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# MONTHLY ECONOMIC REVIEW

February 2010

(latest data as at 8 February)

Parliamentary Library Research Paper

## A Overview

### Recent trend

	08/09	09/10	
Economic Growth	1.5%	-2.2%	Annual average GDP Growth (September year)
Unemployment	4.7%	7.3%	Unemployment Rate (December quarter)
Inflation	3.4%	2.0%	Annual Inflation Rate (December year)
Current Account Deficit	\$15.4b	\$5.7b	Current Account Deficit (September year)
Interest Rates	4.38%	2.78%	90 Day Bank Bills (January month)

### Latest data

Economic growth continued in the September 2009 quarter, with gross domestic product expanding by 0.2 percent (following 0.2 percent growth over the June quarter). On an annual basis, the economy contracted by 2.2 percent, with the manufacturing, wholesale trade, and construction sectors particularly hard hit. The current account recorded a surplus of \$340 million for the September 2009 quarter. This was the first surplus recorded since the December 1988 quarter. The unemployment rate surged to its highest rate in over a decade, with an unemployment rate of 7.3 percent in the December 2009 quarter. An increase in the working age population (those aged 15 years and over), flowed through to an increase in the number of people in the labour force without jobs. A slight decrease in employment numbers over the quarter (-2,000) also contributed towards a higher unemployment rate. Positively, survey results are showing that the employment intentions of firms are firming up as a result of improving business confidence and outlook. Consumer goods and services prices eased by 0.2 percent over the December 2009 quarter, influenced by a 2.4 percent fall in food prices. On an annual basis, the rate of inflation was two percent, right in the middle of the Reserve Bank's 1 – 3 percent inflation target band. Reserve Bank Governor, Alan Bollard left the official cash rate at 2.50 percent after he reviewed the official benchmark interest rate in January.

### Outlook

A gradual economic recovery is forecast; although a pickup in household consumption will be tempered by rising unemployment and the need to restore household balance sheets. It is thought that the unemployment rate has peaked, or is near its peak (although some economic commentators differ). Business confidence levels and employment intentions are consistent with employment growth over the first half of 2010. While the annual rate of inflation is forecast to remain within the Reserve Bank's target band, the Bank has been indicating that an increase in the official cash rate (OCR) in the near future is likely, noting that if the economy continues to recover in line with projections, it expects to *"begin removing stimulus around the middle of 2010"*.

**Topic of the month:** Tax structure trends in the OECD area

# B Economic Growth

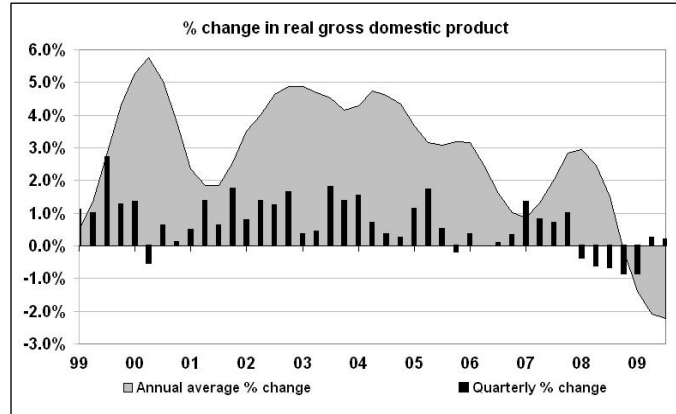
## Background

A country's gross domestic product (GDP) is a measure of economic activity during a set period of time, normally reported on a quarterly and an annual basis. It is the sum of money values of all final goods and services produced in an economy over a set period. The primary indicator used for tracking economic performance over time is known as real gross domestic product, or real GDP. Real GDP is gross domestic product adjusted for changes in prices. New Zealand's official gross domestic product figures are sourced from Statistics New Zealand.

## Gross domestic product

The economy expanded by a further 0.2 percent over the September 2009 quarter, following 0.2 percent growth in gross domestic product over the June quarter. Prior to these last two quarters, the economy contracted for five consecutive quarters.

