

## SIX MONTHLY REVIEW

### INTRODUCTION

During the last six months there has been some slow-down in economic activity as the New Zealand economy has responded to the various policy changes that were implemented by the authorities during the year and has felt the effects of the recession in the international economy. This slower rate of activity will probably be maintained during the next six months.

Early in 1981, the economy entered a period of relatively strong economic growth aided by strong growth in private sector investment, an expansionary budget deficit, an accommodating monetary policy and a level of expectations generated by the fact it was an election year. This election year was notable for the behaviour of economic agents, particularly the financial institutions, being affected more by the expectation of a typical election year economic cycle rather than its realisation. In fact, the deficit was smaller than in the two previous election years when expressed in terms of the gross domestic product and throughout most of the year the deficit tracked lower than its expected level.

The support by the financial sector for the increased level of domestic economic activity resulted in private sector credit expanding at a much higher rate than the growth in deposits. The ensuing competition for funds put upward pressure on interest rates and in an effort to stabilise them and restrict the growth of lending the Government implemented a set of measures during November 1981. The effect of this action is likely to be felt in the first quarter of 1982 with a slower rate of growth in money supply, credit growth and domestic economic activity.

A further factor, and one which contributed to the levelling off in activity in the final quarter of 1981, has been the deteriorating external balance. The effect of the international recession on exports combined with the increased domestic activity has resulted in import payments growing faster than export receipts. This in turn resulted in a reduced stimulus to activity in the domestic market. Since there now seems little prospect of significant improvement in the external sector before the end of 1982, any growth in domestic activity will have to come from other sources.

The growth in the economy during 1981 was led by private consumption expenditure and a recovery in residential building construction. Retail expenditure however slowed again in late 1981 and private consumption is expected to be fairly flat during 1982. The growth in building activity widened into a more general expansion in investment during the second half of 1981. Although this could have been partly in response to expectations of tighter credit conditions and the removal of some tax incentives in 1982 and therefore unlikely to be maintained at the same pace, it would appear that businessmen are generally optimistic as to the longer term prospects for the economy.

The overall inflation rate has increased again over the last six months with the primary contributor being rising prices for existing houses. The other subgroups of the Consumer Price Index have been generally stable, in spite of the increased activity and strong growth in the monetary and credit aggregates throughout most of 1981.

Total employment increased during 1981 in response

to the economic upturn but not sufficient to reduce the level of unemployment. Any slowdown in the economy over the coming year would hold little prospect for an immediate improvement in unemployment levels.

### INTERNAL ECONOMY

#### Incomes

Official wage rate statistics show that pre-tax salary and wage incomes rose in real terms during 1981. The Nominal Weekly Wage Index, which measures movements in award rates, rose at an average annual rate of 19 percent during 1981. This represents an average effective increase of 3.1 percent after adjustment for inflation. The increase in the Nominal Index in the December quarter 1981 of 16.1 percent over the corresponding quarter of 1980 was below the average but this was seemingly caused by the timing of wage agreements and the rate can be expected to rise again in the first quarter of 1982. Wages actually paid (as shown by the Prevailing Weekly Wage Rates Index) have been increasing at about the same pace as award rates throughout 1981.

The Labour Department's Quarterly Employment Survey showed average weekly earnings to be rising at higher rates although because of the timing of the survey the lower growth in the December quarter is not fully accounted for. In the twelve months to November 1981 average weekly earnings excluding overtime rose by 20.1 percent to \$241.90 and average weekly earnings including overtime rose by 20.3 percent to \$259.20. Average ordinary time hours worked per week were down slightly from 37.1 to 36.9 hours per week whilst overtime hours worked rose from 2.0 to 2.1 hours per week.

Farm production, after increasing sharply for two seasons is estimated by the New Zealand Institute of Economic Research (NZIER) to have fallen in volume in the March 1982 year by 1 percent. Factors contributing to this reversal are the impact of high inflation rates on farm incomes, drier weather in many parts of the country and a reduction in farm development.

