

THE NEW ZEALAND ECONOMY

— SIX MONTHLY REVIEW

INTRODUCTION

The upturn in the domestic economy which developed IN 1978 has not been sustained and the overall level of domestic expenditure now appears to be relatively flat in real terms. Consumption has been maintained, but capital investment has been weak with a deepening of the recession in the building industry. Business confidence remains low with significant levels of under-utilised capacity. Unemployment persisted at a high level throughout the period of recovery indicating that it is now a structural rather than a cyclical problem. Net emigration increased slightly in 1979, resulting in a continued high loss of skilled workers from the economy, though the outflow seems to have slowed somewhat in the early part of 1980. Private incomes received a boost last year as farmers benefited from buoyant export receipts for primary products. Wage rates more or less kept pace with inflation, and total wage and salary income increased slightly in real terms due to a rise in the numbers employed. Business profits reflected subdued trading.

On the external side, there has been steady growth in exports, but the current account deficit has deteriorated due largely to the growth of private import payments and an increase in the deficit on invisibles. Increased repayments on external Government debt reduced the net inflow of capital. The terms of trade reached a peak

during the year but have since fallen back sharply. A stock building cycle is expected to reverse in 1980 with a consequent reduction in import volumes.

Government fiscal policy has been less expansionary over the past year than it was in the preceding year and monetary policy was tightened also bringing some reduction in the growth of monetary aggregates. Growth of the monetary aggregates and private sector credit was still high, however. High import prices, notably for oil, and an inflexible domestic cost structure laid the basis for a rapid increase in prices. Notable exceptions were house and section prices, the latter falling slightly last year.

In the absence of further stimulatory policy measures, a flat or slightly declining level of activity appears likely for 1980. Lower terms of trade and a weaker international economy will adversely effect growth in exports. Import volumes should fall, but inflation in foreign countries will increase their value. The oil price situation remains unstable. There is no indication that the invisibles deficit will improve. Fixed investment can be expected to remain weak and stocks will be reduced. Consumption will be the major determinant of economic activity and will in turn depend largely on the level of personal incomes and savings. In this context farm incomes will be adversely affected by the lower terms of trade and higher domestic costs. Increases in salary and wage incomes can be expected to raise the cost

structure thereby inducing further price rises. This will reduce the real value of wage rises. Fiscal drag will further reduce them as wage inflation places salary and wage earners in higher tax brackets.

INTERNAL ECONOMY

Consumption:

The volume of retail trade grew only moderately, if at all, in 1979 following its recovery in 1978. Although total volume rose by 1.2 per cent, this reflected the weakness of trade in the first half of 1978 rather than any buoyancy in 1979. The real value of retail trade fell in the first and third quarters of the year. Rises in the other two quarters did not compensate for these falls so that in the final quarter of 1979 the volume of trade was 1.8 per cent below the corresponding period in 1978. Retail stocks on 31st December 1979 were up in value by 17.6 per cent on a year earlier. Sales increased by a similar percentage over the year indicating a stable stock to sales ratio over the period.

New car registrations were stronger in 1979, rising by 5.5 per cent over 1978. On a monthly basis new registrations have shown no sign of weakening in late 1979 or early 1980. The quarterly surveys of hire purchase finance have indicated a stronger trade in motor vehicles than other consumer durables. In the December quarter of 1979 the value of motor vehicles sold on hire purchase was up 14.1 per cent on the same quarter of 1978 whereas the corresponding figures for household and personal goods sold on hire purchase showed an increase of only 8.3 per cent. Total hire purchase finance rose more slowly than prices, no doubt attributable in part to higher interest rates on this form of credit.

The generally flat level of real consumption expenditure in 1979 was consistent with the movement in disposable personal income which barely kept pace with increases in prices.

Investment:

There was quite a substantial decline in building construction in 1979. High net emigration and increasing debt servicing costs have combined to reduce the demand for housing. One result has been that prices of existing houses have been relatively flat in the last few years, while the costs of building new houses have continued to rise. There has thus been a strong shift in demand toward existing houses, and in fact turnover of such houses increased considerably in the year to June 1979. In spite of some Government measures, such as the introduction of a suspensory loan to new house buyers, new house building has fallen to a low level. During 1979 permits were issued for the construction of 15,605 new dwellings, a reduction of 18.4 per cent on the previous year. Permits issued for additions and alterations to dwellings rose, but overall the value of permits issued for residential construction was down 6.9 per cent, representing a very considerable fall in real terms. Given the lack of growth in the population and the emerging preference for living closer to the workplace, there seems little hope of a significant increase in housebuilding in the near future. Because of high emigration of skilled building tradesmen and the low number of apprentices being trained, the capacity of the industry has also fallen and it is felt that the

industry could not now cope with a large increase in demand, although spare capacity sufficient for a moderate and sustained recovery may exist.

