Reserve Bank Bulletin

QUARTERLY REVIEW OF THE NEW ZEALAND ECONOMY

There are now clear indications that the economy has moved into a recessionary stage. Real GDP declined for the two consecutive quarters in the second half of 1985. This review was prepared with the latest official data available. Readers should note that official national income statistics are produced with a lag of around three to four months.

Introduction

There is clear evidence that the economy is now in the initial phase of a recession. Economic activity as measured by the Statistics Department's estimate of Real Gross Domestic Product (GDP) declined by two consecutive quarters in the second half of 1985; forward indicators of investment are generally pointing downwards and unemployment has started to increase again after a pause at the beginning of the year. The recession is also reflected in the general level of business confidence. The New Zealand Institute of Economic Research's (NZIER) March quarterly survey of business opinion found that a net 63 per cent of respondents were strongly pessimistic about the general business outlook.

Perhaps the most notable aspect of the downturn is that it has not impacted evenly on the economy. The services sector, for example, increased its output relatively strongly over the December quarter and the NZIER survey suggests that both activity and employment in the services sector will continue to hold up throughout this year. Activity in the construction industry also continued to increase strongly through to the end of 1985 reflecting business and dwelling investment decisions which were made earlier in the year.

Business investment indicators are mostly pointing downwards, although there are some notable exceptions such as investment in the tourist sector and in commercial building in the main centres. Continuing high nominal interest rates are likely to cause a sharp contraction in the output of the housing industry.

There has also been a clear difference in the experience between the major metropolitan areas, particularly Auckland and Wellington, and the rural areas and associated servicing towns. As yet the signs of a downturn in the larger cities are somewhat ambiguous, but the problems of the farming sector have clearly started to feed through to the rural economy. Low product prices for most major commodities in overseas markets, a pessimistic outlook for the future and a relatively strong New Zealand dollar have meant that farm incomes, investment and current expenditures have been sharply reduced. Expenditure and investment indicators such as fertilizer and tractor sales and the value of farm building permits issued have all fallen sharply. The effect of the fall off in farm expenditures on the farm-related service industries is now being reflected in regional unemployment statistics and much sharper unemployment increases have been recorded in the provincial/rural areas than in the major urban areas.

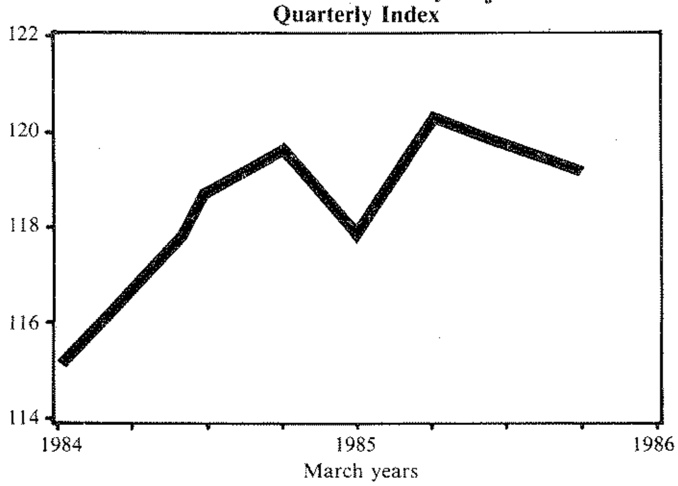
The strength of the New Zealand dollar and the rapid increase in wage rates has also affected the competitiveness of the manufacturing export sector. Nevertheless, exporters have generally maintained their markets, although they have had to accept lower returns to do so.

While the weight of evidence seems to point to a further contraction in the economy there are a number of factors which are likely to limit the extent of the downturn. In the short-term at least, the recent wage round has stimulated consumption, and as has already been noted the prospects appear good for much of the urban services sector and the tourist industry.

