

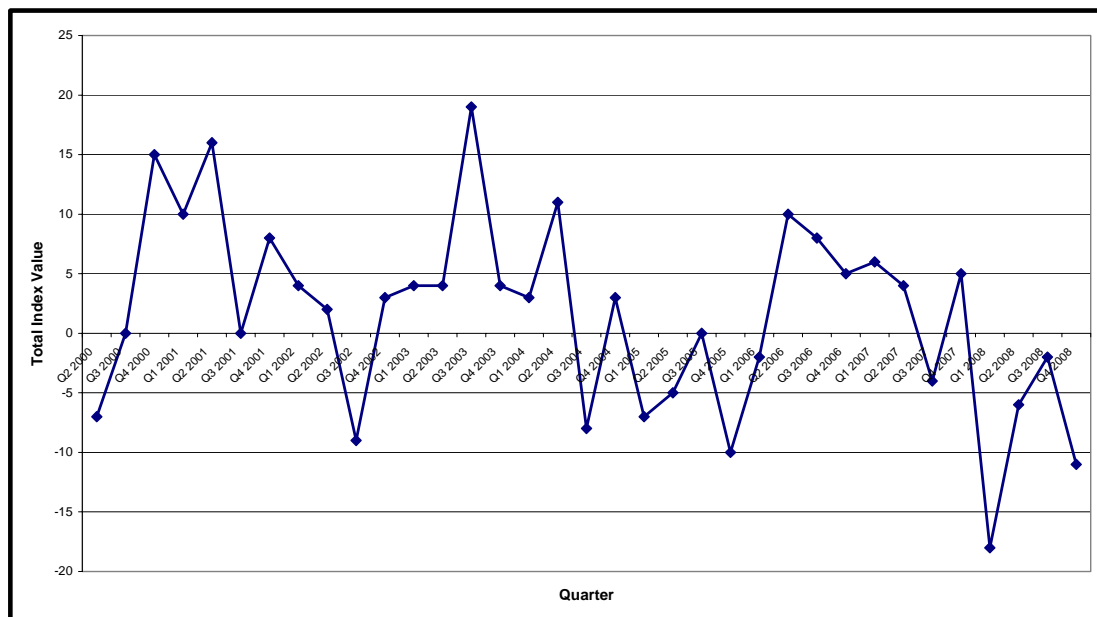
## February 2009

### EXECUTIVE SUMMARY

The overall Business NZ Economic Conditions Index (ECI)<sup>1</sup> sits at -11, down 9 on the September quarter and down 16 on a year ago. The overall ECI is currently sitting at its second lowest level since the index began in 2000.

All sub-indexes remain firmly in negative territory apart from monetary policy/pricing indicators, with the positive result for monetary policy/pricing indicators driven largely by significant declines in interest rates and the drop-off in inflationary pressures.

**Figure 1: Overall economic conditions index**



<sup>1</sup> A background to the Economic Conditions Index (ECI), including measuring movements in the indicators and a glossary of terms, is contained in the Appendix. It is important that the caveats to the Index as outlined in the Appendix are clearly understood. The ECI represents a snapshot in time. Business NZ also produces a Quarterly Business Planning Forecast.

In terms of the sub-indexes:

1. Economic growth/performance indicators sit at -4, down 2 on the last quarter and down 11 on a year ago. New Zealand's economic growth prospects continue to be revised downwards, with most forecasters expecting several more quarters of negative growth. World demand for goods and services has collapsed after several years of strong growth, resulting in reduced profitability for New Zealand exporters. The outlook for the current account deficit has deteriorated once again due mainly to a continuing fall in world prices for NZ's major export commodities. Moreover, New Zealand's high exposure to overseas debt leaves it vulnerable to a change in investor sentiment with Standard and Poors taking a negative view of New Zealand's external credit rating.

2. Monetary policy/pricing indicators sit at 2, the same as for the last quarter and up 5 on a year ago. Falling interest rates combined with a significantly lower exchange rate are acting as a partial buffer for exporters facing significant declines in export prices. Nevertheless, the significantly lower exchange rate has not been enough to stop falls in commodity prices when converted into NZ dollars with Fonterra again slashing their projected payout to dairy farmers for the 2008/09 year. The one bright spot is that the inflation genie is firmly back in the bottle which will allow the Reserve Bank to lower interest rates even further should they so wish. However it is not inevitable that lowering the OCR will automatically result in one-for-one cuts to rates facing households and businesses. This is because of the extent to which banks borrow on wholesale markets which are only just starting to thaw on the back of significant overseas government guarantees and bailouts of the banking sector around the world.

3. Business/consumer confidence indicators sit at -5, down 3 on the last quarter and down 4 on a year ago. Both business and consumer confidence indicators continue to decline, despite a number of factors which should have acted to brighten prospects. Reduced interest rates, overall declines in transport costs, continued tax cuts, and a more competitive NZ dollar have not been enough to arrest the slide in business and consumer confidence, with business confidence particularly affected by an overall drop-off in demand for goods and services. What is particularly concerning is businesses' assessment of activity levels going forward which is bleak overall by historical standards. A deteriorating labour market is likely to adversely impact on household expenditure with retailing, hospitality and tourism being particularly subject to a drop-off in activity. For the first time in many years household debt levels have declined marginally as consumers take a more cautious approach to non-essential expenditure.

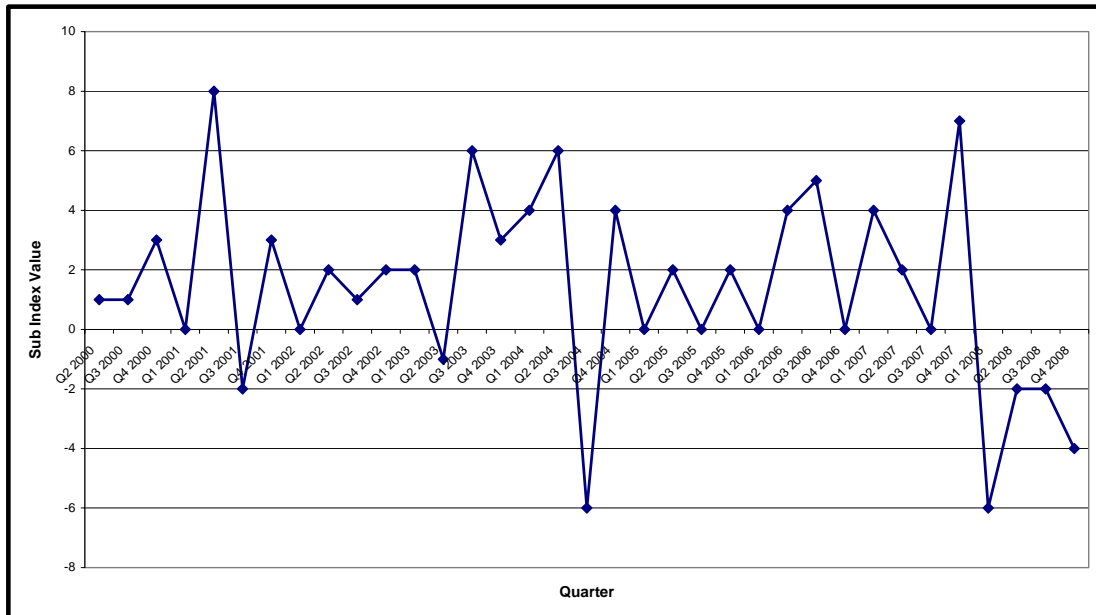
4. Labour market indicators sit at -4, down 4 on the previous quarter and down 10 on a year ago. They are currently at their equal lowest level since the index began in 2000. After a prolonged period of strong growth in a number of labour market indicators, the tide has turned – suddenly, suggesting that employees are being let go after a significant period of labour hoarding. Most surveyed labour market indicators are now negative with expectations of negative employment growth and rising unemployment forecast over the next two years. Wage pressures are starting to ease while the level of annual net permanent and long-term migration appears to be bottoming out as NZ becomes a more attractive destination given the deep recession in many developed countries.