Over the September quarter, household consumption expenditure expanded by 0.8 percent. The increase was driven by purchases of retail furniture, major appliances, and vehicles. Over the quarter, investment in residential buildings fell by five percent, its 8<sup>th</sup> consecutive quarterly decrease. Value-added output from the mining industry rose by 11.1 percent, assisted by the Maari oilfield reaching full production. With the population increasing by 0.3 percent over the quarter, GDP per capita actually fell by 0.1 percent.



In annual average terms, the economy contracted by 2.2 percent over the year to September 2009. Sectors particularly hard hit over the year include the manufacturing sector (with value-added output falling by 11.2 percent), the wholesale trade sector (-10.3%), and the construction sector (-10.0%). Reflecting the drop in construction activity, investment in residential buildings was down by almost a quarter during the year.

## Other data

Consumer confidence remained positive in the December 2009 quarter according to the *Westpac McDermott Miller Consumer Confidence Index*. Reflecting an improvement in consumer confidence, retail sales rose by 0.8 percent in November (in seasonally adjusted terms). This has been the first real sign of growth in retail expenditure since August.

Year ended September 2009	Nominal GDP
Expenditure GDP	\$184,917 million
GDP per capita	\$42,974

Source: Statistics New Zealand.

## Outlook

High household debt levels and employment concerns, along with firms delaying investment decisions (either due to funding issues or current over-capacity) may result in a modest recovery compared to those that occurred following previous recessions. The Reserve Bank has forecast economic growth of 0.6 percent over the December 2009 quarter in its December *Monetary Policy Statement*.

Net % expecting economic improvement in 12 months	Nov-09	Dec-09
NBNZ – Business Confidence	43.4	38.5
NBNZ – Own Activity	33.7	36.9

Source: National Bank.

GDP growth (%)	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Annual (year-on-year)	1.5	-0.1	-1.4	-2.1	-2.2
Quarterly (seasonally adjusted)	-0.7	-0.9	-0.8	0.2	0.2

Source: Statistics New Zealand.

**Next Release:** *Gross Domestic Product: December 2009 quarter.*

**Date:** 25 March 2010

# C Employment and Unemployment

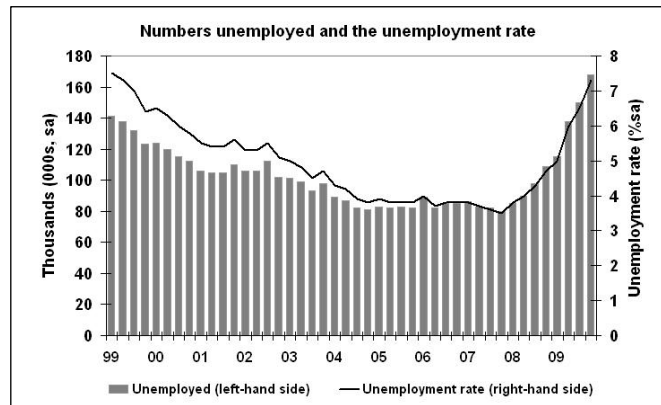
## Background

The unemployment rate measures the number of people unemployed as a proportion of those in the labour force. The labour force is the number of people of working age (15 years and over) who are working for wages or a salary, working for a family business, or who are unemployed and seeking work. In New Zealand, the official unemployment rate is sourced from Statistics New Zealand's quarterly Household Labour Force Survey.

## Employment and unemployment

New Zealand's unemployment rate surged to 7.3 percent in the December 2009 quarter, a rise of 0.8 percentage points over the previous quarter (in seasonally adjusted terms). The result was worse than anticipated, with a number of economic commentators previously forecasting that the unemployment rate may peak at around or just under seven percent. The unemployment rate is at its highest level since the June 1999 quarter.

There were 168,000 people unemployed in the December 2009 quarter in seasonally adjusted terms, a 12 percent rise over the previous quarter. This is the highest unemployment figure since the June 1993 quarter, when there were 173,000 people unemployed.