Output

Real GDP (seasonally adjusted) fell 0.6 per cent in the December quarter, following a fall of 0.4 per cent in the September quarter. The late start to the meat killing season was largely responsible for a 3.3 per cent decline in the output of the manufacturing group and probably accounted for about half the decline in the GDP figure for December. In the construction sector a 2.8 per cent expansion in output was recorded compared to rises of 3.9 and 7.3 per cent in the previous two quarters. The service sector also experienced a significant increase, of 2.2 per cent, in the December quarter while falls occurred in the trade, restaurants and hotels group and in government services.

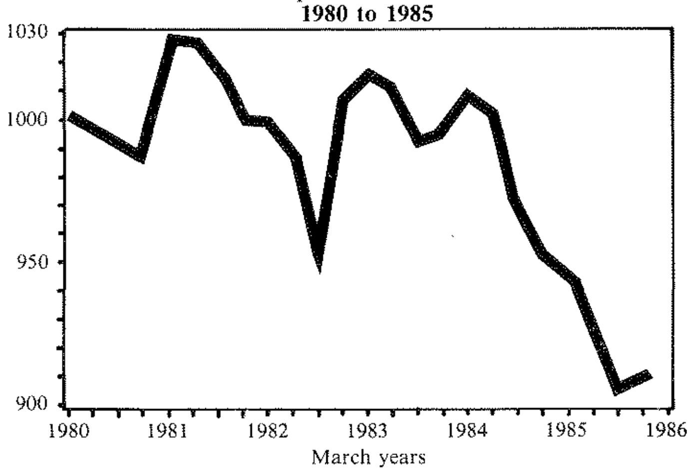
G.D.P. Annual Seasonally Adjusted Quarterly Index



Incomes

After a year and a half of decreases in real average after-tax wage and salary incomes, there was an increase of 0.4 per cent in the last quarter of 1985 as the increases from the wage round began to feed through into pay packets. The rise resulted from a 3.5 per cent increase in average gross incomes, offset by a 2.3 per cent increase in the Consumers Price Index and a 1.8 per cent increase in average tax rates. Nevertheless, the December real post-tax rise followed falls of 2.3 per cent, 2 per cent and 0.8 per cent in the September, June and March quarters respectively, and for the calendar year as a whole real disposable salary and wage incomes fell by 4.6 per cent.

Real Disposable Income Index 1980 to 1985

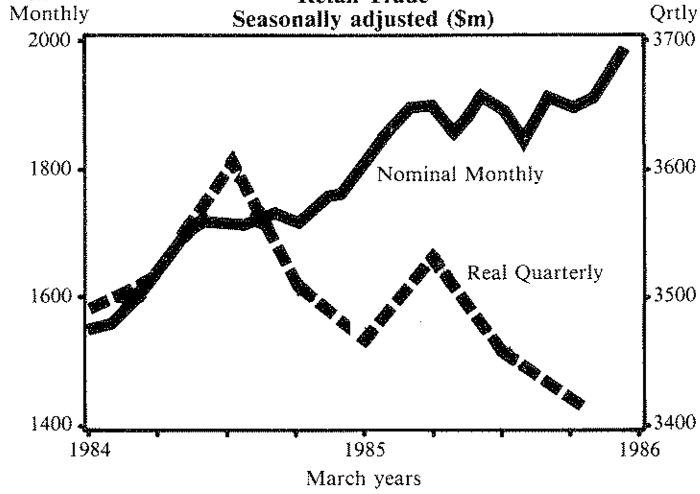


The reduction of inflation in the early half of 1986, coupled with the full impact of recent high wage settlements, implies that real disposable incomes are likely to increase over the March and June quarters of 1986.