Gross income for the average sheep and beef farm in 1981/82 is estimated to reach \$96,600, 18 percent up on the previous years gross income of \$81,800. As a result the net farm income for 1981/82 is estimated to be \$24,600 per farm (or \$17,000 per farmer), 16 percent above the previous year. Although wool production is estimated to have fallen 3 percent in 1981/82 over the previous year, wool income per farm is likely to be up 26 percent. An increase of 22 percent is estimated to have come from the Supplementary Minimum Price Scheme while the remaining 4 percent increase reflects the 'average' market improvement for 1981/82 compared with 1980/81.

Beef income is estimated to increase by 9 percent. Since income from beef at market prices for 1981/82 is estimated to have fallen by 6 percent total SMP payments and producer funded supplements should lift beef income by 15 percent. Beef production is expected to fall by 2 percent in 1981/82 as international prices remain low.

Dairy farm gross income in 1981/82 is expected to rise

19 percent to reach \$62,600 per farm. This reflects favourable climatic and market situations that have also been a feature of the previous two seasons.

In the manufacturing sector profitability (as indicated by the ratio of profit to sales) has shown marked improvement throughout 1981 after having slumped in 1980. The Department of Statistics quarterly survey of manufacturers shows that in the last six months of 1981 profitability was 13.8 percent higher than in the same period of 1980. This result is supported by respondents to the NZIER's Quarterly Survey of Business Opinion. The survey additionally shows that builders and retailers, in spite of inflationary pressures, also experienced increased profitability — a result consistent with the strong growth in activity in these two sectors over the past year. Generally, however, respondents were less optimistic as to profitability in the first three months of 1982 in line with the slowdown in the economy then occurring.

### Consumption

The volume of retail turnover grew by 2.6 percent in 1981 over 1980. This was well ahead of the volume growth of only 1 percent recorded in the previous year, but there are now signs this growth is levelling off as seasonally adjusted retail sales in the December quarter fell by 0.4 percent over the September quarter. In the December quarter 1981 real hire purchase finance of televisions, household and personal goods rose by 14.7 percent. Demand for consumer durables can be expected to weaken in 1982 in response to tighter credit and a fall in real incomes, though the possibility of increased indirect tax levels may affect the timing of sales and bolster sales of some items in the first half of 1982. Factors affecting real incomes are the rising rate of inflation and the bite from fiscal drag early in the year.

New car registrations, which rose by 10.6 percent during 1980, increased by 16.6 percent during 1981. The annual running total was 91,373 at the end of December 1981. Growth in oil company deliveries during 1981 (an indicator of petrol consumption) has been a moderate 1.6 percent following a fall of 1 percent in 1980. The higher consumption reflects the increased activity during the year and higher personal incomes. Hire purchase finance of motor vehicles, however, fell sharply in 1981 by almost 10 percent. This movement is surprising given the growth in car registrations but is probably explained by an increasing resort to alternative forms of finance such as leasing and personal loans.

### Investment

After the prolonged recession in the building industry beginning in the mid 1970s, activity improved during 1981 led by a sharp turnaround in residential construction. For the December 1981 quarter the number of permits issued for new dwellings was over 50 percent higher than for the corresponding quarter of 1980 while the increase in the value of these permits was more than 80 percent. Since December 1981, the annual running total of the number of dwelling permits issued has risen further to exceed 18,000. This is the highest total since 1979.

Non-residential building has been somewhat slower to respond but has shown some improvement since August 1981 with the number of permits issued in the December

quarter of 1981 10.4 percent higher than in the December quarter of 1980. It is doubtful, however, that the annual total to March 1982 will be significantly higher more than the annual total to March 1981 of around 9,100. Because of the lumpiness of the units involved the value of permits issued tends to fluctuate. Nevertheless, a 46 percent increase in the December quarter 1981 over the corresponding quarter of 1980 (a large increase in real terms) provides further evidence of an improvement in non-residential building activity.

