

THE NEW ZEALAND ECONOMY

SIX MONTHLY REVIEW

INTRODUCTION

Developments in the economy over the past six months have reaffirmed the indications, apparent early in 1981, of recovery after the moderate recession experienced throughout 1980. Nevertheless this recovery is a fairly gradual one and has been based primarily on private consumption expenditure and some areas of private capital formation, notably residential construction. The impetus to private consumption expenditure has come largely from a recovery in real private disposable income of wage and salary earners over the past year.

The agricultural operating surplus increased by considerably less than the rate of inflation over the March 1981 year and, given the current subdued growth of the world economy, export volume increases are expected to be lower in the coming two years than in the recent past. Profitability in the business sector has improved sharply this year and confidence regarding future prospects, as expressed in the NZIER *Business Opinion Surveys*, has firm.

Investment in residential building finally bottomed out this year after a long and deep recession in the industry which began in the middle of the 1970s. Non-residential building activity, however, continues to be more subdued. Outside of the major investment projects no marked growth is foreseen here for some time. The growing confidence in the prospects of the economy has also been reflected in increasing investment in plant, machinery and transport equipment.

There would appear as yet to have been no favourable effect from this increased activity on the historically high level of unemployment which has altered very little throughout the year. Increased real sales at retail, wholesale and manufacturing levels have been met partly by a run down in stocks and an increase in hours worked, although more recently there has been a pick-up in manufacturing output.

Growth in all the main monetary and credit aggregates has accelerated throughout 1981. This, in conjunction with an expansionary fiscal stance in the 1981 Budget and rising consumer demand, will place pressure on prices which over the past year and a half moved steadily, if slowly, downward.

Growth in real GDP has been estimated to continue at 3-4 per cent over the next two years, although this could ease later in 1982/83. There is a concern that if the current growth is too rapid, supply constraints will quickly check it. This is especially the case in the building industry and is now being recognised in the planning of the major projects.

INTERNAL ECONOMY

Incomes

Official wage rate statistics indicate that pre-tax salary and wage incomes have been rising in real terms since the September quarter of 1980. The Nominal Weekly Wage Rate Index, which measures award rates, rose by 19 per cent in the year to June 1981, representing an effective

rise of 3.3 per cent after adjustment for inflation. Actual wage rates, as shown by the Prevailing Weekly Wage Index, rose over the same period by 19.3 per cent, an effective rise after adjustment for inflation of 3.7 per cent. The 0.3 per cent difference in movement between the two indices represents 'wage drift' resulting from increased above-award payments and higher average skill levels.

The Labour Department's Quarterly Employment Information Survey for May 1981 showed average weekly earnings rising at slightly higher rates. In the twelve months to May 1981 average weekly earnings excluding overtime rose by 22.5 per cent to be \$226.50. Average weekly earnings including overtime rose by 22.4 per cent to be \$242.53. Average ordinary time hours worked per week were down slightly from 37 to 36.9 but overtime hours worked were unchanged at 2 hours per week.

After several years of continuing increases in the volume of agricultural production, a result of increasing stock numbers coupled with favourable weather conditions, the New Zealand Institute of Economic Research (NZIER) forecasts that over the present 1981/82 year the volume of agricultural production will decline by 1.5 per cent. The previously high levels of stock growth have led to higher stocking rates which have placed pressure on the available grazing land and feed. Lambing percentages in the last few seasons have been higher than usual and are now expected to return to more 'normal' levels. Cattle numbers are expected to drop because of an increased percentage of cows in the total slaughterings. Over the past two seasons this percentage has risen from 31 per cent to 36 per cent. As a consequence, the breeding herd is declining. Finally the very favourable weather conditions that have prevailed over the past few seasons can not be expected to continue indefinitely.

