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Information Section p.7

Commentary

The year ahead: more guesswork than usual

Summary

Looking ahead for the year is always educated guesswork, but this year it is more guesswork than educated. That's because of some very big unknowns: in particular Trump and Brexit.

At home we have had economic growth but it has been weak per person and per hour showing falling productivity which does not bode well for future incomes. The growth has been very reliant on high net immigration which seems unlikely to fall much in the next year. Income growth per person is likely to be driven by more people working and people working longer hours and we're seeing evidence of that.

At 4.9 percent and only falling slowly, unemployment is still too high. It could be the 3.3 percent it was in 2007 giving 40,000 more people jobs. Sadly, 4.3 percent is much more likely.

Wage growth has been slow. Part of the reason could be that some of the strongest growth areas of employment are in tourism and care for aged people and people with disabilities, all low wage jobs. At the other end of the spectrum, Professions, technical and administrative services are also growing strongly. We are seeing increasing wage inequality, likely partly due to these changes. Our employment laws are not helping. While almost all people on collective employment agreements get a pay rise each year to recognise increasing living costs, 55 percent of people who are on individual agreements do not.

Household spending is growing strongly. In part that could be due to a rise in hours being worked per household, and in part it could be due to the 'wealth effect': rising house prices encourage people to spend some of the increase in value of their houses. Household debt is at record levels and makes them vulnerable to big interest rate rises or house price falls.

The slow wage and salary growth in dollar terms, has been relieved by very low price inflation, meaning a rise in real wages (the buying power of wages). But CPI inflation has jumped up to more like normal levels at 1.3 percent. It is likely to rise further with housing costs a big driver.

There are still big risks internationally. The Trump presidency is likely to raise interest rates, inflation and the US dollar. This brings dangers and opportunities for New Zealand. One opportunity is to rethink the model of globalisation that the US and UK people have rejected.

I often start the year with a look ahead towards what we might expect from the economy. It's always educated guesswork, but this year it is more guesswork than educated. That's because of some very big unknowns: in particular what Trump and the US Congress will do, and the impact of the announced Brexit on Europe and the rest of the world. Their impact is not only a direct one on the economy – incomes, jobs, prices, trade – but is also changing the menu of what is 'on the table' in economic policy.

At home

I'll start at home. It's election year of course and that will increase the intensity of public debate – though we have yet to see how much will be heat and how much will be light. I'll largely ignore that.

The year has been one of superficially strong growth in the volume of what New Zealand produces (Gross Domestic Product) which rose 3.0 percent in the year to September compared to the year to September 2015. However it was weak growth per person (per capita) at 0.9 percent, lower than a year ago (1.2 percent) and much lower than the 2000s when it averaged 2.6 percent. When looked at per hour worked, it looks even worse. Though statistics for hours worked have been messed up since June by changes in the way Statistics New Zealand carries out its Household Labour Force Survey (which in the long run will largely be for the better), GDP per hour fell in the three months to September and has almost certainly fallen strongly in the last year. That's a measure of productivity, and to have falling productivity does not bode well for future incomes.

These trends are due to rising production and spending being driven significantly by record levels of net immigration – a new record was set in December at 70,588 and while that may be peaking (some forecasters have been saying that for several months) it seems unlikely to fall much in the next year. So there will not be much there to drive income growth per person other than from more people working and people working longer hours. We're seeing growth in the hours worked per person and the proportion of couples with dependent children where both are working.

Both official and commercial bank economists are attributing the slow wage growth to still relatively high unemployment and the high net immigration. At 4.9 percent and only falling slowly, unemployment is worse than the 4.3 percent which in Treasury's view is neutral in terms of inflation and much worse than the 3.3 percent low in 2007 which is what should be our target. That would give jobs to 40,000 more people. Few think that unemployment will fall below the Treasury view.

Wage growth has been slow: growth in the ordinary time average wage was down to 1.7 percent in the year to September, a level not seen since straight after the Global Financial Crisis in 2010. Part of the reason could be that some of the strongest growth areas of employment are in tourism and care for aged people and people with disabilities. These are all low wage jobs (though the equal pay case for carers gives some hope that that might change). At the other end of the wage and salary spectrum, Professional, scientific, technical, administrative, and support services is also growing strongly. We are seeing increasing wage inequality (something I will write about at another time) likely partly due to these changes. Our employment laws and general employment relationships are not helping. I calculate that while almost all people who negotiate their pay collectively with fellow employees and with the help of a union get a pay rise each year to recognise increasing living costs and skill shortages, 55 percent of people who are on individual agreements and have to negotiate with their employer on their own, do not. It is hard to see better pay increases while only about one in five employees have a collective employment agreement.

On the other hand, household spending is growing strongly. In part that could be due to a rise in hours being worked per household, and in part it could be due to the 'wealth effect': rising house prices encourages people to spend some of the increase in value of their houses. That's a recipe for increased indebtedness and problems if house prices fall or interest rates on their mortgages rise significantly. Household borrowing is currently increasing by about 9 percent per year – a rate not seen since 2008 –

most of it growth in mortgages. Household debt is steadily rising in both dollar terms and as a percentage of disposable household income – now at 167 percent including rental properties, the highest it has been, at least since 1998.