It is likely that building activity will begin to level off in 1982. Shortages of materials and difficulty in obtaining skilled labour are already being felt. Mortgage finance is expected to tighten. This may be offset somewhat by demographic trends. Permanent and long-term emigration has declined from an annual peak of over 40,000 in 1979 to be only 16,732 over 1981. It is continuing to fall and for the year ended February 1982 was provisionally estimated to be 13,789.

Plant and machinery investment indicators improved sharply in the second half of 1981 although growth in surveyed import orders for machinery and electrical equipment has weakened considerably since November 1981. In the September quarter 1981 this category increased by 47.8 percent over the corresponding quarter of the previous year but the growth fell to 15.7 percent for the December quarter and is likely to fall even further in the first quarter of 1982. The rate of growth of actual imports for machinery and electrical equipment is still accelerating however, reflecting the high level of import orders in the mid-year. In the December quarter imports of this category were 47.1 percent higher than in the December quarter of 1980. Consistent with this trend, wholesale trade in machinery is showing the highest rates of growth in two years although the annual increase for the December quarter of 25.8 percent, whilst still high, was down on the September quarter's annual increase of 32.8 percent.

Gross capital expenditure in manufacturing as shown in the Department of Statistics quarterly survey has risen dramatically. The increases recorded in the September and December quarters over the same quarters of the previous year were 64 percent and 99 percent respectively. While this is in part a response to the increased profitability it suggests confidence in activity in the longer run, even though this year may see some slowdown in the rate of increase.

The implications of the expected slower growth in farm incomes for farm investment, especially for the hill country sheep and beef farmer who faces moderating international meat and wool prices, are of some concern. On-farm costs are rising at rates approaching 20 percent per annum and thus for this particular type of farm it is possible reinvestment will not be at levels necessary to maintain recent increases in production. The SMP scheme may relieve this situation somewhat.

There is some evidence of an increase in commercial stocks in the second half of 1981. The seasonally adjusted retail stocks/trade ratio rose by 1.8 percent in the December quarter 1981 after four consecutive quarters of decline. However this is most likely the result of merchants not anticipating the fall in demand in that quarter. The NZIER December Business Opinion Survey indicates that retailers still regard their stock levels as too high.

### Production

Manufacturing production strengthened during 1981

although the rate of growth tapered off slightly in the December quarter. Manufacturing sales (excluding the primary food group) rose in the last six months of 1981 by 25.9 percent over the same period in 1980. This represented a real increase of 8.6 percent (after sales in each industry group are adjusted by the corresponding Producers Price Index Deflator). The highest rates of real increase were experienced in the other manufacturing, non-metallic metals and other foods subgroups of 55.6 percent, 21 percent and 16.8 percent respectively.

Manufacturers have met these improved activity levels both by increasing production and running down existing stocks of finished goods. In the September quarter 1981, the Volume of Production Index rose by 9.7 percent over the September quarter 1980, although the corresponding increase for the December 1981 quarter was only 8.5 percent. This was largely due to a 1.2 percent decline in the Production Index in the December 1981 quarter.

The increased demand for manufacturers' goods has led to only a modest increase in employment of labour. It has been met in the main by a rundown of stocks of materials and an increase in hours worked. The ratio of stocks of materials to value of output fell in the September and December 1981 quarters over the corresponding quarters of 1980 by 14.5 percent and 10.2 percent respectively while hours worked increased in the same period by 4.4 percent and 5.5 percent respectively.

### The Government Sector

In the nine months to December 1981, actual Government expenditure was 19.7 percent higher than in the same period last year while actual receipts were 26.7 percent higher. The large increase in receipts was due to increased terminal company tax payments and higher than expected customs and sales tax collections as a result of faster imports and retail (especially new car) sales. The deficit before borrowing for the nine month period at \$2,145 million was only 3.5 percent higher than in the corresponding period the previous year. Since the March quarter usually records a surplus due to a high tax flow, the overall deficit for the year appears likely to be less than the budgeted figure of \$2,090 million.

