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MONTHLY ECONOMIC REVIEW






October 2008

(latest data as at 9 October)

Parliamentary Library Research Paper

A Overview

Recent trend

	06/07	07/08	
 Economic Growth	2.3%	2.6%	Annual GDP Growth (June year)
 Unemployment	3.6%	3.9%	Unemployment Rate (June quarter)
 Inflation	2.0%	4.0%	Annual CPI Growth (June year)
 Current Account Deficit	\$14.1b	\$15.0b	Current Account Deficit (June year)
 Interest Rates	8.81%	7.95%	90 Day Bank Bills (September month)

Latest data

New Zealand experienced a technical recession over the first half of 2008, with an easing in gross domestic product in both the March (-0.3%) and June (-0.2%) quarters. A technical recession is defined as two consecutive quarters of negative growth in gross domestic product. As a result, the annual rate of economic growth fell from 3.2 percent in the year ended March 2008, to 2.6 percent in the June 2008 year. Both businesses and consumers were more optimistic in September (thought to be driven by lower petrol prices and interest rates). However, given recent international events, it remains to be seen whether this optimism continues. On an annual basis, New Zealand's current account deficit reached \$14,967 million in the year ended June 2008, equivalent to 8.4 percent of gross domestic product. Over the year the deficit rose by \$871 million, driven by an increase in foreign investors' earnings on their investments in New Zealand. The Australian Reserve Bank dropped its cash rate by a massive 100 basis points to six percent, the largest single decline in their cash rate since May 1992. The Bank cited the worsening conditions in the international financial markets, and the deteriorating global economic growth prospects as being factors behind the fall in the interest rate. Six Central Banks (which included the US Federal Reserve, the Bank of England, and the European Central Bank) co-ordinated a 50 basis point reduction in their official interest rates, which was announced on 8 October 2008.

Outlook

The New Zealand Institute of Economic Research (NZIER) has highlighted that the results from their latest *Quarterly Survey of Business Opinion* point towards a continued recession during the second half of 2008. The Treasury believes that it is probable that the economy contracted further in the September 2008 quarter, and has forecast the economy to grow in the December quarter. The income tax cuts from 1 October 2008 will provide a stimulus to the domestic economy, along with falling interest rates, and dropping petrol prices. Over time, the lower exchange rate will assist with export growth, but this is likely to be tempered by the deterioration in the international economic environment. A further reduction in the official cash rate on 23 October looks a certainty, with most economic commentators expecting a rate cut of (at least) 50 basis points.

Topic of the month: Bank deposit insurance

B Economic Growth

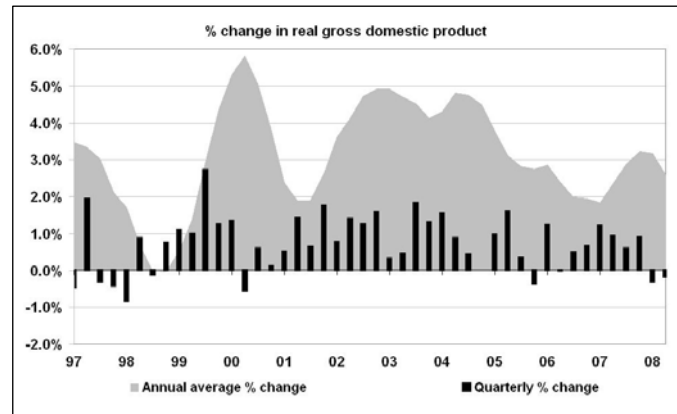
Background

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.

Recent trend

The gross domestic product figures for the June 2008 quarter confirmed that the New Zealand economy experienced a technical recession during the first half of 2008 (defined as two consecutive quarters of easing economic activity). Over the June 2008 quarter the economy eased by 0.2 percent, which was a smaller decline than generally expected. This followed a fall in economic activity of 0.3 percent over the March 2008 quarter.

Over the June 2008 quarter, economic activity in the construction industry eased by 3.8 percent, following a 5.2 percent reduction in value-added output over the previous quarter.



On an annual average basis, the economy expanded by 2.6 percent over the year to June 2008. Value-added output from the fishing, forestry and mining industries expanded by 27.4 percent over the year, due to the commencement of production from the Tui oil field in late 2007.