The slow wage and salary growth in dollar terms, is relieved by very low price inflation – a 0.4 percent increase in the CPI in the year to September, meaning a rise in real wages (the buying power of wages). But CPI inflation has jumped up to more like normal levels, and those the Reserve Bank wants, at 1.3 percent in the year to December. Inflation is likely to rise further, for both domestic and international reasons, which I will come to. The major driver of inflation at present is housing, both rented and owned. While one of the most rapidly rising prices is for existing houses, which is not represented in the CPI, it will certainly be in at least some people's minds (particularly first home buyers) when they are looking at the adequacy of their pay. Another driver is interest rates (again not in the CPI) which are starting to rise. For households with high enough incomes for banks to want to load a mortgage onto them, interest payments will become an increasing burden. We got official confirmation this year that price inflation affects different types of households in different ways in the new Household Living-costs Price Indexes or HLPIs. Since 2007 and over the last year, low income households, especially superannuitant and beneficiary households, have in reality experienced higher than average inflation while high income households have experienced below average inflation. Because the HLPIs include interest rates (unlike the CPI) and some indirect recognition of rising house prices, we may see that partially reverse with mortgaged higher income households experiencing higher increases in living costs.

What will slow down the ruinously rapid house price inflation? The glib answer is "more houses" but the inadequacy of the current rate of house building means that will be a slow process. Our high level of population growth (net immigration being a large part) and the momentum of a price bubble will keep it going in the immediate future, despite increasing unaffordability (one area in which New Zealand is genuinely leading the world – in the worst way). One development that could deflate the bubble might be a rapid rise in interest rates (with devastating effects for some people) but that seems unlikely. The Reserve Bank will be watching carefully and considering whether it can slow the rise in other ways, such as a value-to-income ratio limit on borrowing which would be particularly hard on low income families. Another is a crisis imported from abroad which increases unemployment, knocks people's hopes for income growth or reduces the ability of banks to borrow on international money markets.

The international economy

Is such a crisis likely? As I said at the outset, there are some important unknowns which make weighing this up very difficult. Underlying the Trump and Brexit phenomena however are ongoing concerns.

The US economy has been performing relatively well with the help of near-zero interest rates. Unemployment is at 4.7 percent but with a relatively low proportion of working age people in work or actively looking for work (62.7 percent: in New Zealand it is 70.1 percent though the way it is measured may differ). GDP per capita rose 1.2 percent in the year to October 2016[1]. However interest rates are now starting to rise and we will see how strong the underlying economy is as the monetary stimulation is reduced.

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[1] https://fred.stlouisfed.org/series/A939RX0Q048SBEA

In Europe there are still big concerns, particularly among countries using the Euro. Greece is still in the depths of a terrible depression. One commentator states that "Fifty-two per cent of Greek households rely on pensions to pay their monthly expenses, according to a 2015 study. Yet Greece has only 2.7 million pensioners — 25 per cent of the population." Yet pensions are being cut under the punitive austerity measures being imposed by the European Union, the European Central Bank and the IMF. The unemployment rate is 23 percent with and 44 percent of people aged 15-24 out of work[1]. With political instability and failing banks, Italy is a major concern, and the size of its economy means that it would a much greater worry to the European Union than Greece. The political tensions within Europe created by these situations (and major economic problems still in Spain, Portugal and other member countries) are huge and largely unresolved, and are now being exacerbated by the political reactions to the influx of refugees from Africa and the Middle East. The rise of the far right, some calling for exit from the European Union creates a toxic and unstable economic and political situation.

Concerns still remain about the debt situation in China, where the government is moving the economy from one that has been predominantly export-driven to one more like the higher income countries which are heavily dependent on domestic spending. The government is concerned about the risk of capital flight and is intervening to raise the value of its currency to make that less attractive (contrary to Donald Trump's rhetoric which is that it is manipulating its currency downwards). While still a huge purchaser of commodities such as Australian minerals and New Zealand farm produce, the boom days are largely over as it deals with over-capacity in industry and moves to increase its domestic production capacity. So while it will continue to be a major export market, the boom starting around 2008 that both Australia and New Zealand benefited from is unlikely to be repeated. This is reflected in lower dairy and other produce prices. There are still risks of a financial crisis if the debt situation gets under control.

GDP in Australia fell 0.5 percent in the most recent (September) quarter, driven by a fall in private investment in buildings including housing. Unemployment is at 5.7 percent. The weak economy makes it difficult for our exporters (our exports to Australia fell by 0.9 percent in the year to December) and makes it likely that net immigration from Australia will continue.

The big unknowns are Donald Trump and Brexit, and what they represent.