It is now accepted that the current international economic recovery is a gradual one and that rises in prices for meat and wool will be more moderate than initially expected. Prices under the Supplementary Minimum Prices Scheme, in response to these conditions, have been set well above market prices for the first time since its introduction in 1978. It is estimated that payments to farmers under the scheme will amount to around \$150 million by the end of March 1982, though this figure is dependent upon world meat and wool prices.

An additional boost to farmers' spending power will come from stabilisation payments made by the Meat Producers Board which over the first six months of 1981/82 amounted to about \$20 million. These payments will help compensate for the decline in the ratio of farmers' output/input prices which would otherwise have occurred this year. In the National Accounting framework, these stabilisation payments are not seen as additions to the Agricultural Operating Surplus as they are merely a distribution of previous years' savings. Nevertheless, the effect on farmers' spending patterns is probably little different than from any other increase in disposable income.

In the manufacturing sector the ratio of profit to sales

(excluding primary food group) increased by 4.9 per cent in the June 1981 year according to the Department of Statistics quarterly manufacturing survey. Although this is still a substantial decline in real terms, this is the first annual rise in this series since December 1979. This result is consistent with the increasing number of respondents reporting increased profits in the *Quarterly Survey of Business Opinion* for June 1981. Both the retail and construction sectors are also becoming more buoyant following long periods of depressed activity.

Consumption

The volume of retail turnover, after having grown by only 1 per cent in 1980 over 1979, has been much stronger in the first six months of this year.

Real retail sales in the June quarter of 1981 were 1.2 per cent higher in seasonally adjusted terms than in the previous quarter, and thus virtually maintained the quarterly growth rate of 1.5 per cent experienced in the March quarter 1981. The initial factors influencing this turnaround were the stimulus to personal disposable income provided by February's income tax cut and the 5 per cent June wage order.

This increased demand has been met in the main by retailers running down stocks. The seasonally adjusted retail stocks/trade ratio has fallen by 2.7 per cent and 2.2 per cent in the March and June quarters respectively. Further, the NZIER's June *Quarterly Survey of Business Opinion* indicates that although retailers are generally optimistic about future levels of demand they still view their stock levels as being too high. The wholesale seasonally adjusted stocks/trade ratio however rose by 1.3 per cent in the June quarter and, as the increasing levels of production flow through, the retail destocking will tend to come to an end.

New car registrations, which rose by 10.6 per cent during 1980, have already risen by 11 per cent in the eight months to August 1981. The annual running total now stands at 87,003 at the end of August. Although the growth in oil company deliveries (as an indicator of petrol consumption) for the first six months of this year has been slow, it has still risen by 1.6 per cent above the corresponding period of 1980.

The annual rate of increase in the hire purchase finance of motor vehicles has, however, fallen off considerably. It rose by only 2.9 per cent in the first six months of 1981 compared with the same period in 1980. This is a substantial decline in real terms. Given the buoyant state of the new car market, this trend is difficult to explain although increasing resort to alternative forms of financing such as leasing or personal loans, is probably one explanation.

Investment

The rise in private sector capital expenditure this year has been led by the turnaround experienced in residential building and the higher rates of investment in plant and machinery, although there has been indications of real growth in non-residential building during the June quarter.

The prolonged recession in the residential building industry which began in the middle of the 1970s seems to have come to an end. The number of building permits issued for new houses and flats — the main indicator of residential building activity — fell from a peak annual rate of almost 40,000 in 1974 to a trough of just over

14,400 in the year to February 1981. This was the lowest annual rate since at least the early 1950s. Since February 1981 the annual running total has increased in each month, to be provisionally estimated at 15,546 at the end of August 1981.

Three factors are central to this turnaround. First, there are the demographic factors. Although the natural increase in the population has been falling since the early 1970s, the effect of this on the population aged 15 years and over, where new demand would be generated, has been small. Of more importance has been the fall in permanent and long-term emigration from an annual peak of over 40,000 in 1979 to a level of between 23,000 and 25,000 over the first six months of this year. It now appears possible that the downward trend may have resumed for the provisionally estimated monthly rates of outflow for July and August, after adjustment for seasonal factors, were substantially less than those experienced over the first half of 1981.