Latest monthly data

Business confidence improved significantly in the September surveys (National Bank's *Business Outlook* survey and the NZIER's *Quarterly Survey of Business Opinion*). However, given the recent events internationally, it is more than likely that pessimism will return when the results of the upcoming surveys are released. Consumer confidence, as measured by the Westpac McDermott Miller *Consumer Confidence Survey* also staged a comeback in September, helped along by falling petrol prices and interest rates, and the thought of imminent tax cuts.

Year ended June 2008	Nominal GDP
Expenditure GDP	\$179,190 million
GDP per capita	\$42,150

Source: Statistics New Zealand.

Outlook

The Treasury considers it probable that the economy contracted in the September 2008 quarter, which would result in three consecutive quarters of falling economic activity. In their *Pre-election Economic and Fiscal Update*, they have forecast that the economy will expand by a miniscule 0.1 percent over the year to March 2009. Given that their forecasts were finalised at the end of August 2008, there is a degree of downside risk to this forecast, given the current financial turmoil being experienced internationally.

Net % expecting economic improvement in 12 months	Aug-08	Sep-08
NBNZ – Business Confidence	-20.5	1.6
NBNZ – Own Activity	4.7	16.7
One Network News – Colmar Brunton survey	6	3

Source: National Bank.

GDP growth (%)	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08
Annual (year-on-year)	2.3	2.9	3.2	3.2	2.6
Quarterly (seasonally adjusted)	0.9	0.6	0.9	-0.3	-0.2

Source: Statistics New Zealand.

Next Release: *Gross Domestic Product: September 2008 quarter.*

Date: 23 December 2008

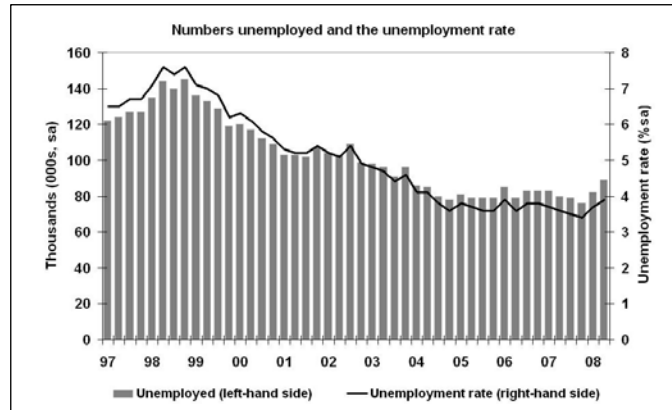
Background

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.

Recent trend

Following a 1.3 percent reduction in employment over the March 2008 quarter, there was a 1.2 percent rise in employment over the June 2008 quarter, with an extra 26,000 people employed. However, as the labour force expanded to a greater extent (+33,000), there was an increase in the number of those unemployed (+7,000). As a result, the unemployment rate rose by 0.2 percentage points to 3.9 percent in the June 2008 quarter.

Reflecting the slow-down in the housing market (along with the effect of the drought on the primary sector) there was a 5.1 percent reduction in employment in the construction industry and 1.7 percent reduction in the agriculture, forestry and fishing industry between the June 2007 and 2008 quarters.



Latest monthly data

There continues to be an unwinding of the previously tight labour market. Employment intentions remain negative, with a net seven percent of firms responding to the latest NZIER *Quarterly Survey of Business Opinion* intending to cut staff numbers over the coming three months, while a net 11 percent stated that they had cut staff numbers over the previous quarter. As a result, there has been a reduction in the number of firms reporting difficulties in filling skilled and unskilled vacancies within their businesses. The latest National Bank *Business Outlook* survey reinforces the above business sentiments, with a net six percent expecting to reduce staff numbers over the coming twelve months.

Quarter (%)	Jun-07	Jun-08
Average ordinary time weekly earnings (pre-tax)	\$846.19	\$886.11
Percentage change in hourly earnings from the same period of the previous year	+4.8	+4.7

Source: Statistics New Zealand.

Outlook

With declining employment intentions, the outlook for the labour market has deteriorated. This has resulted in higher unemployment rates being forecast. The Treasury in the *Pre-election Economic and Fiscal Update* has forecast an unemployment rate of 4.4 percent in the March 2009 quarter, rising to 5.1 percent in the March 2010 quarter. The labour force participation rate has been forecast to fall from 68.1 percent in the March 2009 quarter to 67.7 percent in the March 2010 quarter.