Trump has begun his Presidency with unconscionable attacks on immigration and refugees. He is clearly determined to carry out his campaign promises. However many were ambiguous and vague, so it is too soon to tell what will come out of them in an economic sense. He is pushing ahead with building a "wall" over the most difficult remaining territory between the US and Mexico, costing tens of billions of dollars. While he insists that somehow Mexico will pay for it he has yet to find a way to make it do so, and Mexico will be determined not to. If the US pays for it along with a huge increase in spending on armaments and infrastructure, along with tax cuts Trump and his Republican allies (at least for now) have promised, US Federal government budget deficits will blow out for several years unless there are cut backs in other spending. This will be hard to do – as shown by his promise to stop 'Obamacare' now being accompanied by a promise to simultaneously replace it with something better. Though that will be impossible unless he moves to a universal health care system, it reflects the pressure he knows he will come under if Obama's painfully constructed system is simply destroyed. Serious cuts in Federal

[1] "A Greek tragedy: how much can one nation take?", Henry Foy, *Financial Times*, 20 January 2017, https://www.ft.com/content/44478b7e-dd09-11e6-9d7c-be108f1c1dce

spending are difficult to achieve without cuts in the social security and health systems which the Republicans have attempted under the Obama Administration. That is undoubtedly their goal.

While serious damage will be done to their already weak system of social support, it is also inevitable that the Federal budget deficit will grow. With the growing deficit, interest rates will rise as it borrows to finance the deficit. That will raise the value of the US dollar, weakening US export competitiveness. Trump is threatening tariffs to counteract this. It is not clear whether they will be directed against individual countries (like Mexico and China) or all countries. The impact of them will depend to some extent on this, but if generally applied they will increase prices to US firms and consumers, raising inflation. One of the Republican plans is for a new corporate tax system that greatly reduces the corporate tax rate from 35 percent to 20 percent and converts the tax into something more like a value-added tax (like GST, though with some very different features) that advantage exporters because companies would not be taxed on revenue from exports, and discourages imports, because imported goods would not be tax-deductible. This too will drive up the US dollar, largely negating any benefit.

Overall the plans signal another big increase in inequality in the US, both through an increasingly regressive tax system and through cuts to social support. This may be countered by increasing employment by moving the US to more domestic sourcing and production. There is hot debate over whether that will be successful and whether he can "bring back good jobs".

He will face increasing resistance from the business elite he is counting on, and from whom (along with the military) he is constructing much of his cabinet. They created the system he is trying to dismantle. They sent production offshore because they could increase their profits and benefit from lower wages, employment and environmental protections there. Trump is promising to greatly reduce "regulations" which will include reductions in both employment and environmental protections judging from his cabinet selections and rhetoric. If he is successful in attracting production, he will face labour shortages which will push up wages unless he reverses his attitude towards immigration. His response is likely to be wage suppression. It will be a very anti-union government. That means that US workers are most unlikely to see the benefit from Trumps plans, even if he is successful in bringing some of the production back home, and that is far from certain.

From New Zealand's point of view, we should be prepared for increasing interest rates, higher imported inflation and increased difficulties in exporting to the US. On the other hand we are likely to see a lower exchange rate with the US dollar, and perhaps with other countries if there is an outflow of funds to take advantage of higher international interest rates. Many of Trump's promises on tariffs would breach World Trade Organisation rules and the North American Free Trade Agreement (which could be described as the mother of TPPA and which he wants to change). The reaction of other countries to Trump's tariff plans will determine how much he is able to do and the international impacts. Some business commentators raise the prospect of an international trade war – other countries raising tariffs and other trade barriers to counter Trump's actions. Some such action is possible but the impact on New Zealand will depend on whether there is a general rise in trade barriers or limited action against the US (or specific US exports). It may in fact open up opportunities for New Zealand exports.

As to Brexit – it will be a long process. It will not be completed before 2019 at the earliest and even then some uncertainties may remain. Its impact in the next year will be more political than economic. One of the most direct political impacts will be the encouragement it gives to far right parties in Europe to carry out their own exits from the European Union. A rising of the far right would be a frightening

development on its own. If they are in control of countries in a Europe reverting to its pre-war divided state, the outcomes could be disastrous. But hopefully we are a long way from there.

The positive side of Trump's ascension to power and Brexit is that they both reflect a challenge by their populations to the suffocating neoliberal view of globalisation: that unregulated markets on a global scale are the best route to prosperity. Neoliberalism is now increasingly acknowledged to have failed as a set of domestic policies and ideology in the face of the economic catastrophe of the Global Financial Crisis and the huge inequalities it created – while failing to create the strong economic growth it promised. But the ideology carries on in the form of globalisation we see today. This form of globalisation has been defined and created by an international elite through a series of international agreements, standards and less formal arrangements. It succeeded as long as the large international corporations who were its chief advocates and sponsors backed it – but has increasingly become a naked tool for those corporations to pursue their own interests at the expense of others (such as through intellectual property rules that raise prices of medicine and creative works, and privileged dispute systems). When it became too obvious and too excessive for most people to tolerate, it became increasingly controversial and now is under threat.

There are at least two ways it could go. Under Trump it could become the direct property of the corporate elite – after all, his administration will be the "one percent" taking direct control – or there is now room for new thinking. Just as neoliberalism domestically must be replaced by a system whose objectives begin from people's needs (such as the right to health, education, good jobs, environmental sustainability, security, human dignity and human rights) so too must globalisation be made consistent with what we are pursuing at home. This is not about turning our back on trade and the world, but on more consistent, sensible and human ways of interacting with it.

That though will take longer than the year ahead. Have a good year. It will be an exciting one.

