

# THE NEW ZEALAND ECONOMY

## SIX MONTHLY REVIEW

### INTRODUCTION

After a period of little change in domestic activity the economy now appears to be entering a moderate recession. In the 1979/80 March year, personal incomes were boosted by much higher returns to farmers, while actual wage rates roughly kept pace with inflation. A small increase in real consumption resulted. Private investment was weak, being adversely affected by the poor short-term outlook and the continuing decline in housebuilding. Government budgetary policy was slightly contractionary with a fall in the budget deficit from 8.2 percent of GDP in 1978/79 to 5.0 percent in 1979/80, reflecting tight controls on expenditure. Stocks rose quite rapidly perhaps indicating expectations by merchants and producers of a higher level of activity than actually occurred. There was only a slight fall in unemployment by the end of the period despite continued substantial emigration by persons previously actively employed.

Overseas exchange transactions have recently shown some deterioration in the current account balance. This reflects a deterioration in the terms of trade since mid-1979 and high import volumes associated with the stock build-up. A net inflow of private capital has compensated for a decline in official financing enabling overseas reserves to be maintained. In 1980/81 the external balance is expected to worsen largely as a result of slower growth in export prices due to the international recession, further unfavourable movements in import prices, and a further deterioration of the invisibles balance.

Growth in the money supply has slowed in the past year, initially in response to the tight monetary policy of the second half of 1979. That policy has now been relaxed but slower growth in economic activity has continued to subdue the demand for credit so while an improvement in the liquidity of financial institutions has occurred it has not been reflected in the overall growth in lending. Recession and a worsening external balance could provide a continuing constraint of monetary growth.

In the coming year domestic demand will be restrained by a fall in real disposable incomes. Farmers' net incomes will be reduced by rising domestic costs and slower growth of export prices. Wage and salary earners' gross incomes are keeping pace with inflation but fiscal drag is increasing the proportion paid in tax.

Government expenditure continues to be restrained in real terms. Overall investment is likely to remain weak reflecting the poor short-term outlook and a downward adjustment in stock levels is expected. (Expenditure on energy developments and other major projects will not become significant until 1981/82 and beyond.)

### INTERNAL ECONOMY

#### Consumption:

Retail turnover in the 1979/80 March year at \$6,886 million increased by 18.2 percent over the previous year. This rise is nearly entirely due to price increases with the volume of sales up by only 1.1 percent. During the first half of the year turnover fell in real terms but this was offset by growth in the second half, particularly in the March quarter of 1980 when real turnover rose by 3.2 percent over the same period in the previous year. In the June quarter of 1980 real turnover fell 2.6 percent from the previous quarter. This coincides with a fall in the purchasing power of prevailing wage rates of 2.7 percent in the same quarter.

The number of new car registrations indicated a rise in unit sales of 3.3 percent in 1979/80 although petrol deliveries fell 5.5 percent over the same period. These apparently conflicting trends could be explained by a combination of factors. The increase in registrations could be due to a desire to replace old stock particularly with smaller more economic cars as a result of a rise in petrol prices of 52 percent during the year and this price increase together with stricter Government controls on the sale of petrol has resulted in a fall in petrol consumption. An analysis of new car registrations in seasonally adjusted terms indicates a plateau in sales was reached in mid-1980 although the expected subsequent downward trend has not yet been established.

The rental value of owner occupied homes has risen very slowly as a consequence of the low level of house building and rents will have shown a similar movement.

In the year to March 1980 hire purchase financing of motor vehicles and household and personal goods has risen less quickly than the prices of these goods. It is considered that higher interest rates and the lower domestic economic activity were restraining factors here.

Government consumption (the provision of central and local government services) was subject to policy restraints in 1979/80 and is estimated to have fallen in real terms. In the current year it is likely to be maintained or perhaps slightly increased as the Government will not wish to aggravate recessionary tendencies in the economy.

### Investment:

The decline in housing construction has continued in 1980 although at a much slower rate than occurred in 1979. Approximately 15,000 permits were issued in the year to August 1980, the lowest annual figure for at least fifteen years. Demographic factors and prices have been significant in reducing the demand for new housing. The total population has been static for several years and net emigration continues to be substantial. Migrants are largely among the younger age groups in which the rate of household formation is highest. For the homebuyer, relative prices continue to favour the purchase of an existing home rather than a new one. In the year to July 1980 the Institute of Valuers' Modal House Cost Index rose 14.6 percent, while in the first half of 1980 the Urban House Property Price Index was only 7.7 percent above the level of a year earlier. The range of interest rates on housing mortgages offered by major lenders continues to rise slowly. High nominal rates place a substantial cash flow burden on home buyers.