**BUSINESS NZ ECONOMIC CONDITIONS INDEX**

**Sub Index 1: Economic growth/performance indicators**

Economic growth/performance indicators sit at -4, down 2 on the last quarter and down 11 on a year ago. New Zealand's economic growth prospects continue to be revised downwards, with most forecasters expecting several more quarters of negative growth. World demand for goods and services has collapsed after several years of strong growth, resulting in reduced profitability for New Zealand exporters. The outlook for the current account deficit has deteriorated once again due mainly to a continuing fall in world prices for NZ's major export commodities. Moreover, New Zealand's high exposure to overseas debt leaves it vulnerable to a change in investor sentiment with Standard and Poors taking a negative view of New Zealand's external credit rating.

**Figure 2: Economic growth/performance sub index**



Both domestic and international economic growth forecasts continue to be revised downwards. The International Monetary Fund (IMF) has recently revised the international growth forecast down from 2.2 percent in November 2008 to a new forecast of under 0.5 percent. Already a number of developed economies, including the US and Britain, are in significant recession. The US economy is forecast to decline 1.8 percent, the UK 2.2 percent, Japan 1.7 percent and the European Union (EU) 1.3 percent. The expectation is that international growth will bounce back in 2010, although there are a number of factors that could adversely affect this expectation.

Arguably New Zealand is only beginning to feel the effects of the crisis now the global demand for goods and services has slumped. This slump in global demand is beginning to be felt by businesses in terms of their own activity outlook and is starting to impact on the household sector as a result of redundancies and rising unemployment.

While some forecasters, including the Reserve Bank, had stated as recently as December 2008 that the contraction of the NZ economy would be limited to the first three quarters of 2008, more recent data have put paid to that. In particular, the NZIER's latest Quarterly Survey of Business Opinion (QSBO) shows that firms' own-activity expectations are by far the lowest in the history of the survey with investment and hiring intentions plunging. Given the very strong correlation between the results of the QSBO and Gross Domestic Product (GDP) one can realistically expect at least two to three more quarters of negative growth before tentative growth returns towards the end of this year.

The extent of the slump in world demand is demonstrated by the significant revision of Treasury forecasts from the time of the 2008 Budget (May), to the Pre-election Economic and Fiscal Update (PREFU), and subsequently the December 2008 update. Growth rates for 2009 and 2010 have been slashed from around 2% growth per annum to around 0.5% per annum. Many commentators are saying, with significant justification, that these revised rates of growth are still too optimistic.

**Table 1: Treasury Forecasts over 2008**

Forecast developments over 2008						
	2008 Est./Actual	2009 Forecast	2010 Forecast	2011 Forecast	2012 Forecast	2013 Forecast
Real production GDP (AAPC, March year)						
Budget Update	3.1	1.5	2.3	3.2	3.0	-
Pre-election Update	3.0	0.1	1.8	3.3	3.4	3.1
December Update	3.2	0.3	0.8	2.9	3.9	3.8
Net debt (% GDP, June year)						
Budget Update	1.0	2.5	3.8	5.0	6.2	-
Pre-election Update	0.0	2.8	5.3	8.0	10.6	13.2
December Update	0.0	3.1	7.2	12.2	16.5	20.7

Source: Treasury

The Government's accounts are also projected to take a hammering from reduced revenue as a result of an ailing economy, while expenditure pressures continue to persist as a result of greater social welfare dependency, higher debt servicing costs as net debt increases substantially, and finally, the government's fiscal stimulus package with its focus on bringing infrastructure expenditure forward.

Government net debt is projected to rise from basically zero at present to around 20% by 2013. While still low by international standards and certainly nothing like the significant levels of debt built up over the 1970s and 1980s, the rise in debt will result in higher debt servicing costs. Overseas institutions will be taking an active interest in observing whether or not the Government will take action to reduce debt levels over the medium term as the Minister of Finance has indicated the Government intends to do.

New Zealand's high exposure to overseas debt (mainly from the private sector) leaves it vulnerable to a change in investor sentiment with Standard and Poors taking a negative view of New Zealand's external credit rating.

**Table 2: Treasury Economic Forecasts**

Economic forecasts						
	2008 Est./Actual	2009 Forecast	2010 Forecast	2011 Forecast	2012 Forecast	2013 Forecast
(Annual average % change, year ending 31 March)						
Real GDP per capita	2.1	-0.6	-0.2	2.0	2.9	2.9
Employment	0.8	0.4	-2.0	-1.0	1.6	3.0
Unemployment	3.7	4.7	6.4	6.2	5.4	4.6
Wages	4.2	5.4	4.2	3.7	3.0	2.9
CPI inflation	3.4	3.4	2.4	1.9	1.9	1.9
Merchandise terms of trade	9.4	2.7	-4.3	-0.7	0.3	-0.6
Current account balance						
- \$billion	-14.2	-17.0	-15.7	-13.1	-10.5	-10.5
- % of GDP	-8.0	-9.4	-8.6	-6.9	-5.2	-4.9
TWI	71.9	56.5	54.4	54.2	53.7	53.0
90-day bank bill rate	8.8	5.5	4.8	4.8	5.1	5.6
10-year bond rate	6.3	5.9	5.7	5.8	6.0	6.0

Source: Treasury

Given that NZ's terms of trade (price of exports versus price of imports) have peaked, and the ongoing cost of servicing a large stock of debt, it is looking likely that the current account deficit will remain at present levels for some time, with projections of a deteriorating deficit to 9.4 percent of GDP later this year before an improvement in the out-years.

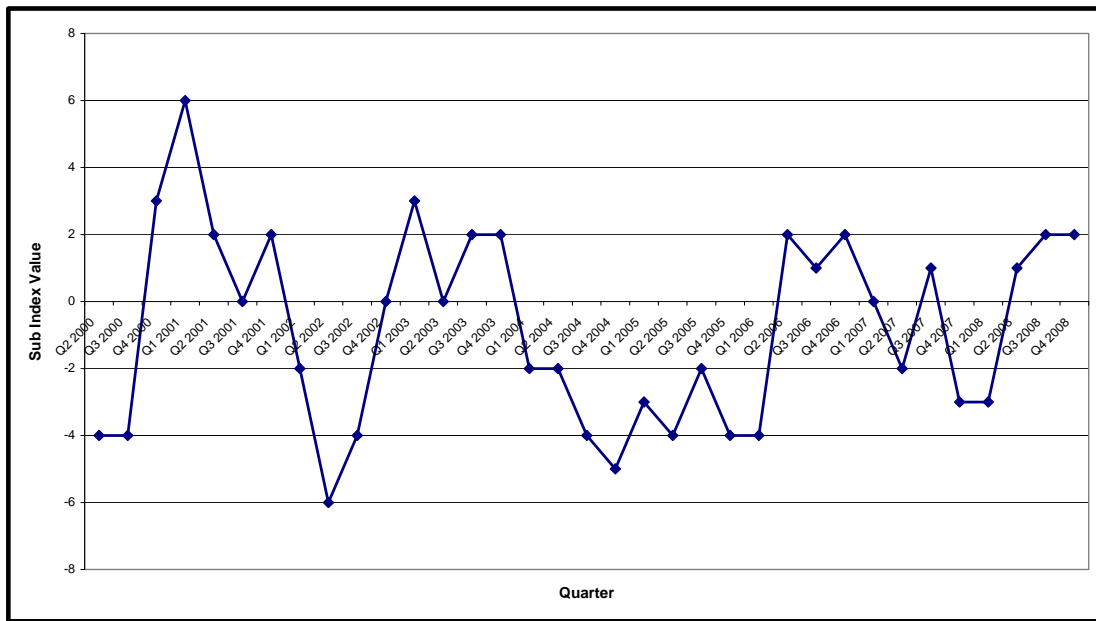
**Table 3: Current account balance**

	% of GDP
Mar 2005	-6.8
Jun 2005	-7.5
Sep 2005	-8.0
Dec 2005	-8.3
Mar 2006	-9.3
Jun 2006	-9.3
Sep 2006	-8.9
Dec 2006	-8.8
Mar 2007	-8.3
Jun 2007	-8.4
Sep 2007	-8.7
Dec 2007	-8.2
Mar 2008	-8.0
Jun 2008	-8.4
Sep 2009	-8.6