Secondly, over the last year there has been a marked acceleration in existing house prices (and to a lesser extent section prices). The Department of Statistics Urban House Property Price Index showed a 13.1 per cent increase in the price of houses sold in the six months to June 1981. This compares with a 6.6 per cent six monthly increase in December 1980 and yields an annual increase of 20.6 per cent. The rate is substantially greater than those experienced in recent years. Section prices have increased by 5.2 per cent in the six months to June 1981 compared with 3.4 per cent in the six months to December 1980.

Building costs have also been rising very rapidly for some time. The Building Industry Advisory Council's building cost index has shown annual rates of increase of around 20 per cent since March 1980. Nevertheless, the relative price advantage which existing houses enjoyed is being reduced.

Thirdly, easy monetary conditions are, at the very least, an accommodating factor behind any upturn in property markets — for example, the real estate boom of 1973/74 was accompanied by rapid monetary expansion. As will be discussed in the section on monetary conditions, the current increase in property prices and building activity are being accompanied by a reacceleration in monetary aggregate growth rates, in particular that of private sector credit.

Trends in non-residential building activity are difficult to analyse because of the lumpiness of the units involved. As a result, the series tends to fluctuate widely in value terms whilst the number of permits issued of itself says nothing about the quality of the investment undertaken. A further hinderance is the current lack of an appropriate deflator to remove price effects. There are nevertheless some indications that non-residential construction may have begun to steady in the June quarter 1981 after declining throughout the previous year.

Although the number of permits issued for new non-residential building in the June quarter 1981 was 89.7 per cent less than in the same quarter of 1980, the rise over the March quarter 1981 was a strong 15.5 per cent.

Using the Commercial Building sub-group of the Capital Expenditure Index as a proxy for non-residential building price movements and applying it as a deflator to the value of permits issued, yields a real annual rate of increase in the June quarter of 6.3 per cent after having fallen in the December quarter of 1980 and the March quarter of 1981 by 27.5 and 19.4 per cent respectively. Nevertheless, outside of the major projects, growth in

this sector is expected to be relatively subdued into 1982/83.

Investment in plant and machinery has risen strongly throughout 1981 after having declined in real terms during 1980. Surveyed import orders for plant, machinery and electrical equipment have risen by 25.2 per cent in the seven months to July 1981 over the corresponding period last year. Actual imports rose by 18 per cent in the June quarter, substantially up on the 5.6 per cent and 2.9 per cent annual rates of growth experienced in the December 1980 and the March 1981 quarters respectively.

Consistent with this trend, wholesale trade in machinery rose by 19.5 per cent in the six months to June 1981 compared with the same period in 1980. The quarterly total of hire purchase finance of plant and machinery, which has shown annual rate of decline since March 1980, is now falling at a markedly slower rate and would appear to be bottoming out. The manufacturing sector has also experienced a strong boost in investment in recent months. Gross capital expenditure as shown in the Department of Statistics quarterly manufacturing survey was 39.5 per cent higher in the June quarter 1981 than a year previously.

Production

Manufacturing production is beginning to respond to the generally more optimistic assessment of potential activity levels adopted by the business community as revealed in the *Quarterly Surveys of Business Opinion*. Manufacturing sales, as shown by the Department of Statistics quarterly manufacturing survey, rose by 22.7 per cent in the June quarter 1981 over the June quarter 1980 (excluding the primary food group). This is a markedly higher rate of increase than experienced over the past year. After adjustment for price increases, as shown in the Producers Price Index, it shows a real annual increase of 4.8 per cent, the first real increase since 1979. The highest rates of real increase were experienced in the other manufacturing, fabricated metal, and textiles and clothing sub-groups of 12.8 per cent, 11 per cent and 6.4 per cent respectively.