The increase in the unemployment rate was mainly due to an increase in the number of people in the labour force who were unable to find a job (driven by an expansion in the working age population, those aged 15 years and over). The labour force (those employed or unemployed) expanded by 16,000 during the quarter, while employment fell by 2,000, resulting in an increase of those unemployed by 18,000. Full time employment fell by 0.3 percent over the December 2009 quarter, while part-time employment was flat (rising by 0.1 percent). The unemployment rate for those aged 18 – 24 years increased to 18.4 percent.

## Other data

Firms' hiring intentions have been improving over recent quarters, with a net one percent of respondents to the NZIER *Quarterly Survey of Business Opinion* in December 2009 expecting to hire additional employees during the current quarter. The survey suggested that the ease of finding both skilled and unskilled labour has fallen (but remains above their long run averages).

Net % expecting increase in 12 months*	Nov-09	Dec-09
Employment in their business	5.3	6.4
Unemployment rate	35.2	28.9

\*equal to the % of respondents expecting an increase minus the % expecting a decrease. Source: National Bank.

## Outlook

Businesses have responded to the recession through a mix of reducing employment as well as hours worked. Therefore, any improvement in the economy will generally result in employees returning to normal working conditions prior to any sizeable uplift in employment taking place. It is thought that the unemployment rate has peaked, or is near peak, although the NZIER has expressed a view that it will peak in mid-2010 at a rate close to eight percent.

Quarter (%)	Dec-08	Dec-09
Average ordinary time weekly earnings (pre-tax)	\$891.05	\$934.78
Percentage change in hourly earnings from the same period of the previous year	+4.9	+4.9

Source: Statistics New Zealand.

Household Labour Force Survey	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
Unemployment Rate (seasonally adjusted, %)	4.7	5.0	6.0	6.5	7.3
Employment Growth (annual, %)*	0.9	0.8	-0.9	-1.8	-2.4

\*change since the same quarter of the previous year. Source: Statistics New Zealand.

**Next Release:** *Household Labour Force Survey: March 2010 quarter.* **Date:** 6 May 2010

# D Inflation

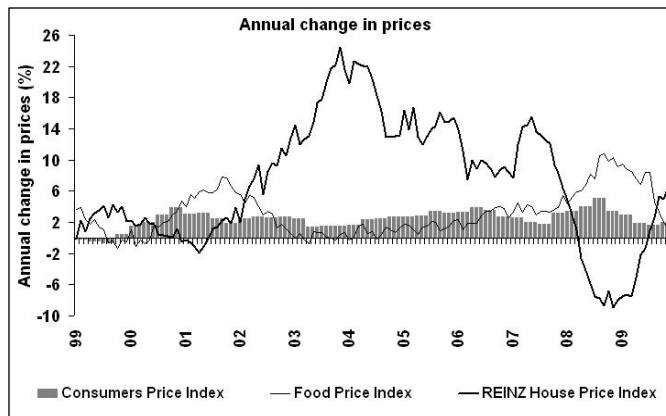
## Background

Inflation is the change in prices of goods and services over a certain period of time. The official rate of inflation is measured by Statistics New Zealand's Consumers Price Index (CPI). The CPI tracks the price of a basket of household goods and services over time.

## Consumers Price Index

Consumer prices eased by 0.2 percent over the December 2009 quarter, with the outcome weaker than market expectations. The annual inflation rate is exactly in the middle of the Reserve Bank's 1 – 3 percent inflation target band, at two percent for the year to the December 2009 quarter.

Over the December 2009 quarter, falling food prices (down 2.4 percent) were the predominant factor behind the fall in the consumers price index. Within the food group, a 17.6 percent drop in vegetables prices was responsible for the majority of the decrease.



On an annual basis, the price of second-hand cars rose by 13.3 percent, while the cost of petrol rose by 3.3 percent. The rate of inflation for those goods and services that are not traded internationally (non-tradable inflation) continued to ease. Non-tradable inflation rose by 2.3 percent over the year to the December 2009 quarter, compared with a non-tradable inflation rate of 4.3 percent in the year ended December 2008.