**Sub index 2: Monetary policy/pricing indicators**

Monetary policy/pricing indicators sit at 2, the same as for the last quarter and up 5 on a year ago. Falling interest rates combined with a significantly lower exchange rate are acting as a partial buffer for exporters facing significant declines in export prices. Nevertheless, the significantly lower exchange rate has not been enough to stop falls in commodity prices when converted into NZ dollars with Fonterra again slashing their projected payout to dairy farmers for the 2008/09 year. The one bright spot is that the inflation genie is firmly back in the bottle which will allow the Reserve Bank to lower interest rates even further should they so wish. However it is not inevitable that lowering the OCR will automatically result in one-for-one cuts to rates facing households and businesses. This is because of the extent to which banks borrow on wholesale markets which are only just starting to thaw on the back of significant overseas government guarantees and bailouts of the banking sector around the world.

**Figure 3: Monetary policy/pricing sub index**



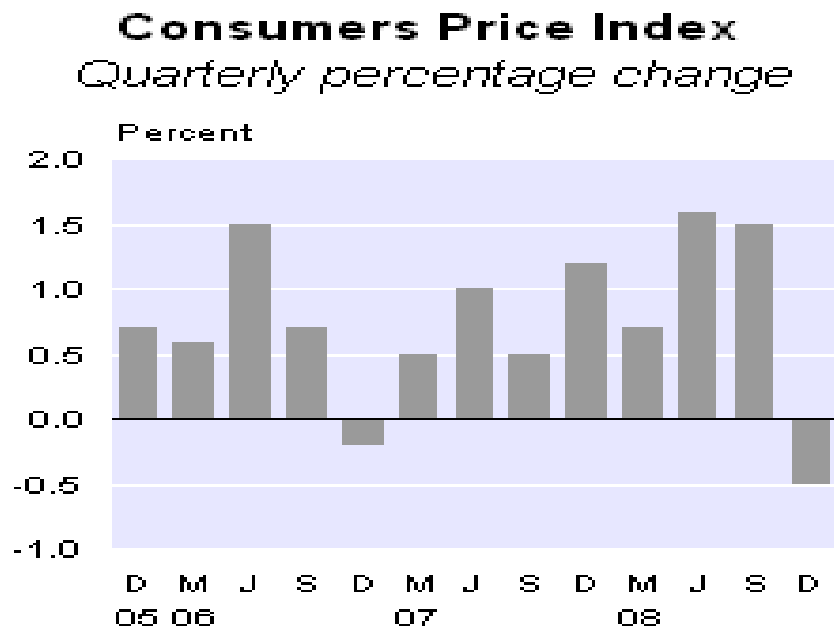
The Reserve Bank continues to slash the OCR in response to a rapid fall in inflationary pressures and very negative business and consumer sentiment.

A 150 basis point cut to the OCR in December 2008 has been followed by another 150 basis points cut, bringing the OCR down to 3.5 percent. A number of forecasters consider further cuts are not out of the question given the negative outlook for the world economy.

Reserve Bank Governor Alan Bollard commented in the RB press release confirming the most recent drop in the OCR that *“the news coming from our trading partners is very negative. The global economy is now in recession and the outlook for international growth has been marked down considerably since our December Monetary Policy Statement.”*

Capacity utilisation is falling away along with a slump in world commodity prices which is taking the heat out of inflation. Reductions in transport and fuel costs largely drove the 0.5 percent decline in the Consumers Price Index for the December 2008 quarter, bringing annual inflation down to 3.4 percent. Expectations are for relatively low rises in the CPI for the next two quarters and that the CPI will be well within the Reserve Bank's target range of 1-3 percent by the end of this year. This allows the Reserve Bank greater freedom to reduce interest rates further without any worry of refueling inflation.

**Figure 4: Consumers Price Index**



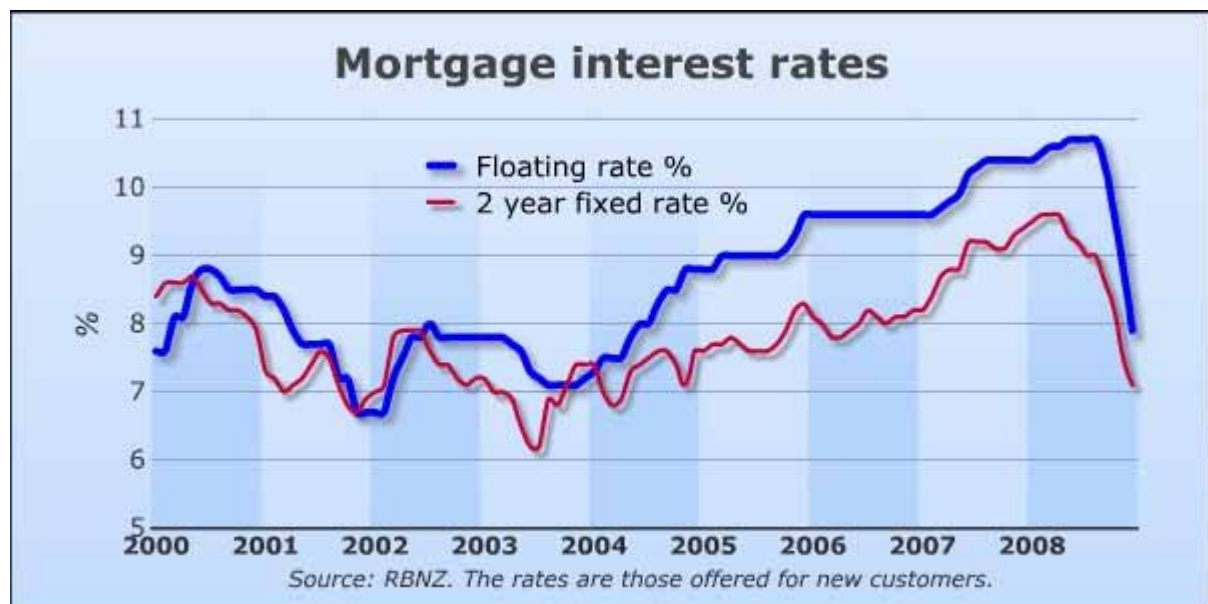
The Reserve Bank is also in the fortunate position of having significant room for further cuts if necessary to stimulate activity. This is a luxury that many other countries do not have as they have already expended that option (see Table 4).

**Table 4: World interest rates**

Central bank rate (%)	Current rate (%)	Previous rate (%)
Reserve Bank of Australia	3.25	4.25
US Federal Reserve	0.25	1.00
Bank of Canada	1.00	1.50
Bank of England	1.00	1.50
European Central Bank	2.00	2.50
Japan	0.10	0.30
Reserve Bank of NZ	3.50	5.00

Despite significant cuts in the OCR and expectations of further cuts, there is a question mark over whether such cuts will necessarily flow through to the cost of borrowing for households, and businesses in particular. Some commentators, including a recent survey by Federated Farmers of NZ, suggest that not all of the cuts are being passed through. While there will always be debate about time lags etc, which inevitably affect what people are paying at any given time, it is important that the nature of risk is considered along with the cost of banks having to borrow on international wholesale markets.

**Figure 5: Interest rates**



Given the degree to which most New Zealand banks obtain finance offshore (some up to about 40 percent) it is not at all obvious that further falls in the OCR will flow through into reduced interest rates facing businesses and households – at least to the extent that many think should occur.