The initial response has been to run down stocks and increase the number of hours worked to service this higher demand rather than to hire more labour. In the June quarter 1981 the ratio of stocks of finished goods to sales fell by 6.6 per cent over the same quarter last year while the ratio of stocks of materials to value of output fell by 11.4 per cent. Although the number of hours worked declined by 1.1 per cent in the June quarter 1981 compared to the June quarter 1980, this was substantially less than the rates of decline experienced in the previous three quarters.

Significantly, the volume of production index which is derived by applying to production in each industry group the corresponding Producers Price Index deflator showed an annual rate of increase of 4.7 per cent in the June quarter after having declined for the previous four quarters. As a consequence of this general improvement in activity, the ratio of profit to sales also showed a positive annual rate of increase of 4.9 per cent in the June quarter 1981 for the first time since 1979.

The Government Sector

Government expenditure and receipts for 1980/81 were \$9,133 million and \$7,609 million respectively. The resulting deficit of \$1,525 million (about 6.3 per cent of

GDP) was 48.5 per cent greater than the 1979/80 deficit of \$1,027 million. The principal cause of this was the lower rate of revenue growth, and especially of direct taxation, which grew by only 18.5 per cent. The rate of growth of central government expenditure was about 20 per cent. This was nevertheless a fall in real terms as the deflator used to convert government expenditure to real terms rose more strongly than this. The NZIER, for example, estimated that public sector real activity fell by about 1 per cent in 1980/81. This is partly verified by the average hours worked in the government sector as measured by the quarterly survey where ordinary time worked per week remained the same in the May quarter 1981 as in the May quarter 1980, at 37.7 hours, but overtime fell from 1.7 to 1.6 hours per week.

Transfers to persons, however, grew by 23 per cent, which was faster than the average rate of inflation over the March 1981 year of 16.5 per cent.

Government expenditure and revenue for the 1981/82 financial year are budgeted as \$10,917 million (an increase of 19.5 per cent) and \$8,827 million (up 16 per cent) respectively. The estimated deficit before borrowing at \$2,090 million represents 7.4 per cent of GDP. This will provide some stimulus to real activity, coming mainly from the government's capital works programme; principally the special projects associated with the energy and liquid fuels development, and also from the Supplementary Minimum Price Scheme.¹ Expenditure on 'Development of Industry' is budgeted to increase by 35 per cent in 1981/82 and transport and communication by 31 per cent. These are the only items budgeted (apart from the departmental service charges) to show real growth above the 18 per cent rise in public sector wage payments implied by the Budget Estimates.

The August 1981 *Bulletin* has already discussed the expansionary effect of the budget utilising the 'cyclically neutral balance' concept. It was shown that this year's budget will be significantly more expansionary than in the last two years and warned that the coincidence of this with generally increased activity could serve to worsen the balance of payments and inflation situations in 1982.

THE LABOUR MARKET

Employment

Although the economy has recently experienced higher activity levels, there have been as yet no flow through effects to the labour market. The number of registered unemployed has declined from 49,854 in December 1980 to 47,596 in August this year and this would appear to be even more favourable movement given that seasonal factors normally diminish job opportunities in the winter months. There is, however, a degree of trade-off between this group and those enrolled on assisted employment programmes. The number in this latter group, after having fallen to 15,750 in March with the suspension of the Summer Student Employment Programme, has risen steeply to total 24,201 at the end of August. The rise in the total of these two series is greater than can be explained by seasonal movements in the supply of and demand for labour.

1. Payments under SMPs are initially by producer boards through Stabilization Accounts held at the Reserve Bank. The Boards will be reimbursed at the end of their respective production and financial years, that is in 1982/83. The cost of this year's payouts will not show until the 1982/83 Budget although the monetary effect is equivalent to a direct government payout during the current March 1982 year.