## Other data

Wage growth continues to slow from a recent peak in late 2008. On an annual basis, salary and wage rates (including overtime) rose by 1.8 percent over the year to the December 2009 quarter, according to the Labour Cost Index. According to the survey sample, 44 percent of salary and ordinary-time wage rates rose over the year, while one percent decreased. Of some concern, the capacity utilisation rate in the latest NZIER *Quarterly Survey of Business Opinion* was reasonably high considering the economy has just exited a recession. This is something that the Reserve Bank will be keeping an eye on, once the recovery takes hold.

Annual Percentage Change (%)	Dec-09	Jan-10
Quotable Value – Residential property*	2.8	4.4
REINZ Housing Price Index**	6.4	n/a
Food Price Index**	0.9	n/a

\*change since the same three months ended in the month of the previous year \*\*change since the same month of the previous year. Sources: Quotable Value; REINZ; Statistics New Zealand

## Outlook

Annual inflation is forecast to remain comfortably within the Reserve Bank's inflation target band over the medium term. The Reserve Bank in their latest *Monetary Policy Statement* has forecast an annual inflation rate of 1.8 percent in the year to the March 2010 quarter, dropping to 1.6 percent in the year to the June 2010 quarter.

National Bank Business Survey	Nov-09	Dec-09
Net % of respondents expecting to increase prices in 3 months time*:	14.8	17.7
Inflation expected in 12 months time:	2.61	2.54

\*equal to the % of respondents expecting an increase minus the % expecting a decrease. Source: National Bank.

Inflation (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
Consumers Price Index - Annual	3.4	3.0	1.9	1.7	2.0
Tradables inflation	2.3	1.7	0.2	-0.1	1.5
Non-tradables inflation	4.3	3.8	3.3	3.0	2.3
CPI - quarterly	-0.5	0.3	0.6	1.3	-0.2

Source: Statistics New Zealand.

**Next Release:** *Consumers Price Index: March 2010 quarter.* **Date:** 20 April 2010

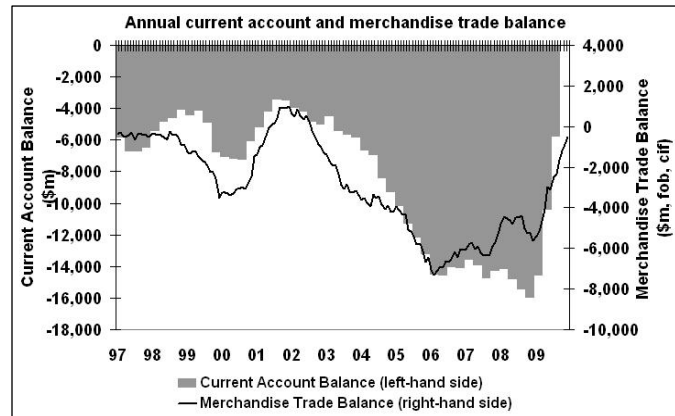
## Background

The balance of payments is the record of the receipts and payments between a country's residents and the rest of the world, over a given period. The current account is that part of a country's balance of payments which embraces its transactions of goods, services, international investment income, and current transfers (e.g. foreign aid). A "balance of payments deficit" refers to a deficit of the current account.

## Current account deficit

New Zealand recorded a current account surplus of \$340 million for the September 2009 quarter, the first surplus recorded since the December 1988 quarter. The surplus was predominantly due to a \$792 million reduction in the investment income deficit (helped by the recognition of company tax liabilities totalling \$1,366 million during the quarter against some of New Zealand's foreign owned registered banks).

On an annual basis, the current account deficit totalled \$5,723 million, equivalent to 3.1 percent of gross domestic product. This is the lowest current account deficit as a percentage of GDP since the year ended March 2002.



## Other data

Commodity prices for New Zealand's main merchandise exports rose for the 11<sup>th</sup> consecutive month in January, up a further 0.4 percent, according to the *ANZ Commodity Price Index*. However, prices in New Zealand dollar terms fell by 1.2 percent after the appreciation of the New Zealand dollar was taken into account. It is thought that dairy prices may have reached a high point, with prices for whole milk powder falling by 1.6 percent in Fonterra's latest online auction.

