.4	-0.9	1.7	...
	ann % chg[1]	1.6	0.9	0.6	0.0	-1.3	0.4	...
Unemployment rate	%[1]	6.3	6.7	6.8	7.3	6.8	6.2	...
Participation rate	%[1]	68.4	68.6	68.4	68.4	67.2	67.8	...
LCI salary & wage rates - total (adjusted)[5]	qtr % chg	0.6	0.4	0.5	0.5	0.5	0.4	...
	ann % chg	2.0	2.0	2.0	1.9	1.8	1.8	...
QES average hourly earnings - total[5]	qtr % chg	0.1	1.4	0.1	1.1	-0.1	0.8	...
	ann % chg	2.8	3.8	2.9	2.8	2.6	2.1	...
Labour productivity[6]	ann ave % chg	-0.1	0.7	1.7	2.8	3.4	2.6	...
Retail Sales								
Core retail sales volume	qtr % chg[1]	1.8	-0.3	0.7	0.1	1.2	0.6	...
	ann % chg	6.4	4.2	4.1	1.7	1.8	2.5	...
Total retail sales volume	qtr % chg[1]	1.4	0.2	1.2	-0.2	1.9	0.5	...
	ann % chg	5.7	4.2	4.7	2.2	3.2	3.5	...
Confidence Indicators/Surveys								
WMM - consumer confidence[3]	Index	101	102	100	103	111	111	117
QSBO - general business situation[4]	net %	0.1	13.0	-4.1	8.0	19.8	23.0	...
QSBO - own activity outlook[4]	net %	9.9	16.9	8.1	17.7	18.7	18.1	...

Monthly Indicators

		2012M12	2013M01	2013M02	2013M03	2013M04	2013M05	2013M06
External Sector								
Merchandise trade - exports	mth % chg[1]	-6.7	1.6	3.2	-0.9	1.1	-1.2	...
	ann % chg[1]	-4.2	-10.2	7.6	4.8	2.0	-7.8	...
Merchandise trade - imports	mth % chg[1]	5.8	-15.0	15.5	0.6	-8.8	-2.7	...
	ann % chg[1]	-10.4	-6.3	1.6	-8.5	6.8	-3.9	...
Merchandise trade balance (12 month total)	NZ$ million	-1155	-1288	-1066	-523	-685	-869	...
Visitor arrivals	number[1]	219,410	214,430	224,470	227,140	231,860	230,380	...
Visitor departures	number[1]	218,610	217,900	220,710	229,980	234,290	231,960	...
Housing								
Dwelling consents - residential	mth % chg[1]	10.2	-0.6	5.0	-8.4	18.5	...	...
	ann % chg[1]	22.5	19.5	28.1	-5.4	42.7	...	...
House sales - dwellings	mth % chg[1]	-6.8	10.9	-3.8	-0.1	3.5	-2.6	...
	ann % chg[1]	8.2	21.1	7.5	10.9	25.2	7.5	...
REINZ - house price index	mth % chg	-0.6	-1.0	1.6	2.4	0.8	0.7	...
	ann % chg	6.7	7.2	8.1	8.6	9.8	8.7	...
Private Consumption								
Electronic card transactions - total retail	mth % chg[1]	0.3	0.3	0.8	-0.3	0.8	0.5	...
	ann % chg	3.6	5.8	2.5	4.2	5.2	5.4	...
New car registrations	mth % chg[1]	0.1	3.5	1.3	0.1	7.7	1.6	...
	ann % chg	3.0	6.5	9.4	11.2	17.8	16.3	...
Migration								
Permanent & long-term arrivals	number[1]	7,330	7,080	7,200	7,730	7,800	7,810	...
Permanent & long-term departures	number[1]	7,480	6,670	6,430	6,430	6,200	6,060	...
Net PLT migration (12 month total)	number	-1,165	12	1,195	2,542	4,776	6,242	...
Commodity Prices								
Brent oil price	US$/Barrel	109.56	113.02	116.19	108.49	102.53	102.52	*102.96*
WTI oil price	US$/Barrel	88.25	94.69	95.32	93.05	92.07	94.80	*95.69*
ANZ NZ commodity price index	mth % chg	-0.1	-0.5	0.4	8.5	10.2	0.7	...
	ann % chg	-12.3	-10.2	-5.9	2.2	17.4	17.3	...
ANZ world commodity price index	mth % chg	1.0	0.3	1.1	7.4	12.6	-1.6	...
	ann % chg	-5.2	-6.1	-4.9	3.9	22.5	26.1	...
Financial Markets								
NZD/USD	$[2]	0.8318	0.8375	0.8389	0.8279	0.8473	0.8267	*0.7915*
NZD/AUD	$[2]	0.7943	0.797	0.8136	0.8013	0.8158	0.8325	*0.8379*
Trade weighted index (TWI)	June 1979 = 100[2]	74.33	75.27	76.26	76.15	78.05	77.31	*74.02*
Official cash rate (OCR)	%	2.50	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill rate	%[2]	2.65	2.66	2.66	2.64	2.65	2.64	*2.64*
10 year govt bond rate	%[2]	3.56	3.56	3.81	3.72	3.34	3.37	*3.82*
Confidence Indicators/Surveys								
ANZ - business confidence	net %	22.7	...	39.4	34.6	32.3	41.8	50.1
ANZ - activity outlook	net %	31.4	...	37.6	32.4	30.3	34.3	45.0
ANZ-Roy Morgan - consumer confidence	net %	114.7	118.3	121.0	115.0	119.2	123.7	123.9
Performance of Manufacturing Index	Index	49.7	51.1	53.8	53.5	53.4	60.5	...
Performance of Services Index	Index	52.2	50.5	57.0	56.3	54.9	55.8	...

qtr % chg	quarterly percent change
mth % chg	monthly percent change
ann % chg	annual percent change
ann ave % chg	annual average percent change

[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, NZIER, ANZ, Haver, Westpac McDermott Miller, ANZ-Roy Morgan, REINZ, BNZ-Business NZ