For the 1982/83 year the Government has indicated a desire to reduce real expenditure by 3 percent and depending on the extent of any direct/indirect tax trade-off this could result in a lower budget deficit.

### The Labour Market

The higher activity levels in the economy during 1981 failed to have any significant effect in reducing the level of unemployment. Total registered unemployed fluctuated around 47,000 for most of the year before increasing to over 56,000 in November. The large increases in unemployment that have been recorded from November can largely be attributed to seasonal factors, notably the enrolment of tertiary students for vacation work, and numbers should decline again by the end of March 1982. However any slowdown in activity during this year is likely to ensure there will be little short-term relief from the historically high underlying level of unemployment.

Registered unemployed numbered 50,167 at the end of February 1982. This was only 1.5 percent higher than

at the same time a year previously but in the same period the number on assisted employment schemes had risen by 76 percent from 20,255 at the end of February 1981 to 35,717 at the end of February 1982.

Because there is a high degree of flexibility of movement between these two groups, and because many of the employment schemes operating attempt primarily to provide short-term relief to the unemployed rather than making a substantive effort to return the worker to the permanent labour force, it can be useful to aggregate these two groups as an indicator of the general employment problem. Seasonal factors should of course be taken into account. The total of registered unemployed and assisted employment peaked at 88,665 at the end of January 1982 before falling to 85,884 at the end of February. With over 8,500 students still enrolled on the Student Community Service Programme this total can be expected to fall substantially during March. Nevertheless a resulting figure of around 76,000 would still represent a long-term upward trend. The March 1981 census of unemployment was 60,860, very close to the total of registered unemployed and assisted employed of 63,214. This yielded an unemployment rate of the census labour force of 4.6 percent. If the figure of 76,000 can be assumed to be close to the base rate of unemployment then this would suggest an increase in the unemployment rate to around 5.5 — 5.7 percent of the labour force.

Providing some relief from this general upward trend in unemployment is a fall in the number of those registered unemployed for thirteen or more weeks (an indicator of structural unemployment). This series has declined from a peak of 17,491 at the end of September 1981 to 15,995 at the end of February 1982. The number has stabilised at around 32 percent of the total registered unemployed after steadily increasing as a proportion throughout most of 1981.

In response to the increased activity levels during 1980 there has been a small increase in employment. According to the Department of Labour's survey, the labour force for November (including part-time employees and working proprietors) was 2 percent higher than at the same time a year previously. However respondents to the NZIER Business Opinion Survey were not optimistic of this improvement being sustained into the March quarter 1982.

Net permanent and long-term emigration was 16,732 in 1981, well below 1980 and 1979 levels of 23,614 and 41,791 respectively. Total net emigration (i.e. including short-term) also fell to 6,240 in 1981 from 10,915 in 1980.

### Prices

After a year and a half of decline, the annual rate of change of the Consumers Price Index troughed at 15 percent in the June quarter of 1981 and by the December quarter had risen to 15.7 percent. The major influence on this upturn has been the strong upward movement in the housing sub-group. This rose by 19.9 percent in the year ended December 1981 compared with a rate of 12.9 percent for December 1980. Another important component, the transportation sub-group is also showing high rates of increase which have been steady at around 17 percent since the June quarter 1981. In general all other groups of the Consumers Price Index have shown a gradually declining trend over the past year and a half. The food group index which in December, 1981 was 16.5 percent higher than a year

previously has continued to decline to show a 14.3 percent rise for the year ended February 1982.

The acceleration in the growth of the CPI housing sub-group reflects the rise in existing house prices over the past year. According to the Valuation Department's Property Price Index house prices rose 30 percent in the year to December 1981 compared with a rise of 18.4 percent in the year to June 1981. This represents a narrowing of the differential that existed between building a new house and buying an existing one, initially created by the sharp rise in building costs in 1974. The Building Industry Advisory Council's Building Cost Index after having risen by 22 percent during 1980 has gradually weakened to increase by 18.1 percent during 1981. As material costs rose by 20.5 percent over the year (according to the Producer Price Index construction sector sub-group) the slower growth in the composite index would largely be caused by lower increases in costs for labour and transport.

