BUSINESS NZ

PLANNING FORECAST

MARCH 2017

BusinessNZ

NZ economy – on track

Executive Summary

Despite a slightly lower growth outcome for the December 2016 quarter than many forecasters had predicted, key data, both quantitative and qualitative, shows the economy now largely back on track.

Agriculture took a bit of a hit in the December quarter with exports down on the back of a mediocre spring/summer period. The November earthquakes and lower dairy production meant regional activity showed mixed results.

While risks to the NZ economy remain - as a trading nation we are exposed to international commodity prices - conditions domestically continue to improve. This is reflected in both business and consumer confidence indicators and employment and investment intentions that are still robust.

From a growth perspective, construction activity continues to lead the pack but the latest BNZ-BusinessNZ Performance of Manufacturing (PMI) and its sister survey the Performance of Services Index (PSI) both show the manufacturing and services sectors also trucking on at very solid growth levels.

Tourism is going from strength to strength with increased tourist numbers, while continued strong migration flows are underpinning the current building boom.

At the international level, the world economy is showing signs of improvement, trade tensions and increased nationalism notwithstanding, evidenced in particular by some of the thinking coming from the United States, notably from President Trump. From a New Zealand point of view, the initial impact of the President's expansionist policies is likely to be relatively neutral.

Higher world interest rates, particularly in the US, will support a firming US dollar, probably, on balance, good news for NZ exporters. Slightly lower commodity prices of late will be offset by a lower NZ dollar and will help to support the Reserve Bank's objective of keeping inflation within the target band of 1-3 percent.

While domestic interest rates have recently shown some slight upward movement, it is likely the Reserve Bank will keep the OCR at current levels for an extended period, the more so as housing prices appear to have plateaued - notably in Auckland, the key pressure area.

The Government's upcoming Budget (25th May) will show continuing improvement in the government books with increasing surpluses forecast for the out-years. As this is an election year, we will almost certainly see the carrot of tax cuts, particularly for low income earners. However, a strong case can also be made for increasing the income level at which the highest personal income tax rate cuts in, currently at the relatively low level of $70,000.

Equally, it can be argued that rather than ad hoc tax changes, it would be more responsible to review NZ's tax system to ensure it is still in line with international best practice. The idea of setting up a tax working party has some merit since it is now several years since the tax system was thoroughly reviewed. Over that time changes have occurred that undoubtedly require tax issues to be looked at afresh.

HIGHLIGHTS

The NZ economy continues to put in a solid performance with upside and downside risks currently finely balanced.

The BusinessNZ Economic Conditions Index (ECI) sits at 13 for the March 2017 quarter, up 1 on the previous quarter and up 12 on a year ago.

The BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI) show significant growth continuing in both key sectors, while other sectors, particularly construction and tourism, also show significant activity.

While sentiment in the agricultural sector is still mixed, global commodity prices appear to be recovering despite some recent fluctuations in the GlobalDairyTrade (GDT).

At the regional level, activity results are also still mixed, with those regions affected by lower dairy production and/or the aftermath of the earthquakes last year taking something of a hit.

Despite some regional variations, overall business and consumer confidence remains solid.

The Government's upcoming Budget (25th May) will likely forecast increasingly healthy surpluses. Tax cuts targeted at lower income earners have already been implicitly signalled.

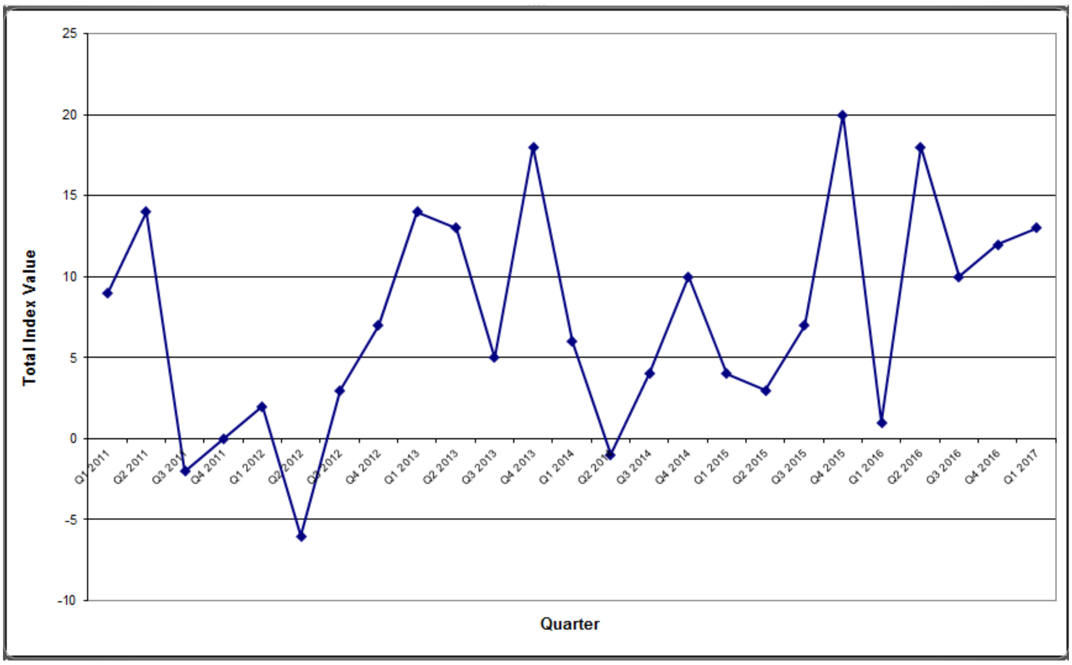
The international economy is showing some signs of improvement although the long-term impacts of Brexit and the "Trump" effect on international protectionism are yet to work through. However, their initial impact is likely to be relatively neutral for New Zealand.