Bill Rosenberg

Information

Forecast.......7

Economy.......8

Employment.......12

Wages and prices.......15

Public Sector.......19

Notes.......20

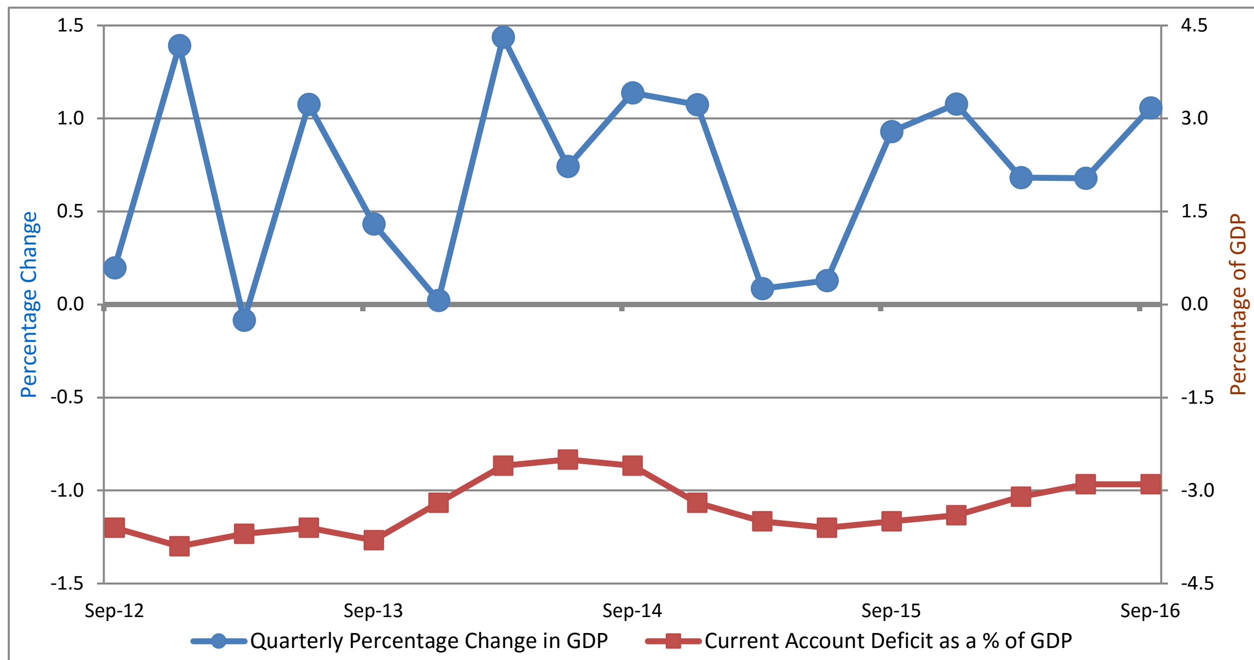
A ★ indicates information that has been updated since the last bulletin.

Forecast

★ This NZIER consensus forecast was released on 12 December 2016.

Annual Percentage Change (March Year)	**2016-17**	**2017-18**	**2018-19**	**2019-20**
GDP	3.5	3.3	2.9	2.4
CPI	1.4	1.8	2.0	1.9
Private Sector average wage	2.0	2.5	2.9	2.9
Employment	4.8	2.3	1.8	1.4
Unemployment rate (% of labour force)	4.8	4.6	4.6	4.7

Economy



- Growth in New Zealand's economy continued steadily in the September 2016 quarter, with Gross Domestic Product rising by 1.1 percent, compared to a revised 0.7 percent in both the June and March quarters. Average growth for the year ended September 2016 was 3.0 percent (and 3.5 percent increase between September quarters). However GDP is barely keeping up with the rapidly growing population: GDP per person grew only 0.6 percent in the September quarter, and 0.9 percent over the year. Real gross national disposable income per capita, which takes into account the income that goes to overseas investors, transfers (such as insurance claims) and the change in prices for our exports and imports, rose by only 0.6 percent over the September quarter and rose only 1.0 percent over the year to September. I estimate[1] that production per hour worked in the economy fell by 1.6 percent compared to the same period last year and fell 0.2 percent in the June quarter, indicating falling productivity which is bad for future wage growth. Business investment growth in the three months (0.2 percent) was a sharp reduction compared to the June quarter's growth (1.2 percent) and much slower than GDP growth. Investment in housing grew a slower 2.3 percent, not as strong as the 5.3 percent in the June quarter, but it grew very strongly at 14.0 percent from the same quarter last year. Household consumption growth was also strong, rising 1.6 percent in the quarter compared to 2.0 percent in the previous quarter and for the year up 5.4 percent. Inflation in the economy as a whole is weaker than CPI with the GDP deflator (a price index for expenditure on the economy's production) rising 0.3 percent in the September quarter and 0.0 percent in the June quarter, with a total rise of 0.6 percent for the year.