That our unemployment is very much a structural problem and not simply a result of a lack of aggregate demand is apparent from the fact that those registered for thirteen or more weeks represent approximately one-third of the total. The monthly total for August of 15,509 did fall marginally on the total for July, the first fall in nine months. However, figures for one month cannot be interpreted as indicative of a trend.

Monetary Conditions

Throughout 1981 the main monetary and credit aggregates have all recorded strong rates of growth. The narrowly defined monetary aggregate, M1, is considered to be more closely related to the level of aggregate expenditure than the broader M3 (the money supply and selected liquid assets of the public). M1 has recently been growing at rates well in excess of those recorded over most of the last two years. For the March and June quarters of 1981 the annual rate of increase was 14.2 and 14.8 per cent respectively over the corresponding quarters of 1980.

After slowing to 12.5 per cent over the year to December 1980, the M3 money supply aggregate growth rate has risen again and is estimated to have been 15.9 per cent at the end of June which put it marginally higher than the Consumer Price Index inflation rate for the first time in over a year. By the end of August 1981 the estimated annual growth rate was 17.6 per cent.

Concern has been expressed at the strong growth of lending to the private sector, well in advance of deposit growth rates. At the end of July 1981 total private sector credit extended by M3 institutions was estimated to be 26 per cent higher than the level a year previously. This compares with a rate of growth in deposits of these institutions of only 17.3 per cent over the same period. Within the total, trading bank lending has been increasing at an annual rate of well over 25 per cent since June while the level of reserves compared with levels a year previously has remained largely stable through much of this year. Savings bank lending has also been growing rapidly (20.3 per cent in the year to March), although some of this increase is due to Post Office lending growing from a low base. Lending by the trustee savings banks grew by around 22 per cent in the year to June whilst finance company lending continues to grow at an annual rate of over 30 per cent.

Institutions have had to compete strongly for deposits in order to try and sustain these lending growth rates. It is this growth in competition for deposits which is largely instrumental in causing the current rise in interest rates. For example, average rates on trading bank transferable certificates of deposit (TCDs) for terms of up to six months ranged from 12.25 to 13.7 per cent in December 1980. The range, although fluctuating, has risen to now stand at between 12.75 and 15.3 per cent for August 1981. Longer term rates (which are usually more influenced by expectations of prices and profits) have also risen with, for example, the range of trading bank deposit rates for between one and two years having risen from 11.5—13.6 per cent in December 1980 to 13—15.3 per cent in August 1981. Lending rates have also continue to edge upwards.

In order to encourage a downward movement in short-term interest rates the Reserve Bank undertook open market operations in the mid year which had some initial success. This success was not sustained into July, however, mainly because of the strong competitive ele-

ment in the demand for deposits, particularly large deposits. By the end of July, short-term interest rates had returned to their levels prior to the interest rate policy initiatives. More recently the Government has strongly restated its view that interest rates should decline and some initial response has been evident in the downward movement of many institutional rates.

Inflation

The three principal factors behind the decline in the rate of inflation are the fall in real activity experienced throughout 1980; the more moderate external price effects and fewer increases in indirect tax rates. Nevertheless, there is a possibility that the rate of inflation will pick up again next year. An important influence will be the expanding money supply discussed above. Additionally the current resurgence in activity levels will place a strain on some resources and input prices.

This strain is already evident in the building industry. The sale value of existing houses as measured by the Department of Statistics Urban House Property Price Index rose by 20.6 per cent in the year to June 1981. In the year to June 1980 the rise in the index was only 7.7 per cent. Similarly section prices as measured by the same index rose by 8.8 per cent in the year to June 1981 after falling by 1.1 per cent over the previous June year. The rural real estate market was also extremely buoyant during the June year of 1981 with the Valuation Department's Farmland Price Index rising by 30.5 per cent over the year. The highest price rises were recorded for grazing farms (43.2 per cent) and dairy farms (35.1 per cent).