Annual Change (%)	Dec-09	Jan-10
World Commodities Prices*	30.0	36.5
NZ\$ Commodities Prices*	1.7	5.0
Overseas Visitors**	0.0	n/a

\*change since the same month of the previous year. \*\*change since the previous year-end. Sources: Statistics New Zealand; ANZ.

## Outlook

The current account deficit has been forecast to decline further over the near term before an expected increase due to greater domestic demand for imports, along with rising interest rates and an improvement in profitability of New Zealand firms (both increasing the profits of foreign investors on their New Zealand investments). The NZIER has forecast a current account deficit equivalent to 1.2 percent of gross domestic product in the year ended March 2010, rising to a figure equivalent to 6.3 percent in the following March year.

Annual Balances (\$m)	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
Current Account	-15,437	-15,969	-14,569	-10,371	-5,723	n/a
Merchandise trade	-2,326	-2,382	-1,336	529	2,284	n/a
Services	-425	-908	-1,118	-969	-635	n/a
Investment income	-13,728	-13,721	-13,035	-10,793	-7,977	n/a
Current transfers	1,042	1,041	920	862	605	n/a
Current Account (quarter*)	-4,174	-3,402	-2,101	-632	521	n/a
Merchandise Trade (fob-vfd)	-2,327	-2,729	-1,824	-410	769	1,628
Merchandise Trade (fob-cif)	-5,048	-5,614	-4,684	-3,110	-1,669	-517

\* Seasonally adjusted. VFD – The value of imports before insurance and freight costs. CIF – Cost of goods imported, including insurance and freight to New Zealand. FOB – Free on board, the value of goods at New Zealand ports before export. Source: Statistics New Zealand.

**Next Release:** *Balance of Payments: December 2009 quarter.* **Date:** 24 March 2010

## Background

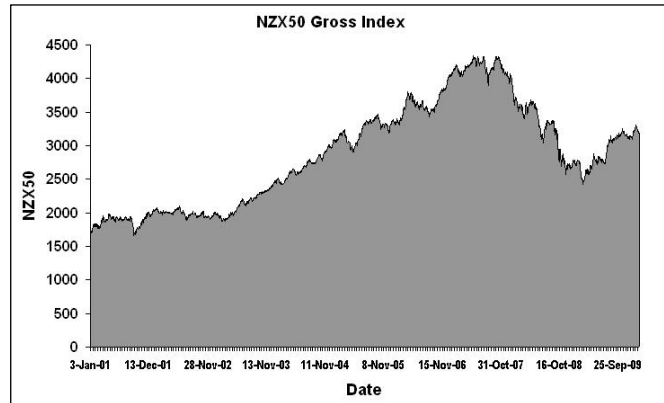
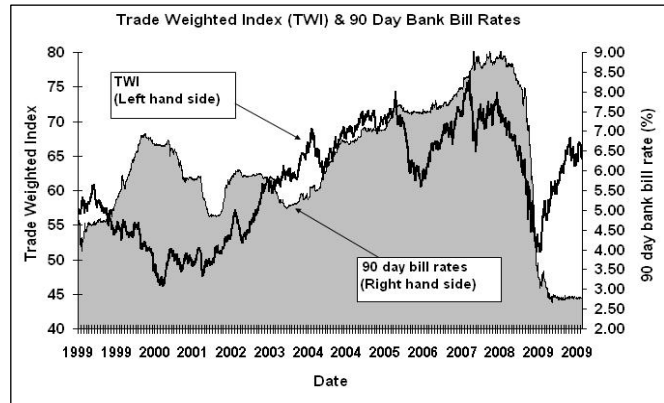
The trade weighted index (TWI) is an index of the New Zealand dollar's value against a basket of five overseas currencies, where each currency is weighted by a combination of the size of the associated country's trade with New Zealand (including the Euro group of countries) and their gross domestic product. The official cash rate (OCR) is the interest rate that applies to overnight borrowing and lending between banks and the Reserve Bank. It is currently a key operational feature of monetary policy in New Zealand. The NZX 50 is the main share index of the New Zealand Exchange. It tracks changes in the share prices of the top 50 publicly listed companies by free float market capitalisation on the NZX market. It is a gross index, so it includes the payout of dividends in its calculation.