Net % expecting increase in 12 months*	Aug-08	Sep-08
Employment in their business	-8.3	-5.7
Unemployment rate	76.7	69.3

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

Household Labour Force Survey	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08
Unemployment Rate (seasonally adjusted, %)	3.6	3.5	3.4	3.7	3.9
Employment Growth (annual, %)*	1.5	1.5	2.5	-0.2	0.7

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

Next Release: *Household Labour Force Survey: September 2008 quarter. Date: 6 November 2008*

D Inflation

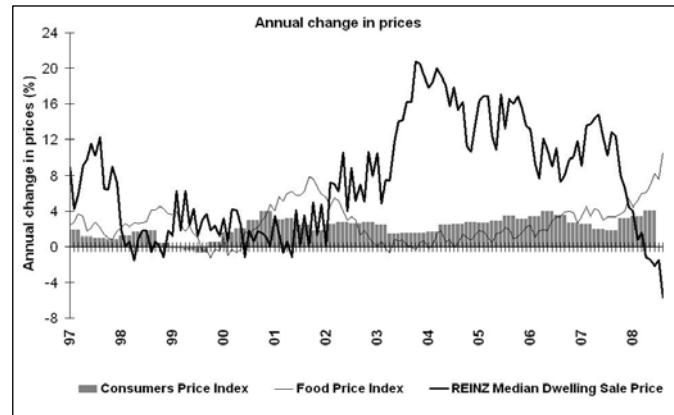
Background

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 Consumer Price Index (CPI). The CPI tracks the price of a basket of household goods and services over time.

Recent trend

The annual inflation rate rose to four percent in the year ended June 2008. The annual rate of inflation has been above the Reserve Bank's medium term target band of 1 – 3 percent since the December 2007 year. The most significant individual upward contributions to inflation over the June 2008 year came from a 25.9 percent rise in the price of petrol, a 5.2 percent rise in costs associated with the purchase of new housing, followed by a 6.6 percent rise in electricity costs.

Prices rose by 1.6 percent over the June 2008 quarter. Increases in transport related costs providing the largest contribution to an increase in prices over the quarter. In particular, the price of diesel rose by 29.0 percent and the price of petrol by 12.8 percent over the June 2008 quarter. If petrol prices had remained constant during the June 2008 quarter, the quarterly increase in inflation would have been 1.0 percent.



Latest monthly data

Median house prices continued to fall in August (down 5.7 percent according to the REINZ), while food prices continued to soar. Food prices rose by 2.7 percent during the month of August, resulting in an annual increase of 10.6 percent. Looking ahead, lower international prices for dairy products may lead to lower dairy product prices in New Zealand. However over the last year, the price of butter has risen by 87.6 percent, cheese by 43.8 percent, and fresh milk by 12.5 percent.

Annual Percentage Change (%)	Jul-08	Aug-08
Quotable Value – Residential property*	-2.2	-4.5
REINZ – National median house sale price**	-1.4	-5.7
Food Price Index**	7.6	10.6

*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

Firms will be under pressure not to raise prices as demand for their goods and services are impacted by the weaker domestic economy. The weaker international economy has resulted in lower commodity prices (including for oil). These lower prices will place downward pressure on inflation; the extent to which this occurs depends on movements in the New Zealand dollar. Annual inflation has been forecast to peak at around five percent in the September 2008 quarter, before easing back within the inflation target band during the second half of 2009.

National Bank Business Survey	Aug-08	Sep-08
Net % of respondents expecting to increase prices in 3 months time*	36.3	35.4
Inflation expected in 12 months time:	3.79	3.65

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

Inflation (%)	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08
Consumers Price Index - Annual	2.0	1.8	3.2	3.4	4.0
Tradables inflation	-0.5	-0.3	2.8	3.4	4.8
Non-tradables inflation	4.1	3.7	3.5	3.5	3.4
CPI - quarterly	1.0	0.5	1.2	0.7	1.6

Source: Statistics New Zealand.

Next Release: Consumers Price Index: September 2008 quarter.

Date: 21 October 2008

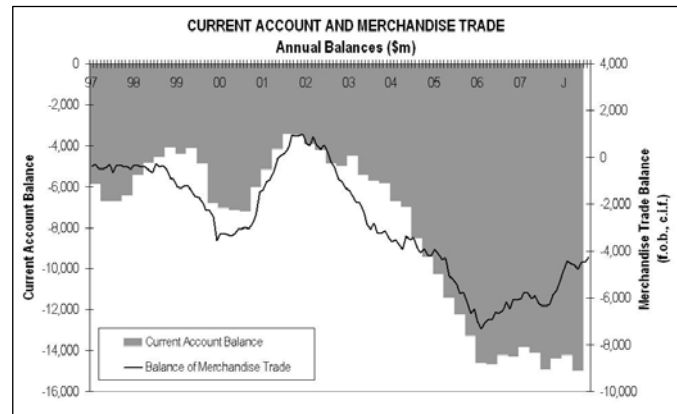
Background

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.