The Building Industry Advisory Council building cost index relating to the cost of building a new house rose at an annual rate of 20.1 per cent in the June quarter 1981 maintaining similar rates of cost increases experienced during 1980. In spite of a slowing in the rate of increase in the cost of building materials as measured by the Producers Price Index and Construction Sector, which rose by 18.8 per cent in the year to June, the higher rate of increase in the composite index was due to marked increases in plant and transport costs and some increased labour costs.

EXTERNAL SECTOR

In the twelve months to August 1981 there was a substantial deterioration in the current account deficit, which increased from \$543 million in the year ended August 1980 to \$730 million. The \$187 million increase from the previous year is primarily the result of a widening of the invisibles deficit.

Export receipts totalled \$6,245 million over the year and have exhibited fairly stable growth throughout 1981 in the range of 18-21 per cent. Exports of milk powder and cheese grew particularly strongly with increases of 56 per cent and 52 per cent respectively. However, the largest export groups are meat (\$1,744.9 million) and manufactures (\$1,068.8 million) and both these groups also grew strongly by 28 per cent and 23 per cent respectively. Manufactured exports over the past year have overtaken wool as our second largest export earner following falling wool prices in the 1980/81 year (receipts from wool exports only grew by 1.8 per cent).

Growth in import payments tended to fall slightly over the year to August 1981 rising by only 20 per cent to

\$5,470 million. The resulting trade surplus rose from \$784 million in the year to August 1980 to \$955 million. Invisible payments and receipts both grew at a rate of about 26 per cent but because of the much higher payments base the invisibles deficit still widened from \$1,328 million to \$1,684 million.

The official capital account (including IMF transactions) showed an inflow of \$818 million for the year ended August 1981, up significantly from the inflow of \$190 million in the previous year. The main factor in this was reduced government debt repayments (down from \$420 million to \$99 million). The private capital inflow was down on the previous year (\$64 million compared to \$135 million) giving a total net capital inflow of \$881 million (\$326 million in the previous year). Official overseas reserves rose by \$84 million over the year.

The NZIER estimates that import volumes in the year to March 1982 will be 8 per cent higher than in the previous year. Some of the main factors contributing to this are the need to service expanding domestic activity, the import of three Boeing 747 aircraft and the import content of the major projects. Export volumes during the year are expected to increase by 6 per cent. Faster growth in domestic activity is however expected to lead to slower growth in the volume of manufactured exports and the large increase in housebuilding could affect forestry exports. The terms of trade for the June year 1981 were estimated to have fallen to below the level that prevailed in 1976. For 1982, however the NZIER sees a slower rate of growth in the world price of manufactured goods and a stronger price growth for primary commodities reversing this trend and leading to some improvement in the terms of trade.

CONCLUSION

The growth in the economy now underway should continue into next year but could level off in the latter part of 1982/83. This assumes that the expansionary monetary and fiscal conditions which currently prevail will moderate to some extent during the course of next year. Real incomes are expected to level off over the year ahead. In part this is the effect of automatic stabilising mechanisms, notably fiscal drag, which in the absence of offsetting policy measures, will tend to constrain the growth of real disposable incomes.

This suggests that the present pick-up in real consumption expenditure may not be sustained throughout the year. Also, the favourable agricultural export conditions over the past few seasons cannot be expected to continue to contribute to real economic growth at the previous levels, particularly if the international recovery in activity remains sluggish. Indeed, the combination of likely export and import volume changes and the assumption of a relatively flat terms of trade could lead to a further widening of the overseas exchange transactions current account deficit over the next year or two. It would appear therefore that the major factor which should underpin economic activity next year is likely to be a continued expansion in investment.

On the other hand, the twin problems of a persistent external deficit and an unfavourable rate of inflation, are likely to constrain the level of domestic activity and thus inhibit any early resolution of the serious unemployment problem New Zealand now faces. This emphasises the need to adopt an integrated medium-term approach to resolving New Zealand's economic problems.