Consumption

The downturn in consumption expenditure experienced in the September quarter of 1985 continued into the last quarter of 1985. Real seasonally adjusted retail turnover fell by 1.3 per cent in the December quarter following a fall of 2 per cent in September. Against this trend, retail trade rose in January and again in February by 1 per cent and 3.2 per cent respectively. If the turnover from the automotive group is excluded from these figures retail trade fell by 1.3 per cent in January, but jumped by 4.9 per cent in February. This bubble in expenditure coincided with an increase in real disposable income of wage and salary earners related to the December wage round. The time taken to calculate back pays meant that many of the December quarter settlements did not affect payments until well into the March quarter.

Retail Trade Seasonally adjusted ($m)



Stocks

As there has been a widespread expectation of a downturn, manufacturers and retailers adopted a cautious attitude to stock management which appears to have prevented a stock build up in the December quarter of 1985. The sharp reduction in the rate of the build up of manufacturing stock levels signalled in the September quarter (when the quarterly increase was only 0.5 per cent after a 5.4 per cent rise in June) continued in the December quarter when stocks fell by 0.9 per cent. This was the first fall in the nominal value of finished goods and material stocks since December 1983.

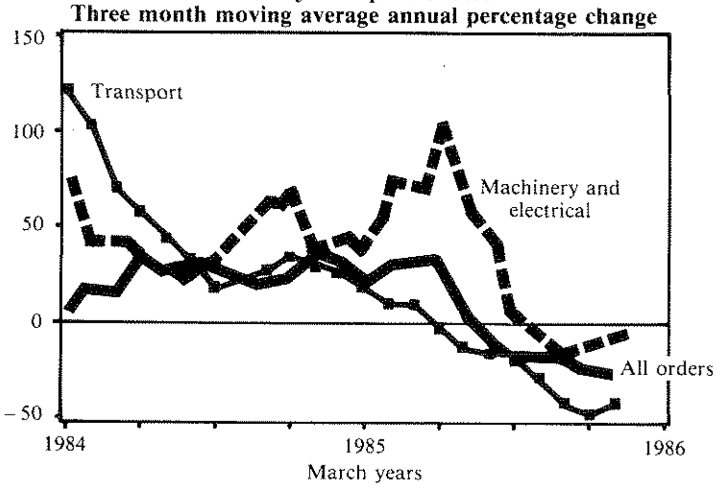
There has been a similar pattern in the movement in the nominal value of retail stocks. After increases of 4.1 and 5.8 per cent in the September and June quarters respectively there was a fall of 0.3 per cent in December. This stemmed the rise in the stocks to sales ratio which had been increasing steadily for some time, and which accelerated over the September quarter.

Investment

The expected weakening in both business and housing investment is now beginning to show in many of the official statistics. For example, the pessimistic outlook evident in NZIER's March survey of business opinion with respect to investment in buildings, was reflected in a 10.2 per cent (seasonally adjusted) December quarter fall in the nominal value of permits issued for buildings (other than dwellings). In January, however, the value of permits issued was up over 100 per cent on the previous year's level. The actual number of permits issued fell, which suggests that the figures may have been distorted by a few large projects. Nevertheless, it is still difficult to obtain a clear picture of the likely trend in investment from this data source.

Stronger evidence of a prospective slowdown in investment is evident in surveyed import orders for machinery and electrical equipment and transport goods. While fluctuations in the value of the New Zealand dollar make it difficult to interpret the data with any degree of precision, the general trend seems clear. The annual percentage change in the three monthly running total of surveyed import orders for machinery and electrical equipment has been negative in the five months since September 1985, and orders of transport goods in the three months ended January 1986 were 42 per cent down on the same period the year before.

Surveyed Import Orders
Three month moving average annual percentage change



It is much clearer that a slowdown in investment in housing is in prospect. The number of building permits issued has fallen (in seasonally adjusted terms), in every month, with the exception of January since July and by nearly 40 per cent from the peak levels of mid-1985. The availability of large amounts of Housing Corporation and Post Office finance at below market interest rates buoyed the market in the middle of last year, but it is now clear that high interest rates are beginning to have a significant effect. Permits declined by 9.2 per cent in February and by a further 7.7 per cent in March. The value of work put in place is not yet reflecting the downturn in permits as there is approximately a six month lag between permits and building activity. However, the decline is being reflected in the number of housing starts which fell by 6 per cent in the December quarter compared to the September quarter. The downturn has not affected the alterations and additions section of the market which has been steady over the last year. The imminent introduction of GST should sustain activity in this area over the period until October. However, as alterations and additions constitute only about one-fifth of the market this temporary boost is unlikely to offset the expected downturn in the new house market.