Non-residential building has also declined although not to the same extent as dwellings. The value of permits issued in 1979 was virtually unchanged from 1978. When increased construction costs are taken into account it is clear the level of activity fell significantly. To a large extent, different skills are employed in much of the commercial and industrial building activity to those employed in housing construction. However one area which showed quite a healthy increase in 1979 was farm building, much of which would involve similar skills to housebuilding. Monthly figures suggest that some recovery in non-residential construction occurred in late 1979.

Other indicators of business investment held up better over the year. Wholesale trade in machinery was up 17.9 per cent in value whilst import orders for transport equipment rose 22.3 per cent by value, though most of the increase in orders occurred in the early part of the year. Any substantial rise in real investment would be difficult to reconcile with current economic conditions and short-term prospects. The Quarterly Survey of Business Opinion conducted by the New Zealand Institute of Economic Research in the December quarter of 1979 indicated that a shortage of orders or sales was the dominant constraint on business activity. Seventy to eighty per cent of respondents in all business categories expected investment approvals to remain the same or decline in the following twelve months.

There is some evidence that inventory accumulation occurred during 1979. Wholesale stocks and manufacturers' stocks of raw materials rose in value by 25.6 per cent and 25.9 per cent, respectively during the year. This inventory investment is consistent with the strong growth in private import payments during the period which did not appear to be reflected in consumption or fixed capital formation.

The major energy projects being undertaken over the next few years should mean a fairly substantial rise in investment expenditure. This may have a positive effect on other areas of investment and economic activity in general, albeit with a lag in some cases.

Incomes:

During 1979 wage rates appeared to rise at rates close to the rate of inflation. The Nominal Weekly Wage Rates Index, which shows the movement in adult wages and salary rates within the jurisdiction of all wage determining authorities, rose 14.1 per cent during the year. The recent public service wage rise will add a few percentage points to this increase when revisions are published. A new statistical series, which has the same coverage as the nominal index, measures movements in actual rates of pay. This series, the Prevailing Weekly Wage Rates Index, increased slightly faster in 1979 than the Nominal Weekly Wage Rates Index rising by 14.4 per cent. The 0.3 per cent difference in movement between the two indices represents wage drift resulting from increased above-award payments. This index will also be subject to revision when backdated increases in pay rates are incorporated.

The Department of Labour's October survey of the labour force indicated a rise in employment compared with a year earlier. The number of full-time employees and working proprietors was up 1.5 per cent while the number of part-time employees had increased 4.8 per

cent. This, together with wage rates which appear to have risen at an average pace similar to inflation, resulted in wage and salary payments increasing by a small amount in real terms last year. Overtime hours worked were little changed.

Farm incomes have risen strongly following their sharp decline in the 1977/78 March year. The provisional national accounts for 1978/79 estimated that agricultural operating surplus rose 45.5 per cent in that year. The New Zealand Institute of Economic Research (NZIER) has forecast a rise of 30 per cent in this item in 1979/80. During 1979 farm incomes were assisted by buoyant prices on world markets for beef and wool. The 5 per cent devaluation of the New Zealand dollar in June 1979 increased the return to farmers from their foreign exchange earnings and up to the end of March 1980 the exchange rate had been devalued a further 3.8 per cent in a number of small steps.

Prices:

After a rise of 10.1 per cent over the year to December 1978, the annual rate of increase in the Consumers' Price Index accelerated throughout 1979 to reach 16.5 per cent in the December quarter. The food group of the index contributed a substantial part of the increase. This group, for which the price index is available monthly, rose 22.7 per cent in 1979 and continued to rise at a similar rate in the first two months of 1980. High prices for meat on export markets have been fully reflected on the domestic market and a reduction in the level of subsidies on milk and butter has also had its impact. Further increases in butter and sugar prices announced in April 1980 are also expected to have a significant impact.