PART 1: THE NZ ECONOMY – WHERE ARE WE NOW?

BusinessNZ Economic Conditions Index (ECI)

The overall BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 13 for the March 2017 quarter, up 1 on the previous quarter and up 12 on a year ago.[1]

Overall Economic Conditions Index (ECI)



Source: BusinessNZ

Data in the ECI is broken into four key sub-groups:

- Economic growth/performance indicators
- Monetary policy/pricing indicators
- Business/consumer confidence indicators
- Labour market indicators

Of the ECI sub-groups:

Economic growth/performance indicators sit at 5 for the March 2017 quarter, up 2 on the previous quarter, and up 6 on a year ago. The fourth quarter of 2016 showed a slower than expected increase in exports but more recent data suggests it was a temporary blip.

Monetary policy/pricing indicators sit at -2 for the March 2017 quarter, down 4 on the previous quarter and down 2 on a year ago. Inflationary pressures have bottomed out with interest rates starting to drift higher.

Business/consumer confidence indicators sit at 5 for the March 2017 quarter, up 2 on the previous quarter and up 8 on a year ago. Confidence has consolidated across both the business and household sector.

Labour market indicators sit at 5 for the March 2017 quarter, up 1 on the previous quarter and the same as a year ago. While overall employment growth remains strong, record labour force participation rates are keeping the unemployment rate stable at around 5 percent.

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[1] The ECI tracks over 30 indicators on a quarterly basis. The overall index value for any particular quarter represents the net balance of the indicators (generally the number increasing minus the number decreasing) thus providing an overall measure of performance. In general, increases in an indicator are seen as positive (e.g. growth in GDP or employment) and declines as negative. However, this is not always the case; for example, declines in unemployment are seen as positive and increases as negative. Results for the March 2017 quarter are estimates.

PART 2: THE NZ ECONOMY – WHERE ARE WE HEADING?

1.1 Economic growth (GDP) – solid results continue

A continuing solid growth rate of just over 3.0 percent is forecast for the year to March 2018 before drifting back slightly to 3.0 percent in 2019 (see below).

Forecasts: Real GDP percent Growth

	Years Ending		
	Mar 17	Mar 18	Mar 19
Highest	3.3	3.4	3.6
Average	3.1	3.1	3.0
Lowest	3.0	2.6	2.4

Source: ASB, BNZ and Westpac

The recent International Monetary Fund (IMF) mission to New Zealand was generally glowing in its concluding statement on the NZ economy, namely: *"New Zealand is enjoying a strong expansion driven by record high net migration, strong construction activity, and accommodative monetary policy. Policy challenges lie in managing the pressures of strong growth on infrastructure and on housing, particularly in Auckland."*

Specifically in terms of the New Zealand economy's outlook and risk, the IMF pointed out that the economy's short-term strength is underpinned by strong investment, including residential and infrastructure investment and the production impact of the recent dairy price recovery. The moderating effect of net migration is adding to demand inflation, projected to rise gradually toward the Reserve Bank's 2 percent mid-point target band.

The IMF's generally positive outlook is also shared by the latest New Zealand Institute of Economic Research's Consensus Forecasts, covering both banks and a number of government-related agencies.

Moody's, the international credit rating agency, has recently retained NZ's risk rating of Aaa.