Given New Zealand's exposure to debt, repricing of risk has resulted in higher interest rates internationally and means that those providing funding to banks via capital markets are likely to demand higher risk margins. This will obviously flow on to the cost of capital for businesses and ultimately householders. There is already

evidence that some major business projects and mergers have been put on hold because of the difficulties in getting financial packages together.

In line with greater lending risk, banks have also tended to review their lending criteria and impose greater discipline on businesses and households seeking finance. While some criteria have changed e.g. generally requiring households to have a deposit of at least 20 percent on housing finance, banks are being much more rigorous in respect to lending to businesses with requirements for comprehensive business plans and forecast cash flows. Asset backing is now considered to be no longer adequate, with, instead an emphasis on businesses and households being able to service their debts out of cash flow. Arguably what banks are currently requiring can generally be considered sound business practice but it has tended to frustrate some customers who have grown used to gaining relatively easy credit.

In line with significant interest rate cuts, the \$NZ dollar has also fallen rapidly with further falls likely. This underlines the importance of having a floating exchange rate as an automatic stabiliser given the worsening economic outlook. Nevertheless, despite a significant drop in the NZ dollar relative to most of our major trading partners, the drop has not been enough to offset the free-fall in international commodity prices when converted into NZ dollars.

**Figure 6: Exchange Rate**



A quarterly Nielsen survey on foreign exchange hedging conducted in December 2008 on behalf of Asia-Pacific Risk Management and the New Zealand Export Credit office found that exporters are generally hedging for a dramatically longer period on average, with a weighted average of 11.4 months hedging in December 2008 compared to 5.7 months in the June quarter. Obviously exporters are prudently acting on the opportunity to lift hedging percentages whilst the currency is moving to cyclical lows.

The ANZ Commodity Price Index stood at 155.5 in January 2009 (down 4.3 percent from the previous month) and down 29.2 percent from its peak in May 2008. The Index is down 26.5 percent on the same time last year. Dairy products continue to take a hit with prices declining by 53.7 percent on the same time last year.

When converted into NZ dollars the ANZ NZ Dollar Commodity Price Index also went down in January 2009 (4.3 percent) to 146.4. On an annual basis commodity prices, when converted into \$\$NZ, were only down 2.6 per cent, reflecting the fact that a sliding \$NZ against our major trading partners, particularly the US, has acted to offset the worst of the slump in international commodity prices. Nevertheless dairy products, when converted in NZ dollars were down a significant 35.2 percent compared to the same time last year.

**Table 5: ANZ Commodity Price Index**  
(July 1986=100)

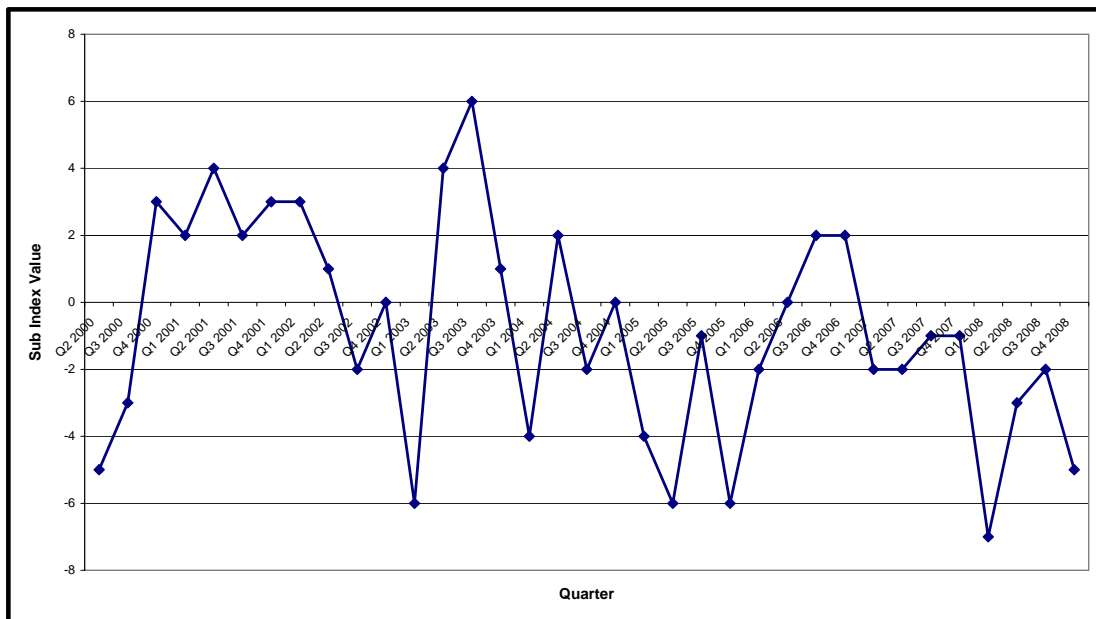
	World Price Index	NZ Dollar Index
Jan 2003	120.2	116.1
Jan 2004	133.3	107.4
Jan 2005	153.1	117.1
Jan 2006	149.6	115.6
Jan 2007	166.2	129.7
Jan 2008	211.7	150.3
Feb 2008	214.0	147.0
Mar 2008	218.3	150.1
Apr 2008	217.7	151.8
May 2008	219.7	155.6
Jun 2008	219.6	158.8
Jul 2008	223.5	163.2
Aug 2008	216.0	166.4
Sep 2008	204.9	164.6
Oct 2008	189.4	165.3
Nov 2008	175.4	162.9
Dec 2008	162.5	153.0
Jan 2009	155.5	146.4

Given that the NZ dollar is likely to drop further, the potential exists for NZ's major exporters to at least remain competitive. Fonterra earlier scaled back its projected payout to farmers for the 2008/09 dairy season from \$7 per kilogram to \$6.60 per kilogram, and then followed this up with a further cut back to \$6.00, announced on 21 November 2008. This has more recently been followed up with a further cut to \$5.10, announced on 28 January. Given the significant decline in world dairy prices, it is possible that further downward revisions will be signaled before the final pay-out is determined although this is unlikely given the scale of the latest revision. It is understood that already there is significant stockpiling of milk products on international markets which simply can't be moved at current prices. This will not be helped by the recent decision of the European Union (EU) to reintroduce export subsidies for their agricultural producers.

**Sub Index 3: Business/consumer confidence indicators**

Business/consumer confidence indicators sit at -5, down 3 on the last quarter and down 4 on a year ago. Both business and consumer confidence indicators continue to decline, despite a number of factors which should have acted to brighten prospects. Reduced interest rates, overall declines in transport costs, continued tax cuts, and a more competitive NZ dollar have not been enough to arrest the slide in business and consumer confidence, with business confidence particularly affected by an overall drop-off in demand for goods and services. What is particularly concerning is businesses' assessment of activity levels going forward which is bleak overall by historical standards. A deteriorating labour market is likely to adversely impact on household expenditure with retailing, hospitality and tourism being particularly subject to a drop-off in activity. For the first time in many years household debt levels have declined marginally as consumers take a more cautious approach to non-essential expenditure.

**Figure 7: Business/consumer confidence sub index**



Despite some pockets of optimism, indicators of both business and consumer confidence continue to be very negative. What is particularly concerning from various business opinion surveys is businesses' own activity expectations.

The NZIER's Quarterly Survey of Business Opinion (QSBO) released on 13 January shows that a net 43 percent of firms reported that they expect a drop in their own activity in the March 2009 quarter, the worst result since at least 1970. The speed of decline, particularly in respect to employment and investment intentions, is alarming to say the least.