The effect of the increase in oil prices and electricity charges can be seen in the fuel and light sub-group of the index which rose 42.6 per cent during the year. Transportation costs also showed a higher than average increase. The introduction of sales tax on beer and tobacco and its increase on spirits in the 1979 Budget caused a sharp rise in the price of these goods. All sub-groups of the index rose by more than 10 per cent except housing which was up 9.4 per cent. The rise in the cost of home ownership was reduced by the modest rise in the Urban House Property Price Index. It rose 5.4 per cent in 1979 with the rate of increase slowing in the second half of the year. Section prices fell over the year by 2.2 per cent.

External factors are partly responsible for our present inflation. New Zealand is probably not as badly off as some other western countries (e.g. Japan and European countries) in its reliance on imported fuels. Much of our domestic and industrial energy needs are already met by indigenous sources and our main reliance on imports is for transport fuels. Yet New Zealand's inflation rate remains above that of most of the countries with which it is often compared. New Zealand is reliant on trade to a greater extent than many other countries and general increases in import prices will therefore have a larger effect on the overall inflation rate but to a considerable extent our inflation is attributable to shortcomings in domestic institutional arrangements and policies.

Labour Market:

Total unemployment (registered unemployed plus those on special work schemes) reached a peak of 56,262

in January 1979 before easing in the following months on a seasonally adjusted basis. It then rose again over the summer and in February 1980 was 49,111, a reduction of 1,450 on a year earlier. The number of registered unemployed tended to rise throughout the year and in February 1980 was 4,450 above a year earlier. Notified vacancies have been well down on year earlier figures in recent months.

The structural nature of current unemployment has shown up in a change in seasonal patterns. In the days before high unemployment, the seasonal peak occurred in the winter months when the freezing works and other seasonal industries were closed. There was normally sufficient employment over the summer to absorb tertiary students looking for vacation jobs and school leavers, even if unqualified, did not normally have trouble finding positions. However, there now appears to be a second seasonal peak over the summer months, due mainly to the absence of employment opportunities sufficient to absorb tertiary students and school leavers.

Unemployment has remained substantial despite high emigration. In 1979 there were 41,868 more permanent or long-term departures from the country than arrivals. A breakdown of figures covering half of this period suggests that over two thirds of this total had been engaged in the workforce. However, many of the emigrants are skilled workers who cannot easily be replaced in the workforce by those who are unemployed. Latest figures indicate however that the rate of net permanent and long-term emigration may be slowing.

Emigration outweighed the natural increase in population in 1979 so that overall there was a slight reduction in population; yet, as previously noted, full-time employment rose 1.5 per cent in the year to October 1979. The occurrence of this rise in the labour force despite a static population is largely attributable to an increased rate of participation in the work force by women. Over 90 per cent of the increase in the surveyed full-time labour force in the year to October 1979 was due to a rise in the number of females employed.

Monetary Conditions:

Estimates for the year ended February 1980 indicate that growth rates of the broader monetary and credit aggregates continued on the downward trend evident since mid-1979 but remained high. The annual growth rate in the narrowly defined money supply *M1* fell steadily from 20.8 per cent in January 1979 to 3.5 per cent in October, but has since picked up again slightly with an increase of 5.4 per cent estimated for the year ended February 1980. The growth rate of *M3* (the money supply and selected liquid assets of the public) has shown a more gradual decline over the year. The annual increase estimated for February is 16.7 per cent, compared to rates of just over 22 per cent in each of the first three months of 1979.

The annual growth rate of domestic credit (i.e. credit to both the public and private sectors) rose to 21 per cent in March 1979 and hovered around that level until July. It then fell to as low as 14.7 per cent in November before rising again to 17.3 per cent in the year to February 1980. Private sector credit annual growth rates in excess of 25 per cent continued through to October, but had dropped to 21.2 per cent by February this year. Trading bank lending showed a similar pattern with a further fall in the annual growth rate indicated for March 1980.

A major factor behind the high but declining growth rates of the monetary aggregates has been the pattern of net Government expenditure. Injections from the Government's budget were very large again for most of 1979/80. Up to September 1979 the budget deficit was running at an even higher level than last year (\$1,043 million at the end of September 1979, compared to \$921 million a year before). However, from October on this was reversed. The deficit up to the end of December was lower than last year, \$1,614 million compared to \$1,757 million a year before. In addition, Government receipts this March were expected to be higher than in the previous year.