Non-residential building permits issued, including additions and alteration, rose 19.8 percent in value in the year to June 1980. This rise was probably entirely due to an increase in costs as indicated by the B.I.A.C. Building Costs Index, which rose 20.6 percent in the year to March 1980. The largest category, 'Office and Administration Buildings', rose only 7.2 percent in value while permits for farm buildings rose 42.7 percent, this high rate of increase being maintained in the latest figures available. Taken together with the increase in livestock numbers which has been taking place these statistics indicate that substantial investment in farming is taking place in response to higher farm incomes and the various incentives available.

Imports of machinery and electrical equipment rose 25 percent in the 1980 June year while surveyed wholesale turnover in machinery was up 20 percent in the same period. These figures indicate some modest real growth has occurred in this area of investment. However forward import orders have been growing only slowly in value since March so a decline in the volume of such imports is in prospect. Actual investment is also likely to fall but may not do so to the same extent as imports. The wholesale stocks/sales ratio for machinery was 20 percent higher than a year earlier so reduced import orders reflects a desire to lower stocks as well as being a reaction to lower demand. Import of transport equipment rose by 16 percent in the June 1980 year. Most of the growth was concentrated in the second half of 1979 and growth in the value of import orders has eased since then.

Restraint on government expenditure has fallen most heavily on public investment. Spending on the works programme and roading fell 6.3 percent in 1979/80 and is budgeted to rise only 4.6 percent in 1980/81, still a significant fall in real terms.

Stocks build up significantly in 1979/80. Retail, wholesale and manufacturing stocks rose in value by 22

percent and livestock values are estimated to have increased substantially. A recession induced fall in the volume of commercial stocks is likely this year although because stock to turnover ratios are not as high as they were before the 1977/78 downturn, the correction of stock levels is not expected to be as severe as it was then. In the June quarter merchants' stocks rose only 2 percent in value terms, indicating a real decline though no such fall is yet apparent in manufacturers' stocks.

### Incomes:

Official statistics of wage rates give slightly different indications of movements in wages for 1979/80. While nominal wage rates did not keep pace with inflation in the 1979/80 June year actual rates rose above award rates. The award rates index showed a 15.9 percent rise which is equivalent to a fall of 1.7 percent in inflation adjusted terms. Backdating of award increases may affect these percentages slightly. Actual earnings rose more strongly. According to the Department of Labour's quarterly survey, average ordinary time weekly earnings rose 20.5 percent in the thirteen months to May<sup>1</sup> 1980, or 18.8 percent at an annual rate. The stronger rise indicates wage drift as actual rates rose above award rates and average skill levels were increased. Also the two measures differ in their coverage and in their treatment of backdating. The quarterly survey indicated a small rise in the full-time labour force of 0.6 percent in the thirteen month period with part-time employment up 1.5 percent. Average overtime hours worked were down slightly. Overall these figures suggest a small increase in real salary and wage payments has occurred in the year to mid-1980.

In the current wage round the general wage increase of 4 percent which took effect from 1st August has been followed up with settlements in key awards of between 13.5 and 14 percent. This would indicate that an increase in award rates of just over 18 percent is likely to be the norm for 1980/81.

Monetary benefits are generally indexed to prices or wages with the result that the value of most benefits has been maintained in real terms during 1980/81. An exception is national superannuation payments which have grown more slowly this year as a result of a change in the basis of their determination from pre-tax to after-tax wages (announced in the 1979 Budget).

For the second season in a row farm incomes rose strongly in 1979/80. The New Zealand Institute of Economic Research (NZIER) has estimated that agricultural operating surplus increased 34 percent in that year. This improvement was largely due to two major factors. Firstly and most importantly the producers were receiving higher returns due to improved prices in overseas markets and secondly good weather conditions in the last two seasons has enabled production to increase largely due to improved livestock performance but there has also been some increase in livestock numbers. In the current year the international recession is expected to result in slower growth of primary product prices. This factor together with a continuation in the escalation of farmers' costs is expected to result in a fall in farmers' net incomes.

<sup>1</sup> It has been necessary to use a thirteen month period on this occasion owing to a change in the Department of Labour's surveys from a six-monthly survey in April and October to a new quarterly survey in February, May, August and November.