The factors driving the rating affirmation and stable outlook are Moody's expectations that:

(a) NZ's economic resilience will remain very high, supported by strong growth;
(b) The country's institutional strength will remain similarly high, with proactive implementation of policies likely to continue to mitigate external and domestic vulnerabilities; and
(c) The country's very strong fiscal position compared with its peers will continue to provide high shock absorption capacity

Several factors are acting as positive drivers of the New Zealand economy's future growth prospects, including:

- World commodity prices, particularly oil, have partially recovered from a very low base, while other global commodity prices, including dairy, have recovered significantly, despite some instability of late
- World equity markets continue to improve with the New Zealand share market showing resilience after earlier falls last year
- Strong net migration inflows remain at record highs, adding to the demand for goods and services
- Construction activity is generally still positive across the country, including housing construction, large scale infrastructure (notably roading) and the continuing earthquake strengthening of commercial buildings
- Tourism growth remains strong (despite some regional earthquake blips) with a flow-on impact on accommodation and hospitality
- Low inflationary pressures combined with continued historically low interest rates are supporting consumption
- The exchange rate has showed some depreciation over the last couple of months, particularly against the US dollar
- Labour demand remains strong although overall wage growth is currently subdued.

Despite these positives, economic risks remain.

First, The IMF is still concerned about the high (and increasing) level of household debt and its potential impact on financial stability should there be a significant external shock to the NZ economy. The real concern is that debt is increasing at a time when servicing costs are relatively low, with historically low interest rates. There is a danger that when interest rates rise, as they inevitably will (although the exact timing of the rise can always be debated), some households will get into strife. Significant household debt reduction was achieved post-2009 but households appear to have forgotten the lessons of the past, at least partially.

Second, in spite of the many positives associated with significant migration inflows, there are risks which need to be managed, including ensuring infrastructure is available to meet the demands of a growing population and that land and housing are available for purchase.

Despite some tentative government moves to free up more land for housing, many people are struggling against a regulatory web of rules and vested interests in pursuing their dream of obtaining land for business and housing purposes, as and when they require it, not when planners make it available.

Third, the New Zealand share market continues to consolidate after falls in the latter half of last year. Increasingly there is a question whether New Zealand shares are becoming too expensive compared with underlying returns and whether it is time to ease back. Given very low interest rates and the amount siphoned off into KiwiSaver schemes, the share market has until now had a ready source of capital looking for a home, with respectable returns. Investment fundamentals suggest a correction is inevitable, sooner rather than later.

Fourth, despite efforts to improve the quality of New Zealand's regulation, there is still a long way to go. The debacle of protests over bottled water exports is yet another example of why the country needs to improve its regulatory mechanisms relating to the use of natural resources.

As Minister Nick Smith correctly stated – bottled water is no different from any other export produced with the use of water – such as dairy, apples or meat; it is still water that's exported.

The sooner clear property rights are allocated to water users, with the ability to trade them without unnecessary regulatory intervention, the better. Current first-in-first served practices, where rights are uncertain, both undervalue and act to hinder business investment decisions. Hopefully the Government's appointed technical advisory group (TAG) will make sense of what has, for a long time, been the politically fraught football of water allocation and use.

Sixth, the outcome of the September general election is still anyone's guess with almost inevitable pre- and post-election horse-trading providing some policy uncertainty. While for a number of years NZ has generally enjoyed a fair degree of policy coherence, for the future, coherence might not necessarily be guaranteed. The rise of nationalism and protectionism is not only an international issue but is also subtly and not so subtly apparent within the NZ political scene.

Seventh, in light of the previous point, the upcoming Budget provides a good opportunity for the current National-led Government to set the scene for another 3 years. While the Prime Minister might have been seen as brave to announce his proposals for extending the age of eligibility for NZ Superannuation out to 67, taking effect from 2037 to 2040 (although some will consider this far too timid), the temptation to promise an ad hoc response to any such issue must be resisted. Developing a coherent overall framework with the aim of improving the New Zealand economy's international competiveness is essential, in respect to both fiscal and monetary and regulatory policies.

The temptation to throw money at squeaky wheels or to relieve perceived itches without thinking of the longer-term consequences is always a risk in election year. This applies equally to getting through controversial legislation where the final result is often a mish-mash of good, bad and sometimes worst cases, producing unclear laws and regulations and providing investors with less rather than greater certainty.

Eighth, rising global protectionism is not in New Zealand's long term interests as a country heavily dependent on global trade. However, the short-term effects of greater protectionism in the US and an expansionary expenditure policy under President Trump's regime should in fact have some benefits for the country, not only by potentially putting upward pressure on the US dollar - which might, on balance, be beneficial to New Zealand exporters - but by providing investors with good returns. Investors, including Kiwi-savers, should be feeling positive as the US share market continues to drive to new highs.