Monetary policy was tightened early in 1979 and again in mid-year as the Government became concerned that its guideline for private sector credit growth would be substantially exceeded. From July 1979 reserve asset ratios for trading banks were the tightest applied since the reserve asset ratio scheme was introduced in 1973. From October 1979 the Government stock ratio applying to borrowings by finance companies was increased from 20 to 22.5 per cent, the highest level this ratio has been set at since it was introduced in 1969.

Interest rates for the October 1979 Cash Loan were raised half a per cent for maturities up to three years. Subscriptions totalled \$135.0 million (excluding Reserve Bank subscriptions). A third issue of Savings Stock in November and December did not achieve the success of earlier issues with only \$6.0 million being raised. This occurred despite a half per cent increase in the interest rate to 11.5 per cent and reflected the strong competition for funds at that time. Because of the downward trend in monetary and credit aggregates in late 1979, which was expected to continue, and a desire to moderate pressure on interest rates, measures to ease monetary policy slightly were announced in December 1979. Reserve asset ratio policy applying to trading banks was eased a little as from January 1980 and the Government security ratios applying to trustee savings banks and private savings banks were lowered by 1 per cent and 2 per cent respectively, with effect from February 1980.

EXTERNAL SECTOR

Overseas Exchange Transactions:

In the year ended February 1980 the trade surplus was \$786.5 million, a moderate improvement on the surplus for the previous year of \$644.0 million. During the year import volumes and prices increased sharply and oil prices more than doubled. The rise in import payments was, however, more than offset by strong growth in exports across a number of sectors. Meat and wool receipts grew particularly strongly, with substantial increases also occurring in exports of manufactured goods and forest products. Invisible receipts and payments both increased by about the same percentage, but as the payments figure rose from a much larger base the result was a further substantial deterioration in the deficit on invisible transactions. This caused an increase in the current account deficit which rose to \$475.5 million from the level of \$424.3 million recorded the previous year.

The net capital inflow (including IMF transactions) during the period was \$441.7 million, similar to that in the previous year. There was an improvement in the private capital account balance from an outflow of

\$16.0 million in the year to February 1979 to an inflow of \$77.7 million in the latest year but this inflow was still well below the level of the years preceding 1978/79. The official capital account inflow was down on the previous year. Borrowing rose by \$239.4 million but repayments rose by \$316.6 million.

Some decline in import volumes can be expected in 1980. Wholesale and manufacturers stock levels were built up in 1979 and at the end of the year more than 50 per cent of the merchants responding to the NZIER Quarterly Survey of Business Opinion considered their stock to be 'too high'. Much of these stocks are of imported goods. There is little chance of them being reduced by growing domestic sales so import orders will probably be reduced. The growth in overseas orders, mineral fuels excluded, has recently begun to ease.

During 1979 the terms of trade reached their highest level since the export boom of 1973/74. The index of export prices relative to import prices was 90 in the June quarter compared with 79 a year earlier (based on December year 1957 = 100). It has since deteriorated under the impact of rising import prices, being estimated at 81 in the final quarter of 1979.

CONCLUSION

The remainder of the year appears to present policy problems more acute than those of 1979. The outlook for the balance of payments is deteriorating and inflation is now higher than a year ago. Uncertainty over oil supply and pricing persists and the international economy is on a weaker trend.

The essence of the short-term demand management problems of 1979 was that the external constraint and inflation gave policy makers little room to manoeuvre in addressing employment and growth objectives. These problems are now, if anything, more difficult. While reductions in personal tax rates have a role in offsetting fiscal drag, it is difficult to see room for significant policy relaxation. Uncertainty about wage settlements and industrial relations exacerbates the difficulties.

It will be necessary to give renewed attention to questions of economic structure in the 1980s if the country is to satisfactorily resolve economic objectives which are currently in conflict. A steady short-term demand management approach, a reduced fiscal deficit and an improved wage settlement procedure, are desirable. More fundamentally, it will be necessary to continue, and if possible accelerate, the progress being made towards economic restructuring. Although development of the country's energy resources promises some medium to long-term benefit, especially for the balance of payments, growth and employment will require that our industrial sectors also continue to expand.

The structural questions include the need to increase competition, reduce unnecessary regulation, and lower protection. It is therefore appropriate to focus attention on such matters as the level and nature of the protective system. An extension of the trading relationship with Australia involving reduced protection could bring considerable benefits to the New Zealand economy if it encourages the development of industries (including agriculture) capable of exporting or replacing imports in a manner which is reasonably efficient by international standards. Recent discussions and ongoing consultations indicate an awareness of the possibilities in this area.