**Prices:**

Consumer price inflation has remained high. The annual rate of increase rose consistently from the December quarter of 1978 to reach 18.4 percent in the March 1980 quarter, before easing in the following period to 17.9 percent. The annual rate of inflation fell slightly to 16.3 percent in the September 1980 quarter. One of the major components of the Consumer Price Index (which is used as the measure of the rate of inflation in New Zealand) is the food price index which has continued to rise more rapidly than the general level of consumer prices. The annual increase in the index peaked at 25.2 percent in March and then declined to 18.1 percent in June. In recent months it has again risen although the long term trend should be downwards in response to weaker primary product prices overseas. Of the other expenditure categories, transportation and miscellaneous (particularly tobacco and alcohol) have shown significant above average increases while relatively slow increases occurred in the apparel and housing groups. The fuel and light sub-group showed the largest rise of any category, being 31.9 percent in the June 1980 year.

Some special factors can be singled out as causes for recent price rises. The substantial increases in electricity prices and in oil and other import prices in 1979 have had a substantial flow-on effect to consumer prices. There have been budgetary increases in sales taxes and subsidies have been reduced. In addition, unit labour costs have been rising. For some years rises in nominal wages and salaries have far outstripped increases in productivity causing increases in the labour cost per unit of output. As an illustration, results from the quarterly manufacturing survey show that in the June 1980 year, unit labour costs were up 25.7 percent while an index of aggregate labour productivity rose only 0.8 percent. Inevitably these cost increases are passed on to consumer prices. Approximately a quarter of consumers' expenditure is attributable to imports and so prices are sensitive to import price inflation. The provisional index of import prices for the March 1980 quarter was 31.2 percent higher than in the previous year, representing a considerable acceleration over the period. This was partly attributable to depreciation of the exchange rate which contributed approximately 8 percent of this increase.

The General Price Index of all industry inputs has shown a trend similar to consumer prices with an acceleration through to the March quarter of 1980 being followed by a reduced rate in the June quarter. The index has consistently risen several percentage points faster than the Consumers' Price Index.

The Urban House Property Price Index showed a significant acceleration in the first half of 1980 rising 5.5 percent from the previous half year. This is the largest increase for 5½ years and compares with an increase in the previous half year of only 2.2 percent. Activity in this sector of the real estate market was also up, the number of sales being 10.2 percent higher than in the previous half-year.

**Labour Market:**

A disturbing feature of the economy in recent months has been a rapid rise in unemployment. Seasonal factors normally diminish job opportunities in the winter months, but this year they can provide only a partial explanation for the increased level of unemployment.

The Government's temporary employment programme and the private sector subsidy schemes have additional jobless with the result that the number of registered unemployed has shown a substantial proportionate increase. At the end of August 59,202 persons were unemployed, a rise of 17 percent on a year earlier and an increase of 11,059 since April. Of the total 18,851 were engaged under the job creation programmes and 40,351 were not employed, the latter figure being a rise of 40 percent since April. Notified vacancies have risen in recent months but remain small in relation to the number of jobless.

Growth in employment has slowed. The rise in the surveyed full-time labour force of 0.6 percent in the thirteen months to May 1980 compares with growth of 1.2 percent in the year to October 1979. The fall in growth in part-time employment between the same two periods was from 4.8 percent to 1.5 percent. Female employment accounts for all of the growth in the period to May 1980 while male employment actually fell in both the full-time and part-time categories. A divergence in the growth rate between male and female employment has been apparent for some years as a rising participation rate by women has caused the female labour supply to grow more rapidly. In recent periods, recession and slow growth may have more severely affected occupations and industries in which the proportion of males is higher than the average, largely in the manufacturing sector.

Net emigration has been trending downwards since mid-1979. The (provisional) net outflow in August 1980 was 14,000 persons, slightly less than half of the figure of a year earlier. So long as the outflow continues it must restrict the level of unemployment to less than it would otherwise be. However, the occupational characteristics of migrants differ from those of the unemployed. For example, in the four months to July 1980, 26 percent of the net outflow of persons who had previously been actively engaged were professional, technical or related workers. Only 2.2 percent of the registered unemployed at the end of July were in that occupational category. Skilled workers may be lost who cannot be easily replaced in the workforce thereby lowering the productive capacity of the economy.