Ninth, despite a general improvement in outlook for the international economy, as noted by the International Monetary Fund (IMF) in its latest forecasts, NZ's key trading partner, China, does pose some risks given an ongoing slowdown in growth rates (still a very healthy 6.7 percent) and some concerns about the stability of its financial system in light of recent capital outflows.

Finally, there are concerns about whether anything can be done to improve significant discrepancies in New Zealand's regional economic growth while at the same time avoiding obvious problems from any attempt to improve regional outcomes through "think big" initiatives.

It should be noted that a number of government (central and local), business and individual initiatives are already targeted at improving regional development.

However, some might consider New Zealand's generally favourable macro-economic climate and sound fiscal and monetary policies mean little more can be done to improve outcomes for regional New Zealand, either in economic or in social terms.

It is generally accepted that certain areas of New Zealand, notably Auckland, are growing strongly (and showing some of the strains associated with rapid growth – e.g. rising house prices) while other areas are not reaching their potential, including making the most of existing infrastructure and building greater economic resilience.

Clearly Auckland is now, by most standards, a truly international city. Between 2006 and 2015 Auckland's population grew 14.5% while the rest of New Zealand grew just 7.6%. In 1961 Auckland accounted for 21% of New Zealand's population. In the 2013 census it was 34%. Come 2043, the city's population will likely have grown by about one million and account for 60% of the country's growth and about 41% of its population.

Other major centres such as Wellington are now expanding, while Christchurch, although it has significant ongoing issues associated with the earthquake rebuild, is making strong headway. Other regional areas (particularly tourist centres such as Queenstown) are facing their own growth pressures but contributing positively to a record increase in tourism. Several regions which might have been expected to face significant downturns from lower dairy pay-outs - the Waikato, Hawke's Bay, Manawatu and Otago – are, according to ANZ New Zealand Job Ads, showing relatively strong employment growth prospects. But certain regions such as the South Island's West Coast and the East Coast of the North Island, continue to face challenges.

It is important upfront to be clear about what regional economic development is and what it is not.

First, Regional Development is not about ensuring an equal spread of population, Gross Domestic Product (GDP), or infrastructure growth. It simply means ensuring each region reaches its potential, subject to market changes and normal supply and demand conditions, to deliver the optimal social and economic results for its resident population and for New Zealand. It is about helping facilitate economic and social growth across as much of New Zealand as possible, not about producing equity of outcomes.

Second, regional development should not be concerned with the failed policies of the past such as "picking winners", think-big and grandiose subsidies. Rather, the focus must be on the long-term and ensuring regions are well-connected both internally and externally so they can make the most of the opportunities they create or that present themselves.

Local government amalgamation is off the political radar for the foreseeable future but there is significant potential for the sharing and choreographing of services between smaller councils in particular, ensuring ratepayers are getting value for money.

It is understood that New Zealand-wide, several hundred million is spent on regional development but with little information on whether ratepayers are getting value for money or, more importantly, on what Economic Development Agencies (EDAs) should be doing that does not "crowd-out" private sector initiatives.

Not only must EDAs be joined up in a more coordinated fashion, their role and Key Performance Indicators (KPI) must be rigorous, measured and clearly understood by ratepayers. Current indicators, e.g. measures of GDP per capita per region, do not necessarily relate well to EDAs' degree of involvement (or lack of it).

Some regions are already expressing concern about their ability to continue to fund local services, particularly areas with declining rural populations. Conversely, there is also concern about strong population growth and associated infrastructure requirements. Reliance on rates as a key mechanism for future funding is, in some cases, unlikely to be tenable.

BusinessNZ made an extensive submission on the Productivity Commission draft report – *Better Urban Planning* - and raised a number of issues specifically about future funding options. The submission is available on BusinessNZ's website.[1] Click here.

The submission considers a number of funding options, including the different options' pros and cons. Options discussed include: user charges, differential and targeting rating, development contributions, uniform annual general charges, other tax mechanisms, including local income taxes or GST, royalties and tolling. Some potentially have merit while others are clearly problematic; for example, sharing the local income tax or GST base which might have little relationship to the amount of goods or services consumed via local government.

While the search for new funding options can be seen as positive, if, in some cases, not necessary, it is important to recognise the danger that any new options will be used simply as a source of additional revenue without a clear understanding of the proper role of local government.

In this context, greater private sector participation in infrastructure development, operation and service provision should also be considered.