Recent trend

New Zealand's current account deficit for the June 2008 quarter, at \$4,623 million in seasonally adjusted terms, was larger than expected. The increase of \$1,097 million over the quarter was driven by a rise in goods and services imports, along with higher earnings for foreign investors on their New Zealand investments.

On an annual basis New Zealand's current account deficit totalled \$14,967 million in the year ended June 2008, equivalent to 8.4 percent of gross domestic product. This compares with a current account deficit equivalent to 8.0 percent in the year ended March 2008.



Latest monthly data

The prices for New Zealand's main commodity exports continued to fall in September. The ANZ Commodity Price Index dropped by 4.9 percent during the month, with international dairy prices falling by 7.9 percent. The tourism industry is also being adversely affected by the global slowdown, with the annual growth rate in visitor numbers continuing to trend downwards. There was a 0.3 percent rise in visitor numbers over the year to August 2008, down from 2.3 percent growth in the year ended January 2008.

Annual Change (%)	Aug-08	Sep-08
World Commodities Prices*	3.6	-1.9
NZ\$ Commodities Prices*	6.2	3.6
Overseas Visitors**	0.3	n/a

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

Outlook

Exporters will benefit from the decline in the exchange rate over recent months; however the slowdown in the global economy will dampen demand for exports. While remaining high in historical terms, New Zealand's terms of trade (which measures the volume of imports that can be purchased with a set volume of exports) are thought to have already peaked, and will ease over the coming period. The Treasury in the *Pre-election Economic and Fiscal Update* has forecast a current account deficit of \$14,597 million in the year ended March 2009 (8.0% of GDP), easing to \$12,234 million in the year ended March 2010 (6.5% of GDP).

Annual Balances (\$m)	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Aug-08
Current Account	-14,096	-14,892	-14,372	-14,211	-14,967	n/a
Merchandise trade	-2,977	-3,174	-2,381	-1,745	-1,834	n/a
Services	421	430	288	189	-64	n/a
Investment income	-12,135	-12,795	-12,836	-13,387	-13,930	n/a
Current transfers	595	647	557	732	860	n/a
Current Account (quarter*)	-3,682	-3,823	-3,184	-3,526	-4,623	n/a
Merchandise Trade (fob-vfd)	-3,738	-3,827	-2,856	-2,031	-1,897	-1,644
Merchandise Trade (fob-cif)	-6,231	-6,287	-5,312	-4,528	-4,479	-4,282

* 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.

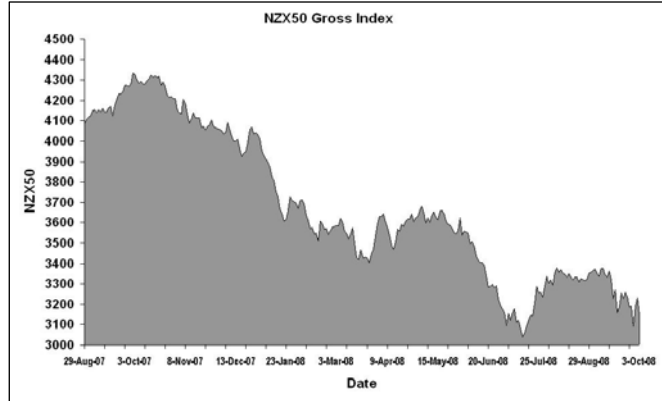
Next Release: Balance of Payments: September 2008 **Date:** 22 December 2008

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 NZX50 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