Employment

Data available for late 1985 suggests that the slowdown in economic activity is starting to have an effect on employment growth. The Labour Department's quarterly survey of employment in November found that total employment was 2.2 per cent above the level a year earlier, but was down 0.1 per cent on the seasonally adjusted August total. Earlier, surveyed employment had risen by 0.8 per cent in the three months to May and by 0.1 per cent in the three months to August. In part the apparent weakness in the labour market in November may be explained by the late start of the meat killing season.

A feature of the labour market has been the strong growth in part time workers. These increased by 7.2 per cent over the year to November 1985 following a 5.3 per cent increase in the previous year. While this growth is occurring across all sectors, it has been most noticeable in the retail and hotel and restaurants sectors.

The disruption to the meat killing season has also affected the registered unemployment data making it difficult to discern any clear trend. After rising quite sharply in October and November there was a fall in seasonally adjusted unemployment in January and February. In March, however, a 2.4 per cent increase was recorded which may be the start of an upward trend.

Unemployment figures provide the most up to date information on the regional impact of the economic slowdown in the economy. While no clear urban/rural split is available, a subdivision between major urban areas and provincial towns suggests the provincial/rural economy is being harder hit than major metropolitan areas. While total registered unemployment is now only about 10 per cent above the low point that was reached in mid-1985, the latter group have experienced an increase in unemployment of only 7 per cent whereas unemployment has risen by over 25 per cent in the provincial/rural group.

The Statistics Department have just released, for the December quarter, the first results of what will be a regularly quarterly household survey of the labour force. The survey provides details of the size and characteristics of the labour force and perhaps more importantly gives the first timely and regular measure of unemployment on an internationally comparable basis. The Household Labour Force Survey (HLFS) figures are conceptually a better measure of unemployment than the number of registered unemployed because they provide an estimate of the number of persons who were without work and were actively seeking employment rather than simply those registered as unemployed. The latter tends to exclude the unemployed who have no incentive to register either because they are not eligible for the unemployment benefit or who believe that their spell of unemployment is likely to be of a relatively short duration. Accordingly, it is somewhat surprising that the total HLFS unemployment figure in December was not significantly larger than the number of registered unemployed for the December quarter 1985 and that the full-time unemployment figure (which is more directly comparable) was actually lower. The

HLFS estimated that 40,200 were seeking full-time employment and were therefore eligible for the unemployment benefit compared with 51,433 persons who were actually registered.

There are a number of possible reasons for the low full-time HLFS figure:

— The HLFS does not count as unemployed those with part-time work (one hour a week or more) who are seeking full-time work. There were 10,400 in this category.

— The HLFS also does not count as unemployed those who are not making an effort to seek employment. It is possible that a proportion of those who register in order to obtain the unemployment benefit are not genuinely seeking work. There will also be a proportion who are in paid work and who are defrauding the Social Welfare Department.

— The HLFS could have underestimated the true level of unemployment by up to 5,000 because of sampling error.

— There may be some tendency for surveyed unemployment to be under reported because of the social stigma attached to unemployment. The financial incentive to register would tend to lessen this effect on the registered unemployment data.

Although it is impossible to precisely measure the 'true' level of unemployment, it seems to be clear from table 1 that the level in New Zealand is a good deal lower than that of most other western economies. This seems to suggest that the New Zealand labour market may be relatively flexible on an internationally comparative basis. One element of that flexibility which seems to have played a significant role in holding unemployment is the willingness of workers to migrate to improve their economic welfare. The net outflow of permanent and long-term migrants, two-thirds of whom are active members of the workforce increased from 6,524 in the year to February 1985 to 20,826 in the year to February 1986 and now seems to have stabilised at about this level.