## Recent trend & latest monthly data

The official cash rate remains at 2.50 percent, with Reserve Bank Governor, Alan Bollard deciding not to increase the benchmark interest rate in his review of late January. He noted that *"as growth becomes self sustaining, fiscal consolidation would help reduce the work that monetary policy might otherwise need to do"*.

There were 287 mortgagee sales during November 2009, bringing the number of sales for the year to 2,943. Mortgagee sales accounted for almost five percent of total property sales in November. Terralink managing director Mike Donald believes that there will be a slight dip in December as it tends to be a slow month for sales overall. He reported that towards the end of 2009, more owners of family homes started losing their properties, whereas it was more property developers and investors towards the start of the year.

The New Zealand Exchange (NZX) raised \$7.28 billion of new capital during 2009, comprising \$3.93 billion of equity, and \$3.35 billion in debt. On 18 January 2010, Pine Gould Corporation Limited replaced Skellerup Holdings Limited on the NZX 50 Index (the index which covers the share prices of the top 50 publicly listed companies on the NZX). While the NZX 50 index averaged 3243 index points during January 2010, it ended the month at 3165 index points (down two percent from the end of January 2010).



## Outlook

The official cash rate looks likely to rise within the next six months, with the Reserve Bank highlighting in its latest OCR announcement that it expects to *"begin removing policy stimulus around the middle of 2010"*. An increase is dependent upon economic conditions continuing to improve in line with the Bank's forecasts. Registered bank economists are expecting an increase in interest rates sometime between April and July. Some are forecasting a gradual increase in the OCR, while others are expecting some 50 basis point rises.

Monthly averages	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10
Trade Weighted Index (TWI) exchange rate	62.85	64.32	66.48	65.24	64.66	66.13
90 Day Bank Bill Rate	2.76	2.77	2.79	2.80	2.78	2.78
Official Cash Rate*	2.50	2.50	2.50	2.50	2.50	2.50
NZX50	3081	3126	3188	3142	3157	3243

\* actual rate at end of month, the Official Cash Rate is an interest rate set by the Reserve Bank to implement monetary policy.

Sources: Reserve Bank; NZX.

**Next Official Cash Rate (OCR) decision: 11 March 2010**

## Background

New Zealand's economic growth rate, unemployment rate and central bank interest rates are compared with our main trading partners. The first table below illustrates the seasonally adjusted quarterly growth rates in economic activity. The second table below shows the harmonised unemployment rate in each OECD country/area, while the third shows the main central bank interest rates for various OECD countries (and currency group in the case of the Euro), along with the date and direction of the latest movements for each.

## Economic growth

Reflecting an improvement in outlook for the global economy, the International Monetary Fund (IMF) has revised upward its forecast of global economic growth to 3.9 percent for 2010. More modest economic growth of 2.1 percent for the 'advanced economies' is projected in 2010, while China's economy is forecast to expand by ten percent. However, despite the improvement in outlook, IMF managing director, Dominique Strauss-Kahn warned that countries risked a return to recession if they withdrew their anti-crisis measures too early.

Quarterly economic growth rates			
Country	Jun-09	Sep-09	Dec-09
Australia	0.7	0.2	
Japan	0.7	0.3	
NEW ZEALAND	0.2	0.2	
United Kingdom	-0.7	-0.2	0.1
United States	-0.2	0.6	1.4
OECD Total	0.1	0.6	

Source: OECD

## Unemployment

The harmonised unemployment rate within the OECD remained steady at 8.8 percent in November 2009, with unemployment rates within member countries ranging from 3.2 percent in Norway (as at October 2009) to 19.4 percent in Spain.

Australia's unemployment rate looks to have either peaked, or to be near peak, with rates falling over the last two months to 5.5 percent in December 2009.

The unemployment rate in the United States has fallen to a five month low of 9.7 percent in January, having been at 10.1 percent in October 2009. However, non-farm employment fell by 20,000 in January, after a reduction of 150,000 in December. Since the recession began in December 2007, a total of 8.4 million jobs have been lost.