[1] See Section 2(d) (p.11-18) on Future Alternative Funding Mechanisms from BusinessNZ's submission (October 2016) to the Productivity Commission's *"Better Urban Planning Draft Report"*

1.2 Monetary conditions – tightening in 2018?

Monetary policy has often been the subject of political point scoring in the build up to general elections, although to be fair, most political parties have taken a softly softly approach to making any significant changes to monetary policy settings.

While there will always be noise amongst some political parties for the Reserve Bank to have multiple objectives (rather than an overriding focus on inflation) and for monetary policy setting to be determined by a board rather than solely by the Reserve Bank Governor, it is unlikely there will be any wholesale changes to how monetary policy operates in NZ post-election.

The Reserve Bank has been seeking to add debt-to-income (DTI) ratio limits to the list of macro prudential tools covered in its Memorandum of Understanding with government but it would be fair to say that government has been luke-warm to any such proposal. The Minister of Finance has requested a thorough cost-benefit analysis before considering adding DTI limits to the list of tools available to the Bank.

It should also be noted that the present Governor of the Reserve Bank, Graeme Wheeler, is standing down later this year with his spot to be temporarily taken by Deputy Governor, Grant Spencer. This will allow an incoming government time to consider what the ideal requirements for a new Governor should be. In the meantime, the government will likely kick for touch on making changes pre- and even early post-election, such as the inclusion of DTI tools.

Interest rates – drifting up

The 90-day bill rate is forecast to lift marginally out to March 2019 (see forecasts below).

At the last OCR review on 23 March the Reserve Bank kept the OCVR at 1.75%, as widely expected, although there is some debate as to when the Bank will raise interest rates to more neutral levels.

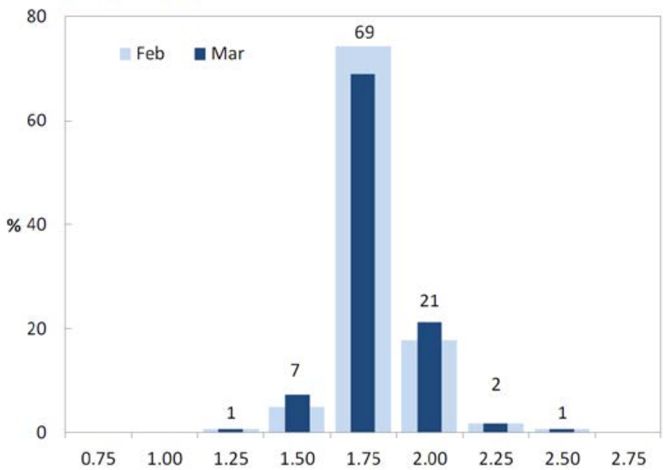
Forecasts: Interest Rates (90 day bills)

	Years ending		
	Mar 17	Mar 18	Mar 19
Highest	2.0	2.1	3.1
Average	2.0	2.0	2.6
Lowest	2.0	2.0	2.4

Source: ASB, BNZ and Westpac

The NZIER monetary policy shadow board, in its most recent statement (21 March), implicitly suggests that the Reserve Bank should clearly state when and what interest rate rises we can expect down the track (see below).

Figure 1 NZIER's *Shadow Board* recommends the Reserve Bank remains on hold, with a slight tightening bias



While the Board concluded that the OCR should remain at its current level, it did find the "ideal" OCR was marginally higher – at 1.79 percent. And while there was no need for a speedy increase, several members of the shadow board implied that the Reserve Bank should be preparing the market for a future increase. But the shadow board's view notwithstanding, most market commentators are not expecting any upward movement until well into 2018.

Robust growth will put further upward pressures on pricing, including potentially on labour force costs but international prices remain benign, reducing the potential flow-on costs from imported consumer goods.

The NZ dollar – lower

The forecasts below show the NZ dollar expected to drift lower against the US and Australian dollar but rise against the Aussie. As a result, the TWI is forecast to show a slight shift lower.

Meanwhile, President Trump's stated plans to ramp up infrastructure spending will significantly boost US domestic activity, promoting a likely further rise in interest rates and a stronger US dollar. This would obviously have negative implications for the NZ dollar as would the potential for an increase in US trade protectionism with its flow-on effect for many Asian countries.

Notwithstanding the above, there is still plenty of water to flow under the bridge before it can be seen clearly whether President Trump's plans have any legs or whether they will fall by the wayside. Either way, the difficulty of estimating movements in exchange rates should never be underestimated.