- By industry, the largest contributors to growth in the latest quarter were Transport, postal and warehousing (up 3.7 percent) and Professional, scientific, technical, administration, and support (up 2.0 percent) which together contributed 0.4 of the 1.1 percentage points rise in the quarter. However Construction continued its strong growth, rising 2.1 percent as did Arts, recreation and

[1] Because of the changes to the Household Labour Force Survey, there is a break in the hours-worked series in June. I estimated the increase for June using the historical relationship with hours paid from the more limited Quarterly Employment Survey.

other services which rose 2.4 percent. Public administration and safety which covers much of central and local government rose a strong 1.7 percent. Manufacturing grew a little more than the whole economy at 1.2 percent boosted by Food, beverage, and tobacco manufacturing (up 1.6 percent), Transport equipment, machinery and equipment manufacturing (up 2.7 percent) and Wood and paper products manufacturing (up 2.5 percent) but offset by falls in Textile, leather, clothing, and footwear manufacturing (down 3.3 percent), Printing (down 2.1 percent) and Non-metallic Mineral Product Manufacturing (down 1.4 percent though following a quarter of rocketing growth of 11.2 percent in the previous quarter). Growth in housing-led manufacturing was much less evident such as in Non-metallic Mineral Product Manufacturing which includes glass, cement and concrete and other construction materials, and Furniture and other manufacturing (up only 0.2 percent after a huge 18.2 percent in the previous quarter). Other than in these manufacturing sub-sectors the only falls were in Agriculture whose production reduced by 1.6 percent (though Forestry and logging rose 10.0 percent), Electricity, gas, water, and waste services whose output fell 0.2 percent, and Information media and telecommunications which was down 1.1 percent. Compared to the same quarter in 2015, Construction was up a huge 12.3 percent, Retail trade and accommodation up 5.7 percent, Transport, postal, and warehousing up 4.7 percent, Professional, scientific, technical, administration, and support was also up 4.7 percent, and Arts, recreation, and other services were up 4.8 percent. However Mining production fell 10.0 percent.

★ New Zealand recorded a Current Account deficit of $1.9 billion in seasonally adjusted terms for the September 2016 quarter (but an actual deficit of $4.9 billion) following a $1.8 billion deficit for the June 2016 quarter. There was another deficit in the goods trade ($686 million, seasonally adjusted, following a $496 million deficit in the June quarter, and in all quarters back to September 2014) and a surplus of $320 million in goods and services ($526 million in June), while the deficit on primary income (mainly payments to overseas investors) rose to $2.1 billion from $2.0 billion in June (not seasonally adjusted). For the year to September 2016, the current account deficit was $7.5 billion or 2.9 percent of GDP compared to a $7.4 billion deficit in the year to June (2.9 percent of GDP). The deficit on investment income was $8.1 billion for the year. During the year to March, foreign direct investors (those with a degree of control of the companies they hold shares in) were paid dividends at the rate of 10.6 percent after tax, compared to 11.8 percent the year before. By comparison they received a rate of return of only 2.6 percent after tax on debt owed to them by their companies. Portfolio investors received returns of 4.2 percent on shares and 2.0 percent on debt.

★ The country's Net International Liabilities were $166.2 billion at the end of September 2016, up from $163.0 billion at the end of June and $153.2 billion a year before. The September net liabilities were equivalent to 64.9 percent of GDP, compared to 64.4 percent in June and 62.4 percent a year before. They would take 2.38 years of goods and services exports to pay off, up from 2.21 years a year before. The rise in liabilities was due to a large $5.3 billion net inflow of investment offset by $2.0 billion in valuation changes without which the net liabilities would have been $168.2 billion. New Zealand's international debt was $296.4 billion (115.7 percent of GDP), of which 29.2 percent is due within 12 months, compared to $145.3 billion in financial assets (other than shares; 56.7 percent of GDP), leaving a net debt of $151.1 billion (59.0 percent of GDP). Of the net debt, $10.9 billion was owed by the government including the Reserve Bank (equivalent to 4.3 percent of GDP and down from $11.2 billion in June) and $108.1 billion by the banks (42.2 percent of GDP), which owed $161.2 billion gross. Total insurance claims made on overseas reinsurers from the Canterbury

earthquakes are estimated at $20.2 billion, and at 30 September 2016, $19.3 billion of these claims had been settled, leaving $0.9 billion outstanding.

- ★ Overseas Merchandise Trade for the month of December saw exports of goods fall 0.9 percent from the same month last year while imports also fell 0.9 percent. This created a trade deficit for the month of $41 million or 0.9 percent of exports. There was a trade deficit for the year of $3.2 billion or 6.6 percent of exports, lower than the 7.2 percent deficit in 2015 but second highest since 2008. In seasonally adjusted terms, exports rose 9.1 percent or $341 million over the month (compared to a 12.0 percent fall the previous month) led by rises in Dairy products (up 4.8 percent or $46 million), Meat (up 6.6 percent or $28 million), Aluminium and Aluminium articles (up 17.0 percent or $14 million, not seasonally adjusted) and Wine (up 8.1 percent or $11 million), offset by falls in Crude oil (down 64.8 percent or $52 million), Fruit (down 3.2 percent or $8 million), and Seafood (down 3.8 percent or $5 million). Seasonally adjusted imports rose 2.9 percent or $161 million over the previous month, creating a trade deficit of $241 million compared to a $421 million deficit in the previous month. The imports were led by rises in Mechanical machinery and equipment (not seasonally adjusted, up 17.4 percent or $99 million) and Petroleum and products (up 5.5 percent or $23 million), offset by falls in Textiles (down 11.0 percent or $22 million) and Plastic and plastic articles (down 6.0 percent or $10 million).