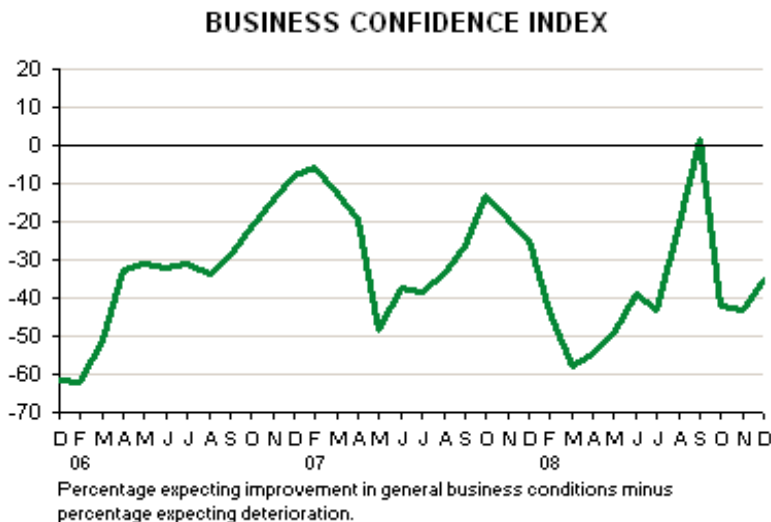
The historically strong correlation between business activity intentions and Gross Domestic Product (GDP) would suggest that there is every likelihood of continuing negative economic growth for much of 2009. On the bright side, as mentioned earlier, it does provide the Reserve Bank with scope to drop interest rates further.

On a seasonally-adjusted basis, the net balance of firms reporting a decrease in their own activity in the December quarter 2008 was 44 percent, compared with a net 32 percent reporting a decline in the previous quarter. The 44 percent was the highest reported decrease since at least March 1970. In simple terms, the demand for goods and services has evaporated which means firms are struggling to move stock irrespective of the price discounting taking place.

In the December 2008 quarter, business capacity utilisation was 88.8 percent, the lowest since June 1999.

The National Bank's Business Outlook (December 2008) similarly shows a negative picture with a net 35 percent of respondents expecting the general economic situation to deteriorate over the coming year while firms' own activity expectations continue to be in the doldrums.

**Figure 8: National Bank Business Confidence Index**



This negativity is pronounced in other areas of business confidence such as the Bank of New Zealand – Business New Zealand's Performance of Manufacturing (PMI) and Performance of Services (PSI) indexes. Both show activity continues to be in decline with new orders falling away but finished stocks in positive territory. This would suggest that companies are having significant difficulties moving stock irrespective of price discounts and this is obviously affecting profitability.

The PMI stood at 42.5 for December 2008 compared with 53.2 a year earlier. The PSI stood at 48.0 for December 2008 compared with 53.9 in December 2007. Both the PMI and PSI have been in negative territory for most of 2008 with the exception of the first quarter of 2008.

Consumers remain pessimistic despite a number of factors which should arguably have impacted positively on consumption. Significant reductions in interest rates, reduced inflationary pressures including a major drop off in petrol prices, and rolling personal tax cuts have not been enough to offset consumer pessimism generated by a relatively bleak employment outlook and associated rises in unemployment.

**Table 6: Westpac McDermott Consumer Confidence Index**

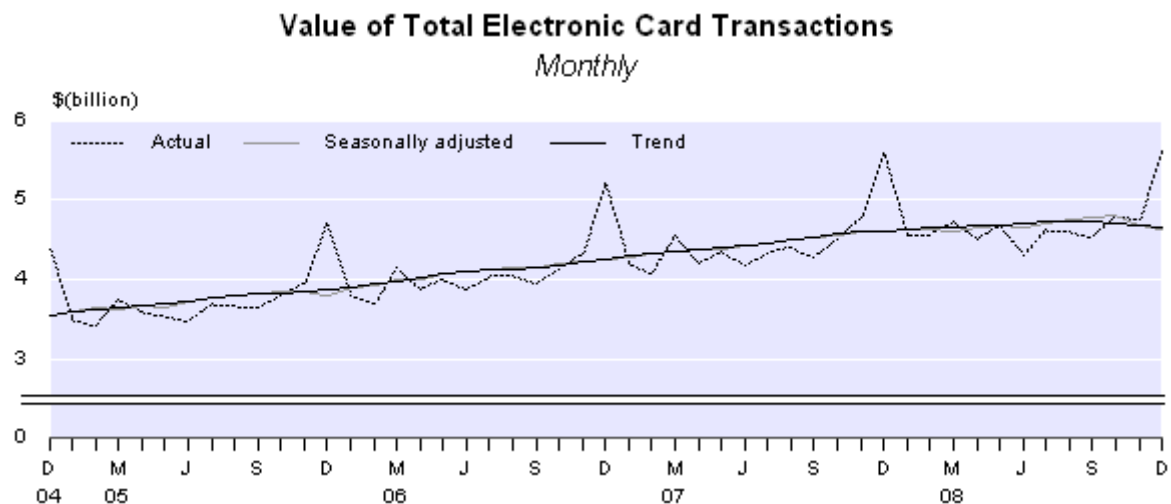
<b>Quarter</b>	<b>Index</b>
Dec 04	130.2
Mar 05	126.7
Jun 05	120.2
Sep 05	120.2
Dec 05	110.1
Mar 06	109.3
Jun 06	106.0
Sep 06	111.7
Dec 06	119.7
Mar 07	117.7
Jun 07	111.4
Sep 07	113.5
Dec 07	110.0
Mar 08	96.5
Jun 08	81.7
Sep 08	104.8
Dec 08	101.3

The Westpac McDermott Miller Consumer Confidence Index fell to 101.3 in December 2008, down 3.5 points on the previous quarter. Despite the positive factors mentioned above, the prospect of a deep global recession in 2009 appears to have overwhelmed consumers, with a fear of significant job cuts and rising unemployment occupying the minds of many consumers at the present time.

This lack of consumer confidence has been reflected in a cut back in consumer spending with both electronic card spending and retail trade basically flat.

Growth rates in the total Electronic Card Transaction (ECT) trend series and the retail ECT trend series have eased since July 2008 and are now both negative. This is in spite of some heavy discounting before Christmas by retailers trying to boost pre-Christmas sales.

**Figure 9: Electronic Card Transactions**



Despite significant reductions in interest rates which are starting to impact to impact on home affordability rates, the build up of household debt is still a major issue for many households.

Household debt, which peaked at 162 percent of household income in the first quarter of 2008, has declined slightly since and is currently hovering at around 159.5. According to the monthly Home Loan Affordability report plunging mortgage rates and another fall in house prices have improved home loan affordability by a record amount in December 2008 to its best level in 4 years.

According to the REINZ Housing Market Report (January 2009), the median house price was \$328,500 in December 2008 compared with \$337,500 in November and \$345,000 for the corresponding period in 2007.

While prices have continued to slide, the big issue facing the housing market is the number of house sales and days taken to sell the average property. Sales have remained low at 4,302 for December 2008, well down on the same period in 2007 (5,597) but marginally up on November sales of 4,279.