Forecasts: Exchange Rates

AUD (cents)			
	Mar 17	Mar 18	Mar 19
Highest	0.95	0.97	1.01
Average	0.93	0.95	0.96
Lowest	0.92	0.92	0.93

USD (cents)			
	Mar 17	Mar 18	Mar 19
Highest	0.71	0.68	0.71
Average	0.71	0.67	0.68
Lowest	0.70	0.66	0.62

TWI			
	Mar 17	Mar 18	Mar 19
Highest	77.6	76.7	78.7
Average	77.3	75.5	75.7
Lowest	77.0	74.8	72.9

Source: ASB, BNZ and Westpac

Inflation – waking from long sleep

Forecasts below show inflation will drift higher but remain well within the Reserve Bank's target band of 1-3 percent to March 2019.

While tradeables inflation remains subdued, non-tradeables (essentially domestically produced goods and services) is showing some upward pressure.

Strong population growth (assisted through record net migration), the buoyant housing market and a labour market starting to heat up are all supporting increased household spending and putting upward pressure on resources. This will take some time to feed through into higher overall wage costs but interest rate rises will be inevitable – the difficult question remains, when? Throw in the potential impact of a lower NZ dollar and that provides decision-makers with a difficult decision.

Notwithstanding the above, the Reserve Bank will be loath to jump the gun in respect to interest rate rises but equally won't want to wait until the horse has bolted, as was the case some years earlier when using interest rates to rein in inflationary pressures was much more difficult. In some respects higher interest rates, when they kick-in, will likely curb household spending behaviour as household debt levels are continuing to rise without respite - although this situation is likely to be offset by strong labour market outcomes. The job of the Reserve Bank Governor gets no easier!

Forecasts: percent Change in Inflation (CPI)

	Years Ending		
	Mar 17	Mar 18	Mar 19
Highest	2.1	1.9	2.2
Average	2.0	1.6	2.0
Lowest	1.7	1.4	1.8

Source: ASB, BNZ and Westpac

1.3 Business activity and consumer confidence on solid footing

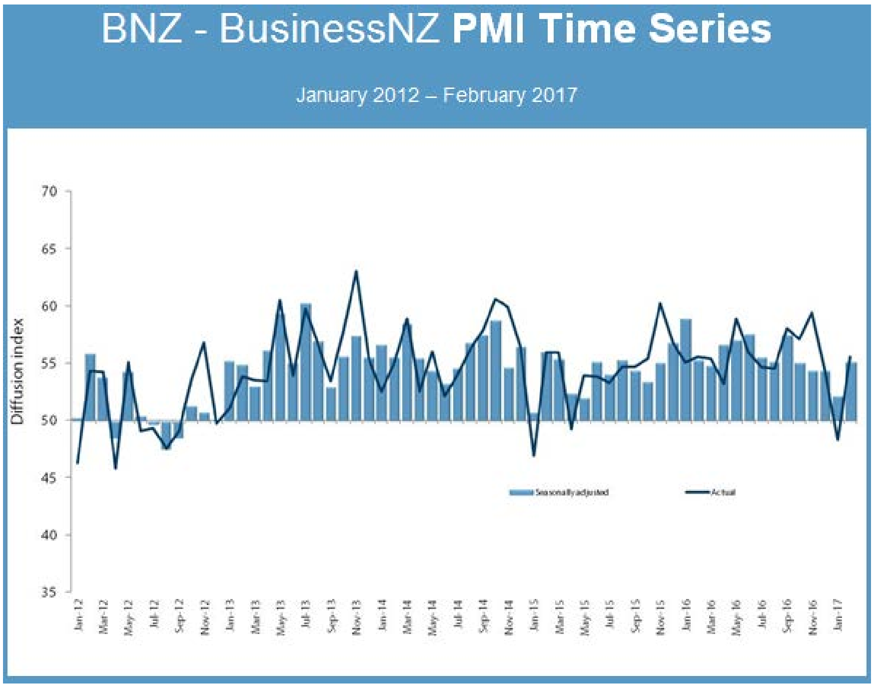
Business activity solid

Business and consumer confidence surveys show, almost without exception, that the economy is performing well across a broad range of sectors. Importantly, businesses are generally upbeat about their own business prospects - a sound basis on which to judge future economic performance/growth.

Investment intentions remain positive while employment intentions are also at very positive levels, as evidenced by a number of recent business confidence surveys. Not surprisingly, consumer confidence too remains at solid levels. Consumers appear relatively confident to spend, being relatively optimistic about their future net financial situation. This is evidenced by both the ANZ-Roy Morgan NZ Consumer Confidence and Westpac McDermott Miller Consumer Confidence Index for March 2017.

The BNZ – BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI) both show continued solid growth.