- ★ The Performance of Manufacturing Index[1] for December 2016 was 54.5, the same as the previous month. The employment sub-index was at 51.6, a rise from 49.1 in the previous month.

- ★ The Performance of Services Index[1] for December 2016 was 58.4, a rise from 58.1 in the previous month. The employment sub-index rose to 54.0 from 52.3 in the previous month.

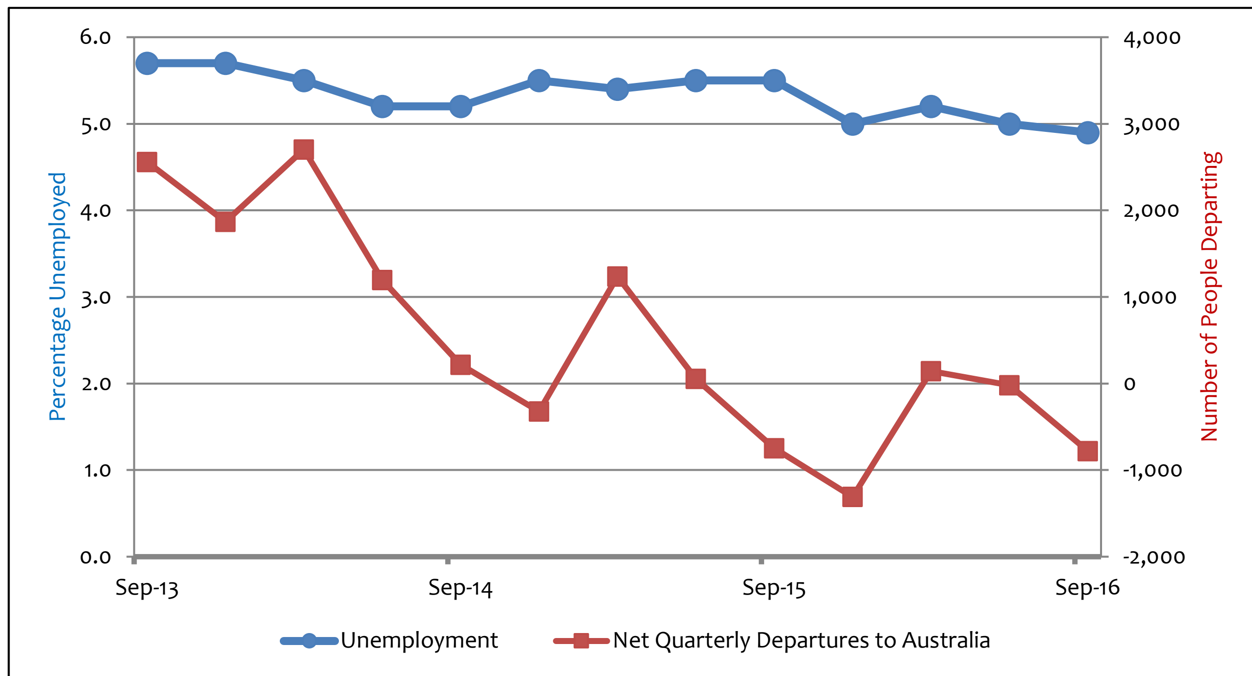
- The Retail Trade Survey for the three months to June 2016 showed retail sales rose 6.0 percent by volume and 5.5 percent by value compared with the same quarter a year ago. They rose 2.3 percent by volume and 2.2 percent by value in the quarter, seasonally adjusted. By value the fastest rises were in Non-store and commission retailing (which includes internet purchases) which was up 6.9 percent, Hardware, building, and garden supplies (up 5.9 percent), Pharmaceutical and other store-based retailing (up 4.9 percent), Food and Beverage services (up 3.6 percent), and Furniture, floor coverings, houseware, textiles (up 3.4 percent). There were falls in Recreational goods (down 2.9 percent), Accommodation (down 2.1 percent) and Fuel (down 0.7 percent). Supermarket and grocery stores, the largest single sector, rose 1.2 percent by value (up $53 million).

- On 10 November 2016 the Reserve Bank reduced the Official Cash Rate (OCR) to a new record low of 1.75 percent, down from 2.00 percent, where it had been since August. It indicated that the rate is unlikely to be lowered further unless there were unforeseen events, pointing a finger at those resulting from the "uncertain" international outlook. The Bank's Governor said that the global economy was operating below capacity despite signs of improvement in some countries, and global inflation remains low. "Political uncertainty remains heightened and market volatility is elevated." Despite record low interest rates in New Zealand, they are still significantly higher than other countries, keeping the New Zealand dollar "higher than is sustainable for balanced economic growth". It also creates deflation (negative inflation) in tradeable goods and services (exports and those in competition with imports). He again called for a lower exchange rate. His description of factors supporting the domestic economy showed the weak structural basis for current economic growth: "Domestic growth is being supported by strong population growth, construction activity,