Figure 10: House prices and value of housing stock

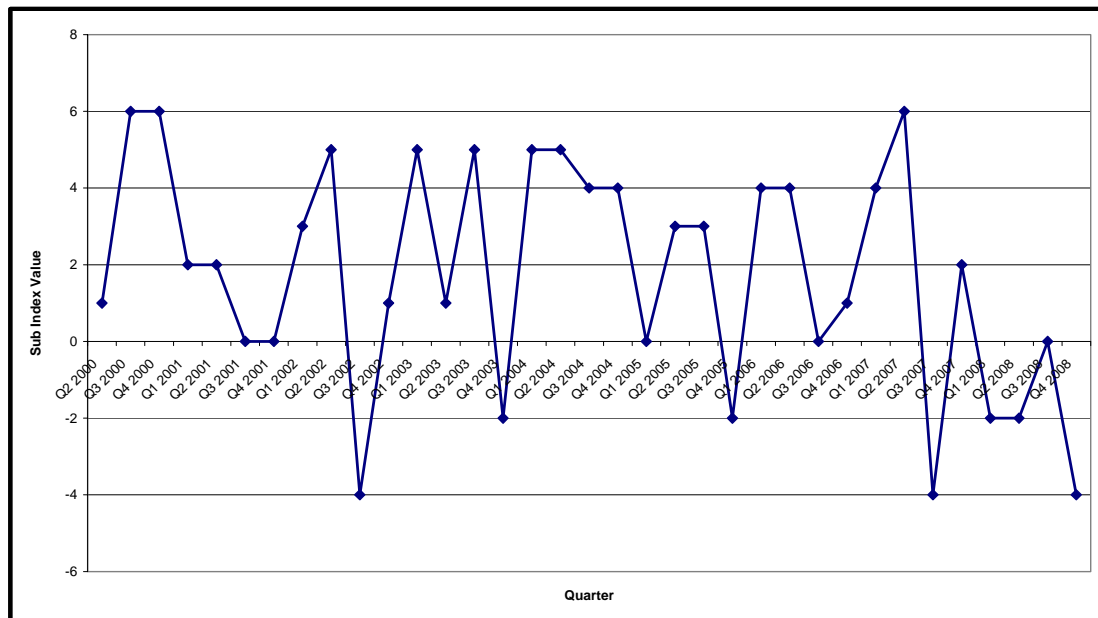


On the positive side, with interest rates falling rapidly, there will be opportunities for investors to enter the market and this will act as a buffer against significant further falls in house prices. Also acting as a buffer will be the fact that building consents have continued to trend down, meaning less housing stock available for purchase at a time when the expectations is for rising net migration as individuals and households return to NZ given the depressing outlook for many developed countries. Perhaps of more fundamental importance to housing prices is that unlike many other countries, New Zealand does not have a surplus of housing stock nor have banks, in general, supplied finance to those unable to service housing debt. This means that forced mortgagee sales are still not having any major effect on the market - yet.

**Sub Index 4: Labour market indicators**

Labour market indicators sit at -4, down 4 on the previous quarter and down 10 on a year ago. They are currently at their equal lowest level since the index began in 2000. After a prolonged period of strong growth in a number of labour market indicators, the tide has turned – suddenly, suggesting that employees are being let go after a significant period of labour hoarding. Most surveyed labour market indicators are now negative with expectations of negative employment growth and rising unemployment forecast over the next two years. Wage pressures are starting to ease while the level of annual net permanent and long-term migration appears to be bottoming out as NZ becomes a more attractive destination given the deep recession in many developed countries.

**Figure 11: Labour market sub index**



After a number of years of strong employment growth and reducing levels of unemployment, the tables have recently turned with expectations of negative employment growth out to 2011 and projections for unemployment to rise to between 6 and 7 percent.

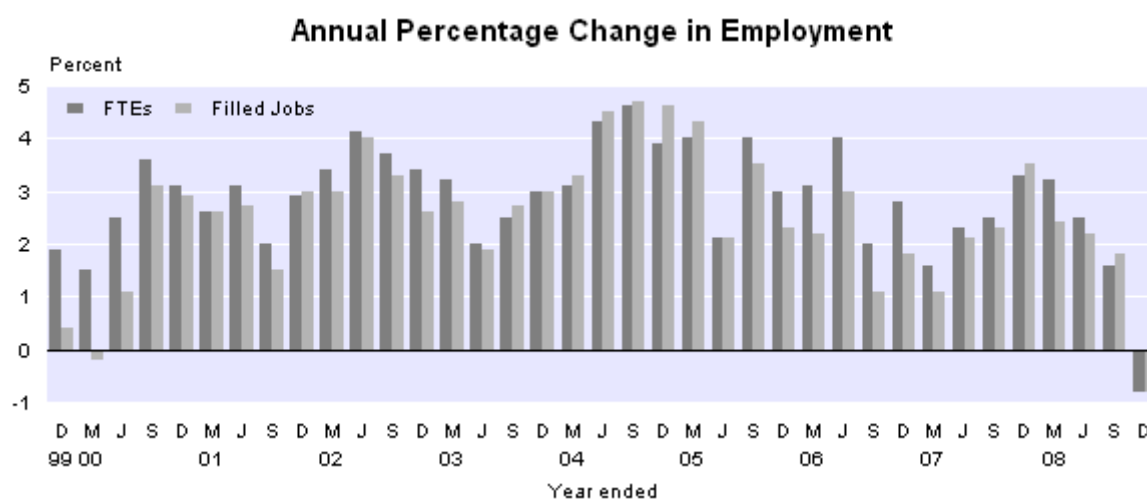
Both official statistics and business opinion surveys now show the labour market in a rather sharp decline after the dizzy heights achieved over the past 5 years.

Statistics NZ's Quarterly Employment Survey (QES) provides evidence of a rather sharp fall in employment for the December quarter 2008.

The QES shows that total paid hours, when seasonally-adjusted, decreased by 1.4 percent in the year to December 2008. This is the first annual decrease in paid hours since the year to September 1999, and was mainly due to decreases in the manufacturing, construction, and wholesale trade industries.

Employment, as measured by full-time equivalent employment (FTEs), decreased by 0.8 percent in the year to December 2008.

**Figure 12: Employment**



The Department of Statistics Household Labour Force Survey (HLFS) for the December quarter 2008 shows that the unemployment rate has risen from 4.2 percent to 4.6 percent. This resulted in the number of unemployed rising by 10,000 over the previous quarter.

Despite the rise in unemployment, the number of people employed actually rose by 21,000 (0.9) over the December 2008 quarter, mostly driven by a rise in male part-time employment. Nevertheless, despite the rise in employment, total actual hours worked per week fell by 1.9 percent over the December 2008 quarter.

Forward looking indicators of likely labour market activity such as the NZIER's Quarterly Survey of Business Opinion (QSBO), and the Department of Labour's (DOL) Job Ads series show that the employment outlook has turned negative at a rather alarming rate.

The NZIER QSBO (January 2009) shows that a net 32% of firms intend to cut staff numbers over the next three months which is the highest rate since June 1991 (when unemployment coincidentally was at a peak of 11 percent).

As would be expected, there has been a notable easing in the difficulty of finding skilled and unskilled staff. A net 20 percent of firms reported that it had become easier to find skilled labour and a net 43 percent that it had become easier to find unskilled labour. These figures are the highest in 17 years.

The Westpac McDermott Miller employment confidence index collapsed in the final quarter of 2008, falling 17.2 points to a new survey low of 104.0. In the four and a half year history of the survey, the index has averaged a solid 128.2, and has never been lower than 120.8 (June 2008 quarter).

The Department of Labour's Job Ad Series shows that the Job Ad Rate (number of Job Ads)/(Number of employed, from the HLFS) continues to decline along with the number of job ads (both newspaper and Internet job ads). While it is important to clearly understand the caveats associated with this data, given that the Job Ad counts are derived from only 7 major regional newspapers across NZ and 4 major websites, the direction of the job ad rates is clearly down.