Section prices, in response to the recovery in residential building, have also accelerated. According to the Valuation Department section prices rose 15.9 percent in the year to December 1981, compared with an increase in the year to June 1981 of 8.3 percent.

The rural real estate market was extremely buoyant during 1981. The Valuation Department's Farmland Price Index for the year ended December 1981 showed an increase of 40.3 percent. This has only been exceeded in 1974 when an increase of 48.3 percent was recorded. The largest price rises were for dairy farms (43 percent) and horticultural farms (42.6 percent). One reason attributed to the large increase has been the high level of Government support for the agricultural sector.

## MONETARY CONDITIONS

The first three quarters of 1981 saw the main monetary and credit aggregates all recording very high rates of growth. In particular, private sector lending was very strong and increased much faster than the rate of growth for deposits or reserve assets. For example, whilst trading bank lending grew by 31 percent in the twelve months to September 1981, trading bank deposits grew over the same period by only 19.4 percent (20.1 percent if compensatory deposits are included) and trading bank average holdings of reserve assets were 1.5 percent lower than a year earlier. Finance companies and trustee savings banks were two other major groups for which lending grew significantly faster than deposits. This lending facilitated the pick up in demand for housing, new cars and consumer goods. The credit expansion can be attributed to an easier monetary policy combined with the expectation of high levels of government spending prior to the election. As it transpired, Government sector net injections were in fact less than had been anticipated.

During the year the unexpected lower fiscal deficit and the deterioration in the external accounts combined to frustrate the expectations of gains in reserves and deposits and the trading banks' lending to deposit ratios rose by over 6 percentage points. At the same time strong demand for credit and intense competition for deposits amongst financial institutions resulted in upward pressure on interest rates. The monetary aggregates were beginning to show increasing rates of growth with both the narrowly defined M1 and M3 (the money supply and selected liquid assets of the public) increasing at rates of around 17.5 percent in the year to September 1981.

It was against this background the Government initiated its November policy measures:

1. The Financial Service Regulations were amended to give the Reserve Bank powers to monitor and object to any notified increase in lending interest rates by financial enterprises employing funds of more than \$2 million.
2. The terms of Inflation Adjusted Savings Bonds were improved to allow larger holdings. There was an issue of 'Premium Stock' which is a variation of 'Savings Stock'.

Additionally Post Office Savings Bank Bonus Bonds prizes were increased.

These actions have had some measure of success in constraining monetary and credit growth. The annual rate of growth of M1 and M3 fell to 16 percent and 16.7 percent respectively in the December quarter. Private sector credit growth in the December quarter fell to 27.3 percent for the year, down from a 33.8 percent annual increase in September, 1981. However, estimated annual rates of growth for January and February 1982 indicate that this level has not diminished further and may even have grown slightly. This 'stickiness' has been influenced significantly by finance company lending which grew by 39.6 percent in the December quarter 1981 over the same quarter of 1980.

Trading bank lending growth has declined, although only slowly, as indicated by the monthly percentage increase when seasonal factors are discounted. This monthly increase has averaged about 1.8 percent over the four months since November 1981 compared to about 2.6 percent in the four months prior to November.

Nevertheless lending rates remain historically high and with the Government now actively competing in the bond market, further upward pressure has been placed on interest rates for deposits. Lending interest rates have largely stabilised as was the intention of the controls put in place in November. However, the weighted average of rates on transferable certificates of deposit (6 months and under) had risen from an average of 14.5 percent during October 1981 to 15.8 percent in February 1982 and has since probably risen further. Selected finance company interest rates of one year and three years had risen from 14.4 to 16 percent and 15.5 to 17 percent respectively between October 1981 and March 1982. The interest rate controls on lending appear to be making the situation much tighter for institutions. As with all direct controls, the impact is uneven and some institutions and markets appear to be more adversely affected than others. Overall, monetary conditions are still in a transitional phase but it is likely that lending will continue to abate over the coming months and a return to more sustainable growth rates should become apparent as credit becomes less readily available.