tourism, and accommodative monetary policy. Recent dairy auctions have been positive, but uncertainty remains around future outcomes." He is also of the view that "High net immigration is supporting growth in labour supply and limiting wage pressure." The Bank's data shows that in the year to September the working-age population rose by 2.8 percent, easily the highest rate since 2000 and probably in the last 25 years, made up of a natural increase of 1.1 percent and migration increase of 1.7 percent. House prices continue to worry the Bank, "posing concerns for financial stability". The Governor is not confident the slowing of price growth in Auckland will continue while there are not enough houses. He expects CPI inflation, kept low by tradables deflation, to rise from December. RBNZ forecasts show tradeables inflation rising to over 3 percent from mid-2018 and total CPI inflation to 2.0 percent in December 2018. The next OCR announcement will be on 9 February 2017 and will include a Monetary Policy Statement.

★ According to REINZ, the national median house price rose $51,000 or 11.0 percent to $565,000 in the year to December 2016 and rose 0.4 percent from the previous month seasonally adjusted though fell 0.8 percent from $520,000 in actual prices. The Auckland median price rose 9.1 percent or $70,000 over the year to $840,000 and fell 1.4 percent (both seasonally adjusted and in actual prices) or $28,000 on the previous month. Excluding Auckland the national median price rose $41,000 to $420,000 or 10.8 percent higher than a year before. It was up 1.2 percent or $5,000 on the previous month. Five regions had record median prices: Northland ($410,000, up 14 percent over the year), Hawkes Bay ($345,000, up 11 percent), Wellington ($530,175, up 22 percent), Otago ($310,000, up 10 percent), and Southland ($235,000, up 15 percent). There was a rise from 755 to 977 in the number of sales in the $1 million plus range over the year and from 1,760 to 1,771 in the $600,000 to $1 million range. However sales below that price level fell steeply, with the 2,227 sold valued under $400,000 now only 34.1 percent of sales compared to 40.1 percent a year ago, a 24.0 percent fall. Total sales were down 10.7 percent from 7,313 a year ago to 6,533 in December 2016.

Employment



Note: as described in the September Bulletin, the release reported on below of **Household Labour Force Survey** statistics on employment and unemployment reflects a major revision of the survey that took effect from June 2016. The changes include the measurement of unemployment, whose values have been revised back to 2007. Other employment statistics, including numbers employed and hours worked, cannot be accurately compared between June 2016 and previous months.

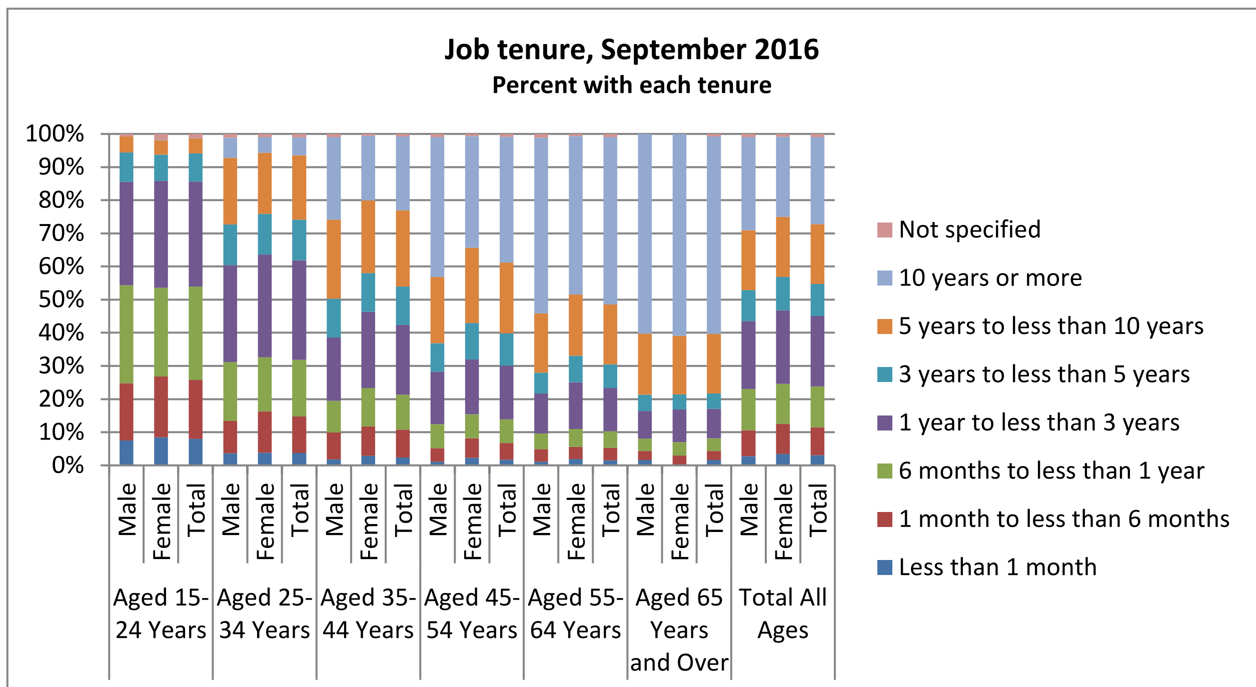
- According to the Household Labour Force Survey (HLFS) the unemployment rate in the September 2016 quarter fell to 4.9 percent or 128,000 people, compared to 5.0 percent in June (131,000 people), seasonally adjusted. It is still more than half as much again than the 3.3 percent it was in December 2007. The unemployed were not the only people looking for work: the new statistics include a measure called "underutilisation" which includes the officially unemployed as above, people looking for work who are not immediately available or have not looked sufficiently actively to be classed as officially unemployed, plus people in part time work who want more hours ("underemployed"). In the September quarter there were a total of 329,000 people looking for work classed as "underutilised", or 12.2 percent of the labour force extended to include these people. Of them, 105,300 were underemployed, 125,800 were officially unemployed, and 97,900 were additional jobless people looking for work (these figures are not seasonally adjusted). The 12.2 percent underutilisation rate is down from 13.2 percent a year before but still considerably higher than in September 2007 when it was 8.8 percent. It is higher for women at 14.9 percent than for men (9.8 percent). Excluding the officially unemployed, the underutilisation rate is 7.5 percent. There are 43,500 unemployed people who have been out of work for more than 6 months. This is apparently a large increase from the 42,000 a year before but a change in the survey question could have contributed to this. This is 34.6 percent of the unemployed compared to 31.1 percent a year before, and has not been previously reached in a September quarter since 2000. Those out of work for more than a year are 14.6 percent of the unemployed compared to 11.3 percent a year before