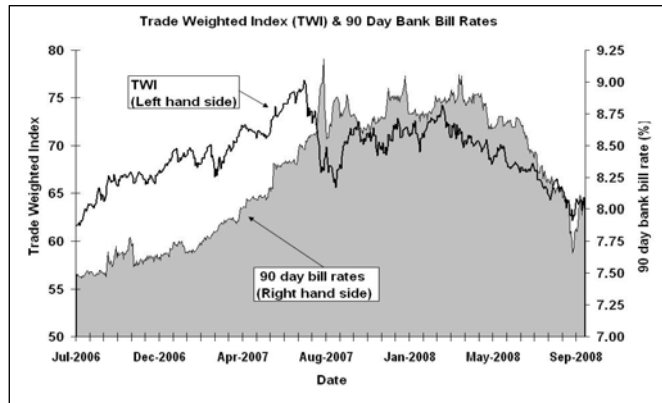
The tightening in the supply of credit due to the global financial crisis is impacting business operations within New Zealand. Rural services business PGG Wrightson has had to delay its purchase of half of Silver Fern Farms in a \$220 million deal, due to banks being unable to finalise credit approvals in time. Maitua Valley Milk has postponed the construction of a \$90 million dairy processing plant due to delays in closing funding arrangements. The New Zealand sharemarket has not been immune to the financial volatility being experienced overseas. The NZX50 ended the 8th October at 2948 index points, a reduction of 27 percent since the start of 2008.



The Reserve Bank reduced the official cash rate by 50 basis points to 7.50 percent in mid-September. The Bank announced that in making a 50 basis point cut to the official cash rate that it has brought forward some of the projected interest rate reduction, given the tight credit market conditions and the time it will take for lower interest rates to feed through the economy. The Bank believes that the weakness in economic activity will feed through to lower inflation over the medium term. In a press release issued on 30 September, the Reserve Bank has reiterated that the New Zealand banking system remains sound, and that *“the liquidity measures taken to date by the Bank are handling the pressures from global markets”*. There are now 18 registered banks operating in New Zealand, with the Southland Building Society becoming the latest. It will remain a mutually-owned building society and use the trading name SBS Bank.

Outlook

The current level of international financial volatility is expected to continue over the short-term. How this affects New Zealand remains to be seen, and much depends on what occurs internationally. The Reserve Bank is most likely to reduce its official cash rate again on the 23rd October, with some economic commentators calling for the Bank to match the reductions made by the Reserve Bank of Australia (see next page). The degree to which any reduction is passed on to mortgage rates depends on the international cost of borrowing incurred by New Zealand's banks.



Monthly averages	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08
Trade Weighted Index (TWI) exchange rate	70.31	69.32	68.11	67.18	65.52	63.82
90 Day Bank Bill Rate	8.87	8.71	8.68	8.46	8.20	7.95
Official Cash Rate*	8.25	8.25	8.25	8.00	8.00	7.50
NZX50	3583	3618	3398	3166	3335	3281

* 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: 23 October 2008

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 standardised unemployment rate in each OECD country/area, while the third show 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

Economic activity in the OECD expanded by 0.1 percent over the June 2008 quarter, with seven OECD countries reporting an easing in economic activity over the quarter. Two of the 30 OECD member countries experienced a technical recession over the first half of 2008 - Ireland and New Zealand. According to the OECD, there are several quarters of weak growth forecast ahead for most OECD countries. In Treasury's *Pre-election Economic and Fiscal Update*, consensus forecasts of New Zealand's top 20 trading partners in 2008 and 2009 have been revised downward to 2.9 percent and 2.8 percent respectively (from 3.1 and 3.0 percent). Treasury notes that the recent developments in the financial markets have increased the risks of further downwards revisions to these forecasts.

Quarterly economic growth rates			
Country	Dec-07	Mar-08	Jun-08
Australia	0.7	0.7	0.3
Japan	0.6	0.7	-0.7
NEW ZEALAND	0.9	-0.3	-0.2
United Kingdom	0.5	0.3	0.0
United States	-0.0	0.2	0.7
OECD Total	0.4	0.5	0.1

Sources: OECD

Unemployment

Employment in the United States fell by 159,000 in September, with job losses continuing in manufacturing, construction and the retail trade industries. As a result, the unemployment rate remained steady at 6.1 percent in September, following a 0.4 percentage point rise in the month of August. The downturn in the US housing market has particularly hit employment in the construction industry, with employment in this industry falling by 607,000 since its peak in September 2006. The standardised unemployment rate in the OECD has been trending upwards since the start of the year, averaging six percent in August 2008.