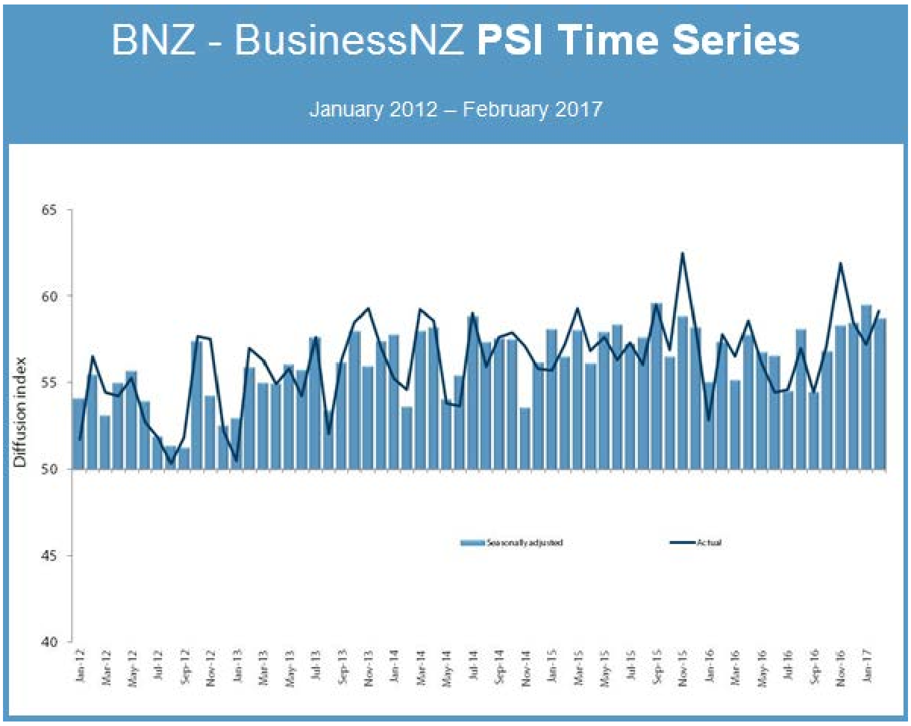
The PMI saw activity increase in February after a dip in expansion during January. The seasonally-adjusted PMI for February was 55.2 (a reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was 3.0 points higher than in January and the highest level of expansion since September 2016. Overall, the manufacturing sector has remained in expansion in almost all months since October 2012.



The key sub-indices of Production and New Orders (see below) continue to show solid growth after a slight blip in January, largely due to seasonal factors. For February 2017, *production* stood at a healthy 56.8 while *new orders* were similarly in a strong positon.

While a few respondents continued to outline negative seasonal factors affecting their overall activity levels during February, the 61.7% of positive comments received pointed to increased orders, both at a domestic and offshore level.

The BNZ – BusinessNZ Performance of Services Index (PSI) - similarly shows very positive results for February, a continuation of the expansionary phase in the services sector for a number of years now.



The PSI for February was 58.8, down slightly on the 59.5 for January. The key sub-indices of activity sales and new orders/business remain above the 60 mark with *activity/sales* at 60.6 and *new orders/business* at 61.8.

Other areas of activity also show solid improvement and construction and tourism activity are going from strength to strength.

In a welcome move, Federated Farmers mid-season Farm Confidence Survey released mid-March showed farmers' confidence in the economy and in their own businesses improved significantly improved. The survey, undertaken for Federated Farmers by agricultural market researchers Research First, produced the following overall findings:

- Farmers' confidence in the general economy has improved but remains in slightly negative territory (net score -2.0).
- For the first time in three years, farmers' net confidence in the profitability of their farms is positive (net score +15.5).
- Farmers' production expectations have increased slightly (net score of +16.8), although this overall increase is carried by dairy farmers, the only industry group whose production expectations have increased.

Notwithstanding the general positive overall outlook, there are significant differences between sectors. Dairy farmers are now considerably more confident than their sheep and beef counterparts, whose confidence, especially in their own profitability, has if anything worsened. This reflects the dramatic improvement in dairy commodity prices in the second half of 2016, albeit off a low base, and slippage in meat and wool commodity prices.

While the outlook for dairy currently looks to be improving, it is hard to get away from the fact that given NZ's very low production of dairy compared with world production but its relatively high trade in dairy, NZ dairy farmers will always but subject to the vagaries of global production changes, whether caused by favourable climatic conditions or promoted through explicit and implicit overseas subsidies.