TABLE 1
INTERNATIONAL COMPARISON OF RATES OF UNEMPLOYMENT

	1985 Unemployment Rate %
New Zealand	3.8[1]
Australia	8.1*
United States	7.1*
Japan	2.6*
United Kingdom	13.2*
Germany	8.8*

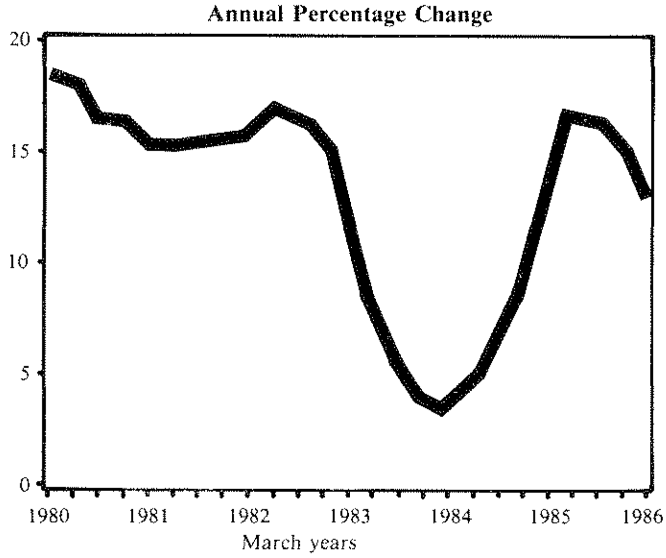
1 December Quarter 1985.
* September Quarter 1985.

Prices

The Consumer Price Index (CPI) increased by 2.3 per cent over the March quarter of 1986. This third consecutive quarterly increase below 3 per cent (2.8, 2.3 and 2.3 per cent) has added to the annual decline in the CPI. After a peaking at 16.6 per cent in the June quarter of 1986 the annual inflation rate has now fallen to 13 per cent. A similar quarterly increase for the forthcoming June quarter would return inflation close to a single figure level for the first time since the third quarter of 1973 (excluding the wage and price freeze period of the early 1980s). The Food Price Index has already moved into this region with a 9.6 per cent annual increase for the year ended March 1986. This index showed a 0.7 per cent increase for the month of March after increases of 1.1 per cent in February and 1.9 per cent in January. The higher increases were due in part to reduced supplies of fresh fruit and vegetables associated with unfavourable climatic conditions.

The March quarter increase in the CPI was perhaps a little higher than might be expected given the effect of the strong New Zealand dollar on import prices. The Producer Price Index, which is often a good forward indicator of changes in the CPI, increased by only 0.6 per cent in the December quarter. The continued flow through of higher mortgage servicing costs, which was responsible for one third of the March quarter CPI increase, is the principal reason for the higher rate of increase in the CPI. Although mortgage interest rates seem to be at their peak, the lags involved in data collections might mean that mortgage interest rates will continue to place some upward pressure on the index for the next one or two quarters. Looking further forward the process will start to reverse itself, with stable or near stable house prices, and falling interest exerting downward pressure on the index.

Consumers Price Index
Annual Percentage Change



Conclusion

The downturn is now clearly evident. So far the fall in the aggregate level of economic activity has not been pronounced, although it is likely that a further decline is in prospect before the economy bottoms out. The aggregate measures of economic activity, however, have tended to obscure quite different experiences between different sectors of the economy and between different geographical localities. Much of the farming and associated servicing sectors are quite clearly in considerable financial difficulty, while the commercial service sector in the major metropolitan areas continue to experience quite buoyant conditions. While the rural downturn is likely to have some impact on the cities, in due course the effects are likely to be much less severe.