## EXTERNAL SECTOR

In the twelve months to February 1982 there was a substantial deterioration in the current account deficit which increased to \$1,073 million from \$665 million in the year ended February 1981, primarily as a result of a widening deficit on invisible transactions. Although the current account deficit is large in nominal terms, it is estimated to be less than 4 percent of GDP which is substantially below the 10 percent figure achieved in 1974/75, the year in which the deficit previously

exceeded a billion dollars.

Export receipts for the year to February 1982 were 14.5 percent higher than a year earlier, recording \$6,645.6 million. High prices for dairy products resulted in particularly high rates of growth for cheese (+42.6 percent), milk powders (+36.5 percent), and butter (+32 percent).

The major export categories of meat (\$1,738 million) and manufactured exports (\$1,151 million) also recorded high annual rates of growth in the year to February 1982 of 18.4 percent and 16.8 percent respectively. The growth in manufactured exports has slowed from the peak 35 percent growth which occurred over the year to December 1980, but the higher rates in part reflected the small starting base. The strong demands of the domestic economy combined with the effects of the international recession is also having some effect.

Import payments increased by 18.8 percent over the year to February 1982 to \$5,933 million. As a result, the trade surplus fell from \$811 million in the year to February 1981 to \$712 million. Invisible payments grew by less than invisible receipts (24.2 percent and 28.4 percent respectively) but because of the much higher payments base the invisibles deficit still widened from \$1,477 million to \$1,785 million.

The official capital account (including IMF transactions) showed an inflow of \$1,327 million for the year ended February 1982, up significantly from the inflow of \$464 million the previous year. A major factor behind this was the increase in Government borrowing from \$766 million in the year ended February 1981 to \$1,793 million (though repayments were also up). The private capital inflow was down on the \$81.5 million of the year to February 1981 to \$51.4 million. Official overseas reserves rose by \$266 million over the February 1982 year.

The NZIER estimates that import volumes in the year to March 1982 have increased by 12 percent although special items such as Air New Zealand Boeing 747s, the US butter purchase and items for the major projects do make this 'artificially' high. Export volume growth in the year to March 1982 is estimated to have risen by 8.5

percent. The NZIER expects the terms of trade to fall slightly by 1.3 percent in the year to June 1982 compared to the previous year as import prices grow faster than export prices.

## CONCLUSION

The most recent economic indicators tend to confirm a slowdown in economic activity following a buoyant period through most of 1981. The outlook for 1982/83 according to the New Zealand Institute for Economic Research is for a deteriorating external account, little improvement in inflation or unemployment and slower, but still positive growth. GDP is expected by the NZIER to increase by only 1 percent over the year compared with the 4 percent growth during 1981/82. The lower growth rate is to be expected given the constraints of a rising external deficit, lower Government expenditure and a tighter monetary sector.

Export earnings will be affected by weak prices for dairy products, beef, forest products and aluminium. The volumes of meat and dairy product exports are expected to fall but may be offset somewhat by greater wool and other primary products exports (hides, skins and fish). Import growth will be strong even discounting the special items such as the major projects and Air New Zealand 747s, in part because the currently higher levels of investment are expected to be largely sustained.

New Zealand's short-term future depends to a large degree on how prolonged the world recession is. Nevertheless, in so far as a general upturn in the world economy is hoped for in 1983, the continued confidence the business sector seems to have in investment prospects augers well for New Zealand's ability to respond. Major uncertainty has been relieved with respect to many of the major projects and most are now expected to proceed. Most importantly, the projects have given a needed boost to investment expenditure and growth prospects in New Zealand both directly and through induced investment expenditure in other sectors as well. Private investment is likely to be the major element underpinning economic activity in 1982.