Higher sustained real growth in the economy is necessary to reduce unemployment despite low population growth. This is particularly so at present because increasing participation by women and a changing age structure have the potential to add substantially to the labour force. The proportion of the population in the age group 15 to 59 years is expected to gradually rise from 58.3 percent in 1978 to 62.4 percent in 1991. The Department of Statistics' 'low' projection is for an increase in the labour force of 231,000 in the decade to 1991. This projection assumes 'medium' fertility, a continuation of past trends in participation rates until 1986 followed by no change, and net emigration till 1984.

**EXTERNAL SECTOR****Overseas Exchange Transactions:**

In the year to August 1980 there was a worsening in the current account deficit (by \$113 million to \$543 million) in contrast to an improvement in 1978/79. In the main, the deterioration in the current account can be attributed to increased imports which grew much more quickly than the previous year (by 30 percent compared with 17 percent) reflecting higher import prices,

increased domestic activity in 1979/80 and stock-building. Export receipts rose strongly again (by 25 percent) but because of the higher growth in import payment the trade surplus rose by only \$26 million compared with an increase of \$325 million the previous year. Receipts for invisibles grew more strongly (up 24 percent compared to 17 percent) while payment for invisibles rose more slowly (up 17 percent compared to 22 percent) with the consequence that the deficit on invisible transactions rose only \$139 million compared to an increase of \$241 million the previous year.

The net capital inflow during the year to August was \$326 million, which is \$95 million lower than the previous year. A turnaround in the private capital account to an inflow of \$135 million from an outflow of a similar size the previous year was not sufficient to offset reduced inflows from official transactions and consequently official overseas reserves were somewhat lower than a year earlier. Government borrowing was lower by \$350 million while its debt repayments rose \$130 million. Other official receipts were up \$183 million. IMF (International Monetary Fund) transactions had a higher negative balance, \$130 million compared to \$61 million in the previous year. Repurchases (repayments) of earlier IMF drawings increased but no new drawings were made during the year although there was an allocation of SDR's amounting to \$32 million.

The build-up of stocks in 1979/80 was associated with growth in import volumes. NZIER has estimated that real imports rose 6.5 percent in the March year. In the current year, recession and a rundown in stocks should result in an easing of the volume of imports. After two years of strong growth in both manufactured and agricultural exports a slowdown in growth would normally be expected in the current year as a result of the international recession affecting New Zealand's major overseas markets. However the momentum of export volume growth appears likely to continue for some time due partly to the impact of favourable weather conditions on pastoral exports. Overseas prices will be affected. In the March 1980 quarter the terms of trade were 8 percent below a peak reached in the June quarter of 1979 and a further deterioration has been forecast by NZIER for the current year as import prices grow faster than export prices. Therefore some further widening of the current account deficit is expected as price effects and a higher invisibles deficit outweigh the favourable volume changes.

#### **MONETARY CONDITIONS:**

1980 has been characterised so far by a continued slowdown of most growth rates in monetary and credit aggregates from the very high levels reached in the first half of 1979. Broadly defined money, M3, was growing at an annual rate of 22.5 percent in March 1979, and this has come down to 15.6 percent (estimated) by August 1980. Similarly the growth rate of private sector credit has come down from 25.0 percent to 17.4 percent over the same period.

The most important factor in this slowdown has been the reduced growth rate of lending by the major financial institutions, particularly trading banks, to the private sector. Although the restrictive monetary policy stance of the previous year clearly has had a bearing on the lending slowdown, the slower rate of activity growth through 1980 also has been of some significance. The decline in economic activity has obviously had a significant effect on the demand for credit, as can be seen

from the pattern of interest rate movements since last year, and from the trends in the lending statistics.

Interest rates generally peaked in the last quarter of 1979, particularly the shorter-term interest rates which tend to reflect current conditions in the financial market (compared with the longer-term interest rates which are influenced more by expectations of the future course of prices and of profit opportunities), and are consequently more volatile. As an example, trading bank transferable certificate of deposit (TCD) interest rates were, on average, 15.53 percent (for terms of less than 6 months) over the week ended 26th December 1979, whereas for the week ended 24th September 1980 they were 13.08 percent on average. These high levels at the end of last year were in part due to the tight monetary policy designed to reduce lending by financial institutions in the face of a continuing demand for credit.