Standardised unemployment rates			
Country	Jul-08	Aug-08	Sep-08
Australia	4.3	4.1	4.3
Japan	4.0	4.1	
NEW ZEALAND	3.9 (Jun)		
United Kingdom	5.4 (Jun)		
United States	5.7	6.1	6.1
OECD Total	5.8	6.0	

Source: OECD

Central banks

The Reserve Bank of Australia lowered its cash rate by 100 basis points to six percent on 8 October 2008, in a move which surprised economic commentators (a reduction of around 50 basis points was expected). The Bank decided that an *"unusually large movement in the cash rate was appropriate in order to bring about a significant reduction in the costs to borrowers"*, given the state of the international financial markets, and the impact upon funding costs in the wholesale market. In a co-ordinated move (also on 8 October 2008), six Central Banks announced that they were dropping interest rates by 50 basis points. The Banks included the United States Federal Reserve, the Bank of England, the European Central Bank, the Bank of Canada, Sveriges Riksbank (Sweden), and the Swiss National Bank.

Central Bank interest rates (as at 9 October 2008)				
Central Bank	Key Rate	Interest Rate (%)	Effective from	Direction (Basis points)
Australia	Cash Rate	6.00	8-Oct-08	-100
European Central Bank	Main Refinance Rate	3.75	15-Oct-08	-50
Japan	Uncollateralized overnight rate	0.50	21-Feb-07	+25
NEW ZEALAND	Official Cash Rate	7.50	11-Sep-08	-50
United Kingdom	Bank Rate	4.50	8-Oct-08	-50
United States	Federal Funds Rate	1.50	8-Oct-08	-50

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

Bank deposit insurance

Bank deposit insurance schemes protect customers' bank deposits, either in full or part, in the event of a collapse or a run on a bank's funds. The schemes are mostly government run or established, connected with the central bank in some countries, but run by private institutions in others. Most countries within the OECD have such a scheme apart from Australia and New Zealand. However, the Australian Federal Government has proposed legislation that would protect the first A\$20,000 of depositors' funds.

The first compulsory bank deposit insurance scheme was established in the United States with the creation of the Federal Deposit Insurance Corporation (FDIC) in 1933 in response to the Great Depression. It is an independent agency of the United States federal government. The Corporation covers funds in deposit accounts, money market deposit accounts and certificates of deposit. It does not cover other financial products and services that banks offer, such as stocks, bonds, mutual shared funds, life insurance policies, or annuities. Since the FDIC was established, no depositor has lost any money in an insured-fund.

According to the *International Association of Deposit Insurers (IADI)*, there were 99 countries with a deposit insurance system in operation as at May 2008. A number of countries had more than one deposit insurance system in operation, while the US Federal Deposit Insurance Corporation covered not only the United States, but also the Marshall Islands, Micronesia and Puerto Rico. Several African countries were also covered by a single scheme.

Several countries have sought to strengthen their bank deposit insurance schemes over the past couple of weeks. The United States has increased the deposit amount insured from US\$100,000 to US\$250,000 from 3 October 2008 through to 31 December 2009. The Irish Government increased the statutory limit for its deposit guarantee scheme from €20,000 to €100,000 per depositor per banking institution from 20 September 2008. It then announced on 30 September 2008 that it would guarantee all deposits for four Irish banks and two building societies until 28 September 2010. On 7 October 2008, European Union finance ministers agreed to increase the minimum guarantee on bank deposits from €20,000 to €50,000 across the 27-nation Union.

The Reserve Bank of New Zealand has not advocated deposit insurance in New Zealand in the past (although it keeps its position under review in light of developments overseas). Its reasoning is summarised below:

1. Such schemes may not be effective in dealing with bank runs, as they do not provide immediate and full payout of deposits. Therefore, if there is a bank run, depositors still have an incentive to withdraw funds from the bank concerned as soon as possible.
2. The real risk from a bank run comes from the larger and wholesale depositors, rather than from smaller depositors. A deposit insurance scheme is unlikely to stop the flight of capital from larger and wholesale depositors (unless their whole deposit is covered).
3. A deposit insurance scheme may weaken market discipline and increase moral hazards. If such a scheme was in place, the banks may undertake riskier activities, knowing that their customer's deposits were guaranteed in case of failure. Bank customers may reduce their level of awareness in the ongoing management and functioning of the banks.
4. If every financial institution had to pay the same premium regardless of risk, then the scheme could disadvantage those banks that were better run and more risk adverse, while providing support for those banks undertaking riskier activities.
5. As New Zealand is a small country, and only has 18 registered banks operating, a deposit insurance scheme is likely to be more expensive to operate and fund than similar schemes in much larger countries (although, this would depend upon the structure of the scheme and the role of the insurer).

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