1.4 Labour market – going from strength to strength

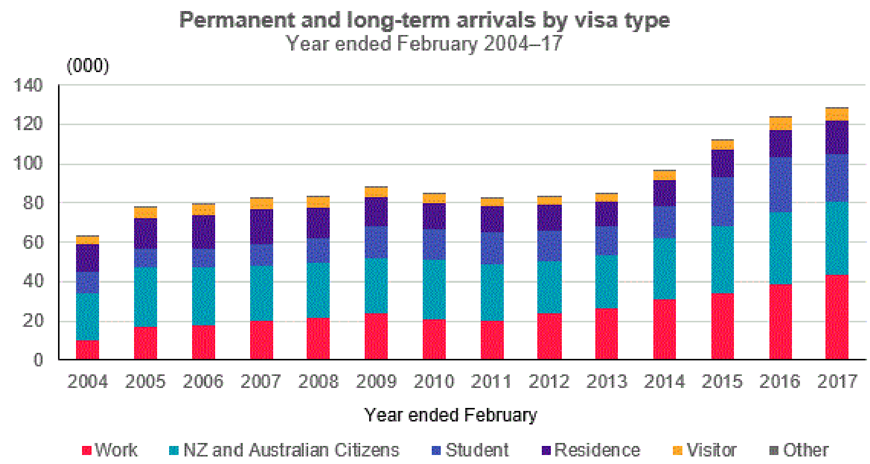
Employment – solid growth continues

Relatively strong growth in numbers entering the labour market and record participation rates have resulted in unemployment remaining around the 5 percent level, although the forecast below shows a gradual decline in unemployment out to March 2019.

The New Zealand Institute of Economic Research's (NZIER) Consensus Forecasts (13 March) show the employment forecasts as revised higher given labour demand has been strong with businesses more confident about taking on new staff. While the expansion of the labour force from strong net migration has offset some labour shortages, prospects are for only a slight reduction in unemployment over the forecast period.

Net migration continues to reach record highs and annual net migration is over 71,000. Many arrivals have work visas, boosting the potential labour force.

That international inflows are particularly concentrated in Auckland has resulting in a strong increase in Auckland's the population, adding to housing demand and with associated labour force growth.



Source: Stats NZ

While overall employment growth is encouraging, there are significant differences across the country. High population growth areas such as Auckland and the Bay of Plenty have experienced strong rises in employment activity and associated reductions in unemployment but other regions where dairy is prominent have shown static or even rising unemployment. On a more positive note, the traditional "boom" and "bust" from movements in international commodity prices (notably dairy) have not been as prominent as in the past, suggesting increased moves to diversify in many rural-based economies at least on the margins), with tourism opportunities expanding in quite innovative ways from farm walking tracks/homestays through to adventure tourism opportunities.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Mar 17	Mar 18	Mar 19
Highest	5.2	5.4	5.7
Average	5.0	4.8	4.8
Lowest	4.7	4.4	4.3

Source: ASB, BNZ and Westpac

Labour costs – drifting up

Forecasts below indicate labour costs expected to increase slowly to 2.2 percent for the year ending March 2019.

In many respects it is slightly puzzling that with greatly improved employment growth, and firms' reported difficulties in finding skilled staff, wage costs have not risen significantly – yet.

While it typically takes a year or so for labour shortages to flow through to a pickup in wage growth, there is likely to be a considerable pick-up post this year. As an aside, with the making of wage claims based on inflationary pressures historically part and parcel of the NZ way, it perhaps has taken longer than might have been expected for many to realise claims should be based more on normal supply and demand conditions, including productivity improvements, than on the Consumers' Price Index (CPI). The CPI has been at historically low levels for a number of years now.

Recent statistics from StatisticsNZ show that, perhaps not surprisingly, labour productivity fell 0.7 percent in the year ended March 2016, with labour inputs in the measured sector increasing a significant 3.3 percent over the same period. This is the largest increase in labour inputs since the beginning of the series in 1996.

In general, labour productivity growth lags behind increases in employment as it takes time of new employees to get up to speed, as it were.

Productivity is widely regarded as the key to improved living standards and a significant increase in productivity could fund wages' growth while ensuring NZ remains internationally competitive. Current rates of productivity growth (negative) do not augur well for any significant wage increases over the forecast period although normal supply and demand factor would suggest some upward movement in wage rates are inevitable.

Forecasts: Labour cost index percentage change (wages & salaries)

	Years ending		
	Mar 17	Mar 18	Mar 19
Highest	1.8	2.2	2.5
Average	1.7	2.0	2.2
Lowest	1.6	1.9	2.0

Source: ASB, BNZ and Westpac