On the other hand, some of the longer-term interest rates have stayed much closer to their peak levels. This is particularly the case with some of the longer-term savings bank interest rates, and also with the longer-term finance company deposit rates which didn't peak until the second quarter of 1980, and since then have only declined by approximately one percentage point.

Trading bank lending growth rates reached their highest level about mid-way through 1979 when the rate of increase was almost 30 percent per annum. Monetary policy was tightened in response to this clearly excessive lending growth, and for a period the reserve asset requirements on the banking system was at its historically tightest level. Growth rates of bank lending have come down since July 1979 significantly, even though as shown by the short-term interest rates discussed above there was a continuing demand for credit through until at least the end of 1979. In response to the declining growth rates of bank lending and money supply aggregates (as well as a desire to moderate interest rates), policy was progressively relaxed (in January and May 1980) to what could now be described as a 'neutral' stance. This involved not only the easing of the reserve asset ratio policy, but also the less competitive marketing of government securities which are alternatives for the public to deposits with financial institutions. However, bank lending continued to fall back from May when it was growing at an annual rate of 16.3 percent, through to September when it grew at an annual rate of 13.8 percent.

Further evidence of the lack of demand for credit can be found in the utilisation of trading bank credit limits (most of which are overdraft authorities). In December 1979 seasonally adjusted utilisation of total credit limits was 76.8 percent, and it has steadily declined to 73.8 percent in August 1980. Furthermore, the trading bank lending to deposits ratio (69.3 percent for August 1980) indicates considerable room for lending growth in the banking system's portfolio. (Historically the lending to deposit ratio has gone as high as 80 percent although that would be regarded as very high).

The only major exception to this picture of declining growth rates of lending caused (after 1979) by slack demand for credit is the finance companies. Finance company lending was growing at an annual rate of 30.7 percent in December last year, and it continued to rise through to May 1980 when it was growing at 32.7 percent per annum. In response to this excessive growth rate finance company government security ratios were raised (in July 1980), a movement against the trend of a general easing of statutory investment requirements. It is not entirely clear why the finance companies have

been able to continue to increase their lending so rapidly when the other evidence cited above points to a reduced demand for credit overall. Interest rates on finance company loans remain relatively high. It would appear, however, that the explanation is largely that finance companies tend to specialise in various forms of credit designed to finance consumption expenditure (especially for the purchase of cars) for which demand remained high in contrast to reduced demand in other areas including investment expenditure.

Reinforcing the impact of declining private sector credit growth on the growth rates of the monetary aggregates, funds have continued to be lost overseas via the widening current account deficit. The effect of these two factors together have more than offset the liquidity injection from the fiscal deficit which at \$1,430 million in the year to August 1980 was \$255 million higher than last year. (It should be noted that the annual fiscal deficit is expected to move closer to year earlier levels over the remaining period through to March 1981).

## CONCLUSION

A promising feature of the current economic situation is the relative stability which has been achieved in fiscal and monetary policies. In the face of what appears to be a mild recession there will be a demand for reflation of the economy, in particular to avoid further unemployment. However, any significant relaxation or policy stimulus will clearly have harmful consequences for the balance of payments and the inflation rate. Stability is important to ensure the economy is set on a long term growth path that will enable it to be better placed to overcome any future destabilising influences caused by

shocks in the international economy. In addition, longer term stability is conducive to the successful implementation of structural changes of the type required to lay the basis for sustained growth.

The costs of major economic changes are often more quickly felt than the benefits but the benefits can be substantial in the long-term. For example, downward adjustments under the new exchange rate system add to consumer prices but are necessary in terms of the impact on the balance of payments, in particular the sense of assurance for exporters that their profitability will not be eroded by domestic inflation. This and earlier policies introduced to assist exporters have contributed to the strong export volume growth of the recent past. Construction of the large scale energy related investment projects approved by the government in the past year will add to import costs and the international financing burden, but should reduce the balance of payments constraint on growth of activity and employment. These projects are expected to add significantly to total investment expenditure in 1981/82. Rationalisation of domestic industry may cost some jobs initially but is necessary to create a more efficient and internationally competitive industrial base.

A major concern for the immediate future is to avoid disruptions to progress currently being made towards the long-term goals. In addition, social consequences of current and potential adjustments cannot be ignored and the implementation of programmes for the retraining, relocation and assimilation back into the labour force of displaced workers should be accorded priority in a period of high unemployment. There is clearly a need to alleviate areas of social concern while maintaining a commitment to achieving a more efficient and stronger economy in the long run.