Harmonised unemployment rates			
Country	Nov-09	Dec-09	Jan-10
Australia	5.6	5.5	
Japan	5.2		
NEW ZEALAND		7.3	
United Kingdom	7.9(Sep)		
United States	10.0	10.0	9.7
OECD Total	8.8		

Source: OECD

## Central banks

In a decision that surprised the financial community, the Board of the Australian Reserve Bank decided to leave the Bank's benchmark interest rate (the cash rate) unchanged at 3.75 percent in early February. All economists canvassed in a survey prior to the announcement expected the bank to increase its cash rate. In announcing its decision, the Bank noted that its board judged it appropriate to hold rates steady as there was limited information available regarding the impact of previous rate rises. The Bank had increased its cash rate by a total of 75 basis points during the last three months of 2009. The Board also noted that lenders had increased their lending rates a little more than the cash rate increases over recent months.

Central Bank interest rates (as at 8 February 2010)				
Central Bank	Key Rate	Interest Rate (%)	Effective from	Direction (Basis points)
Australia	Cash Rate	3.75	2-Dec-09	+25
European Central Bank	Main Refinance Rate	1.00	13-May-09	-25
Japan	Uncollateralized overnight rate	0.10	19-Dec-08	-20
NEW ZEALAND	Official Cash Rate	2.50	30-Apr-09	-50
United Kingdom	Bank Rate	0.50	5-Mar-09	-50
United States	Federal Funds Rate	0.00 – 0.25	16-Dec-08	-75

Sources: Central Bank interest rates as at the date stated.

## Tax structure trends in the OECD area

The OECD produces internationally comparative data on tax levels and structures of its member countries on an annual basis. The most recent *Revenue Statistics* publication includes information on tax revenues from 1965 to 2007, along with revenue estimates for 2008.

The OECD defines taxes as being compulsory, unrequited payments to general government, where general government includes local, state and federal governments, along with social security funds.

The following table shows the tax structure for the OECD area as a whole (for general government) as at 1965, 1975, 1985, 1995 and 2007, along with the tax structure in New Zealand as at 2007. The breakdown of tax revenue for each category is shown as a percentage of total tax revenue.

### Tax structures in the OECD - The percentage share of major tax categories in total tax revenue

Year	1965	1975	1985	1995	2007	NZ 2007
Personal income tax	26	30	30	27	25	42
Corporate income tax	9	8	8	8	11	14
Social security contributions <sup>1</sup>	18	22	22	25	25	..
(employee)	(6)	(7)	(7)	(8)	(9)	..
(employer)	(10)	(14)	(13)	(14)	(15)	..
Payroll taxes	1	1	1	1	1	..
Property taxes	8	6	5	6	6	5
General consumption taxes	12	13	16	18	19	24
Specific consumption taxes	24	18	16	13	11	6
Other taxes <sup>2</sup>	2	2	2	3	3	9 <sup>3</sup>
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

**Notes: (1)** – Including social security contributions paid by the self employed and benefit recipients that are not shown in the breakdown over employers and employees. **(2)** – Including certain taxes on goods and services and stamp taxes. For New Zealand, includes Non-Resident Withholding Tax (NRWT), dividends and interest that were unallocated between personal and corporate income tax.

In 2007, personal income taxes ceased to be the largest single source of revenue for OECD countries as a whole, with 25 percent of total taxes being sourced from personal income taxes. New Zealand receives a much higher proportion of its total tax revenue from personal income tax (42% of total tax revenue in 2007) due to the fact that it does not have separate social security contributions, nor does it have a payroll tax. Local body rates revenue is the predominant source of property tax revenue in New Zealand, with property taxes contributing approximately five percent of total tax revenue for general government in New Zealand in 2007.

For the OECD as a whole, since 1965 there has been a move away from specific consumption taxes (such as sales taxes for specific items) towards general consumption taxes (such as a goods and services tax/value added tax). General consumption taxes contributed 19 percent of total tax revenue in the OECD in 2007, up from 12 percent in 1965. For specific consumption taxes, the proportion of total tax revenue has fallen from 24 percent in 1965 to 11 percent in 2007.

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