**Table 7: Job Ads: Seasonally adjusted (quarterly)**

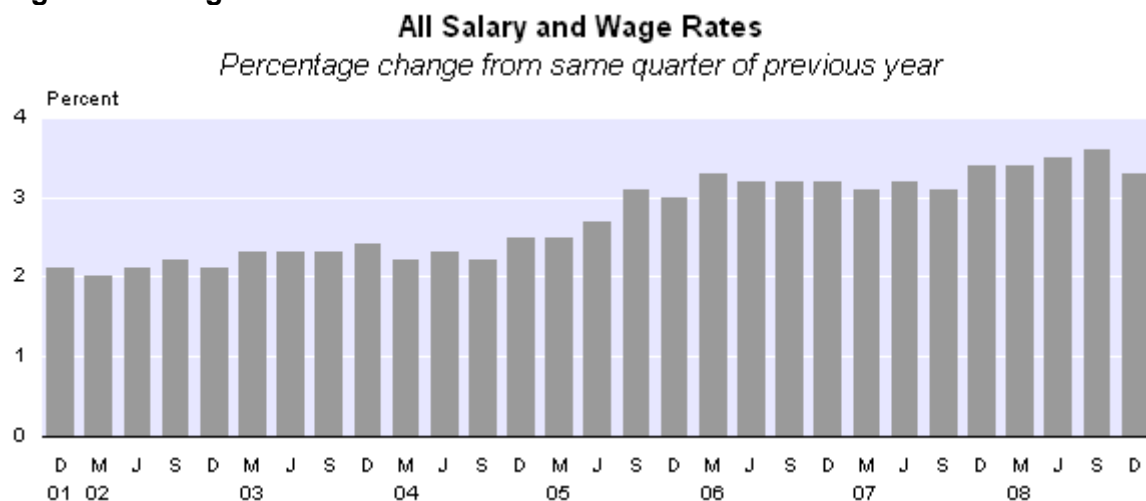
Quarter	Newspaper Job Ad Rate	Internet Job Ad Rate	Total Job Ad Rate
Jun 04	6.15	2.36	8.51
Sep 04	6.23	2.55	8.78
Dec 05	5.99	2.76	8.75
Mar 05	5.60	3.12	8.72
Jun 05	5.65	3.32	8.97
Sep 05	5.30	3.87	9.17
Dec 05	4.97	4.02	8.99
Mar 06	4.85	4.17	9.02
Jun 06	4.63	4.52	9.15
Sep 06	4.56	5.38	9.94
Dec 06	4.91	5.76	10.67
Mar 07	4.70	5.99	10.69
Jun 07	4.64	6.56	11.2
Sep 07	4.52	6.19	10.71
Dec 07	3.85	6.61	10.46
Mar 08	3.66	7.25	10.91
Jun 08	3.11	6.68	9.79
Sep 08	2.47	5.60	8.07
Dec 08	2.2 (est)	5.00 (est)	7.2 (est)

The general pessimism about future labour market conditions is starting to impact on wage and salary rates, although by historical standards wage and salary rates achieved for the December quarter 2008 were still robust, although down substantially on the September 2008 quarter record growth in salary and wage rates.

The Labour Cost Index (LCI) recorded an increase of 0.7 per cent in salary and wage rates (including overtime) for the December 2008 quarter, down from a record 1.1 percent increase in the September 2008 quarter. On an annual basis the LCI showed that salary and wage rates (including overtime) were 3.3 percent higher in the December 2008 quarter than in the December 2007 quarter. This increase is down from a 3.6 percent annual rise for the September 2008 quarter (the largest since the series began in the December 1992 quarter).

The Quarterly Employment Survey (QES) recorded that seasonally-adjusted total gross earnings increased by 4.1 percent in the year to December 2008, but did not increase in the December 2008 quarter. This is the first quarter since June 1999 to show no growth in seasonally-adjusted total gross earnings.

**Figure 13: Wages and Salaries**



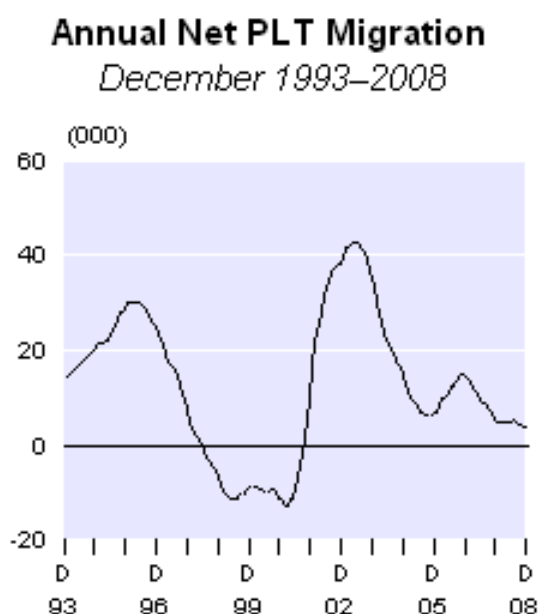
Given the declining labor market outlook, it is likely that restraint will be placed on wage demands as individuals and businesses adjust to tighter economic conditions. This includes elements in the public sector which have tended to lead the drive for increased salaries over recent years.

**Table 8: Labour Cost Index (LCI) Salary and Wage Rates**

Sector	Salary and ordinary time wage rates Percentage change		All salary and wage rates (including overtime) Percentage change	
	From previous quarter	From previous year	From previous quarter	From previous year
All sectors	0.7	3.3	0.7	3.3
Public sector	0.9	3.5	0.9	3.5
Private sector	0.7	3.2	0.7	3.2

Net migration (which is a good leading indicator of general economic activity for the future), has continued to decline and is substantially down on the 11,400 average inflows recorded for the December years from 1990-2008. Net migration was 3,800 in the December 2008 year, down from 5,500 in the December 2007 year. The latest figure is the lowest for any 12-month period since the October 2001 year (1,700).

**Figure 14: Net permanent long-term migration**



A net inflow of 40,900 non-NZ citizens and a net outflow of 37,000 New Zealand citizens were recorded in the year ended December 2008. The majority of the net outflow of NZ citizens was to Australia (35,300) followed by minor net outflows to the United Arab Emirates (600) and Canada (500).

The net outflow to Australia was over 35,000 in the December 2008 year, up from 28,000 in the December 2007 year and higher than previous peaks in the January 1989 year (33,700) and the December 1979 year (33,400). To put this outflow to Australia in perspective, it is equivalent to the Westpac Stadium filled to capacity.

The net outflow to Australia was spread across both age and occupational groups with migrants aged 15-29 years accounting for around 40 percent of the total. Net outflows were recorded in each occupational group, led by trades workers and professionals (each 2,400) and service and sales workers (2,300).

While it is too early to state with any great degree of confidence that the tide is turning, it is likely that net migration may have bottomed out with expectations of rising net inflows over coming months for a number of reasons. The most significant reason being that New Zealand is perhaps better positioned than many countries to weather the current global crisis and with many countries in deep recession there may be added incentives for expat New Zealanders to return home as well as a desire for others to come here in light of our relatively cheap housing, low interest loans and a low exchange rate which may be tempting for some foreigners considering relocating.

## **APPENDIX 1: Background to the economic conditions index**

The Economic Conditions Index tracks 32 indicators on a quarterly basis. The overall index value for any particular quarter represents the net balance of the 32 indicators (generally the number increasing minus the number decreasing) thus providing an overall measure of performance.<sup>2</sup>

For the purpose of this index, if an indicator improves it is given a ranking of 1. If it stays the same it is ranked as a 0 (no change) and if it deteriorates it is given a ranking of -1. For example, if 15 indicators improve, 15 deteriorate and two stay the same, then the overall index would state no change (i.e. 0).

The index backdates data to mid-2000 to provide for a reasonable time series.

The 32 indicators contain official 'hard' data (e.g. employment/unemployment rates) and more qualitative data (e.g. business/consumer opinion surveys).

In general, increases in an indicator are seen as positive (for example, growth in Gross Domestic Product or employment) while declines in an indicator are generally seen as negative. However, this is not universally the case. For example, declines in unemployment are considered to be positive and increases in unemployment negative.

It should be noted that some indicators are difficult to categorize as good or bad, depending on the relative state of the economy (e.g. a rising/declining exchange rate relative to our trading partners). Therefore, certain indicators have not been included in the index, such as exchange rates, while others, such as net permanent and long-term migration, have been included (increases positive, declines negative).

Similar concerns can be expressed in relation to movements in the Consumers Price Index (CPI) where generally speaking, a rising CPI is considered to be negative for the economy while declines or even negative CPI growth for a quarter or so can be considered positive.

Despite this, significant and persistent declines in the general level of prices can have adverse impacts on asset prices and households' general net wealth, so prolonged deflation can be negative on the economy. For this reason a rising CPI is to be considered negative but smaller quarterly rises are seen as positive.

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<sup>2</sup> Note: where monthly data only is available (e.g. Business NZ's PMI and some interest rate measures) it has been averaged over the relevant quarter for consistency.

Declines in the CPI are seen as positive for a quarter as well as positive thereafter, providing the CPI decline is relatively smaller. In most cases this has minimal effect on the overall measure of inflation given that the occasions on which measures of the CPI (tradables/non tradables inflation) have been persistently negative, are infrequent.

As there is a significant time-lag between the end of a quarter and obtaining its official data, the last quarter measured in the index will contain only partially official figures with which to identify changes from the previous quarter. For this reason, where updated figures are not yet available at the time of release, the previous quarter's index value will be generally carried forward (e.g. previous quarter 1, current quarter 1; previous quarter -1, current quarter -1; previous quarter 0 (no change), current quarter 0 with the latest quarter being updated as new information comes to hand.

While the Economic Conditions Index provides a useful measure of overall performance, it is desirable to group indicators into sub indexes so the main drivers of quarterly economic performance can be identified. Four sub-indexes (each with eight indicators) record movements in the following categories:

### ***Sub Index: Economic growth/performance indicators***

- (a) *Gross Domestic Product*
- (b) *Export volumes*
- (c) *Export value*
- (d) *Import volumes*
- (e) *Import value*
- (f) *Current Account balance*
- (g) *NZ's overseas debt*
  - (i) *Corporate sector*
  - (ii) *Official Government debt*

### ***Sub Index: Monetary policy/pricing indicators***

- (a) *Producers Price Index (Inputs)*
- (b) *ANZ Commodity Price Index*
  - (i) *World Price Index*
  - (ii) *NZ \$ Index*
- (c) *Official Cash Rate (OCR)*
- (d) *90-day Bank Bills*
- (e) *Variable first mortgage housing rates*
- (f) *Inflation (CPI)*
  - (i) *Tradable sector inflation*
  - (ii) *Non-tradable sector inflation*

**Sub Index: Business/Consumer Confidence Indicators**

- (a) *New Zealand Institute of Research Quarterly Survey of Business Opinion (QSBO)*
  - (i) *General business situation*
  - (ii) *Businesses own activity*
- (b) *Westpac McDermott Miller Consumer Confidence Index*
- (c) *Business NZ's Performance of Manufacturing Index (PMI)*
- (d) *Business NZ's Performance of Services Index (PSI) - NEW*
- (e) *Retail sales*
- (f) *Building permit issues dwellings*
- (g) *Household debt*
  - (i) *% of disposable income*
  - (ii) *debt servicing as % of disposable income*

**Sub Index: Labour market indicators**

- (a) *Net gain/loss from permanent and long-term migration*
- (b) *Labour force participation rate*
- (c) *Employment*
- (d) *Unemployment rate*
- (e) *Labour Cost Index – salary and wage rates*
- (f) *Level of Job Advertising*
- (g) *Job Ad rates*
- (h) *Work stoppages (person days of work lost)*

**Data Sources:** Business NZ, Statistics New Zealand, Reserve Bank of New Zealand, New Zealand Institute of Economic Research (NZIER), ANZ Bank, Westpac, Department of Labour (DOL).

**APPENDIX 2: Glossary of terms**

**ANZ Commodity Price Index**

Measures the price of a number of commodities. Two indexes are included. The first provides commodity prices in world price terms. The second provides commodity prices in NZ dollar terms.

**Job Ad rates**

Measures the percentage of job advertisements compared to the total number of jobs. A greater number of jobs advertised compared to the total number of employed indicates a higher Job Ad rate (%).

**Level of Job Advertising**

Measures the level of job advertising (seasonally-adjusted) from both newspapers and the internet.

**Building consents issued (dwellings)**

Consents issued by local authorities for the building of residential dwellings.

**BNZ Capital-Business NZ Performance of Manufacturing Index (PMI)**

A monthly index which measures five significant components of manufacturing activity.

**Consumer Price Index (CPI)**

Measures the change in prices of goods and services relating to households.

**Current Account**

The current account balance is the difference between the payments NZ receives from overseas and the payments NZ makes. It includes the balance of merchandise trade, services and investment income.

**Deflation**

A general decline in the price of goods and services.

Disposable income

Total after tax income.

**Employment (HLFS)**

The proportion of the labour force employed.

**Export prices**

Domestic currency export prices.

**Gross Domestic Product (GDP)**

The total market value of goods and services produced in NZ after deducting the cost of goods and services used in the process of production over a given time period.

**Household debt**

Measures the claims on households. Normally measured either as claims as a percentage of nominal disposable income or as debt servicing (interest) costs as a percentage of nominal disposable income.

**Import prices**

Domestic currency import prices.

**Labour Cost Index (*salary and wage rates*)**

The salary and wage rates component of the Labour Cost Index (LCI) measures movements in base salary and ordinary time and overtime wage rates. The LCI has fixed industry and occupational weights and measures changes in salary and wage rates for a fixed quantity and quality of labour input.

**Labour force participation rate**

The percentage of the working age population in the labour force.

**Net gain/loss from permanent and long-term migration**

Measures the net difference between overseas migrants who arrive in New Zealand intending to stay for a period of 12 months (or permanently), plus New Zealand residents returning after an absence of 12 months or more, minus New Zealand residents departing for an intended period of 12 months or more (or permanently), and including overseas visitors departing New Zealand after a stay of 12 months or more.

**NZ Institute of Economic Research's Quarterly Survey of Business Opinion (QSBO)**

A survey of business opinion reflecting the business outlook for the economy as a whole and for firms' actual and intended business activity.

**NZ's Overseas Debt**

Measures corporate and official debt owed overseas. It is a gross figure which includes liabilities only and does not take account of overseas assets held by New Zealanders.

**Nominal Income**

Income without taking account of inflation or other factors which may impact on purchasing power.

**Non-tradables sector inflation**

Inflation for goods and services traded domestically (i.e. goods and services not subject to fluctuations in exchange rates).

**Official Cash Rate (OCR)**

The interest rate the Reserve Bank sets in conducting monetary policy. Commercial banks can borrow cash overnight from the Reserve Bank at an interest rate of 25 basis points above the OCR, and deposit cash at 25 basis points below the OCR.

**Producers Price Index (PPI)**

The PPI outputs index measures changes in prices received by producers. The PPI inputs index measures changes in costs of production excluding labour and depreciation costs.

**Real Income**

Income after taking account of inflation or other factors impacting on the purchasing power of money.

**Retail trade**

Retail trade statistics measure the sales from a wide range of businesses that provide household and personal goods and services. Retailers include supermarkets, bookshops, restaurants, hotel, motels, repairers of household equipment and motor vehicles.

**Seasonal adjustment**

Adjusting a time series to measure and remove the regular seasonal components (e.g. the effect of Christmas on retail sales).

**Tradables sector inflation**

Inflation for goods and services that can be traded on international markets (i.e. those goods and services subject to fluctuations in exchange rates).

**Unemployment rate (HLFS)**

The proportion of the labour force not in work, but actively seeking employment.

**Variable first mortgage housing rate**

Measures the floating cost of borrowing money secured by housing assets as opposed to the fixed rate which measures the cost of borrowing for a specified period of time and does not fluctuate during the length of time the mortgage is on a fixed rate (typically 1-5 years).

**Westpac McDermott Miller Consumer Confidence Index**

Measures consumer responses to a number of questions which reflect consumer confidence levels.

**Work Stoppages (person days of work lost)**

Number of person days of work lost as a result of a strike or lockout.

**90-day bill rate**

Defined as the interest yield on 90-day bank bills. Rates are closely related to movements in the Official Cash Rate (OCR)