(again possibly affected by the changed survey question). Compared to OECD unemployment rates, New Zealand had 10th lowest (out of 34 countries), compared to 11th equal in June.

- The number recorded as employed rose by 35,000 between the June and September 2016 quarters (seasonally adjusted). The recorded employment rate rose from 66.2 percent to 66.7 percent over the three months. Similarly the participation rate (the proportion of the working age population either in jobs or officially unemployed) rose from 69.7 percent to 70.1 percent, all in seasonally adjusted terms.
- In the North Island, unemployment rates fell compared to a year ago in all but Taranaki, but none of the falls were statistically significant (that is, the error in the estimates of unemployment means it cannot be ruled out that the falls were in fact zero). In the North Island, Northland still has the highest unemployment at 7.6 percent while Waikato at 4.5 percent has the lowest. Auckland is at 5.3 percent and Wellington 4.6 percent. Gisborne/Hawkes Bay is at 6.5 percent. The South Island looks considerably better, with Tasman/Nelson/Marlborough/West Coast at 2.8 percent (down a statistically significant 2.2 percent from a year before), Canterbury at 3.9 percent, Otago at 3.7 percent and Southland at 5.3 percent.
- By industry, the increase in employment of 17,700 since the June quarter was made up of both gains and losses. The biggest gains were of 10,400 in Education and Training, 8,400 both in Construction and in Arts, recreation, and other services, and 6,900 in Agriculture, forestry and fishing. The biggest losses were 8,300 in Manufacturing, and 4,500 in Financial and insurance services.
- The seasonally adjusted female unemployment rate at 5.1 percent in September was higher than for men (4.6 percent), but both fell from the previous quarter (5.4 percent and 4.7 percent respectively). Māori unemployment fell from 12.1 percent in September 2015 to 10.6 percent in September 2016, and Pacific people's unemployment fell from 12.3 percent to 10.1 percent over the year.
- **Youth unemployment** for 15-19 year olds was 19.3 percent in September, up from 18.6 percent in June, down from 20.1 percent a year before (note that these and the other statistics for the whole youth population are seasonally adjusted, but those for Māori and Pacific Peoples are not). For Māori in September 2016 the unemployment rate was 26.6 percent and for Pacific Peoples it was 31.1 percent. For 20-24 year olds youth unemployment was 9.1 percent, down from 9.4 percent in June and 10.9 percent a year before. For Māori in September 2016 it was 15.2 percent and for Pacific Peoples it was 11.1 percent. The proportion of 15-19 year olds "not in employment, education, or training" (the NEET rate) for 15-19 year olds was 7.1 percent, up from 6.9 percent in June and 6.7 percent a year before. For Māori in September 2016 the rate was 11.6 percent and for Pacific Peoples it was 11.2 percent. For 20-24 year olds the NEET rate was 14.7 percent, up from 14.3 percent in June but down from 14.9 percent a year before. For Māori in September 2016 the rate was 26.7 percent and for Pacific Peoples it was 19.3 percent. For the whole 15-24 year old group, unemployment was higher for those in education (14.1 percent) than those not in education (11.6 percent). There were 74,000 people aged 15-24 years who were not in employment, education, or training (NEET), up from 71,000 in June and 71,000 a year before.
- From the June quarter, the HLFS started surveying **union membership** and having a **collective employment agreement**. In the September 2016 quarter, total union membership was estimated at 375,400, a 1.0 percent fall from 379,300 in the June quarter. The membership is 18.7 percent of

employees (or slightly higher if those who didn't know were discounted) compared to 19.1 percent in the previous quarter. Women make up 58.0 percent of the membership compared to 49.3 percent of all employees. As a result, the proportion of women employees who are in unions is higher than for men – 22.0 percent compared to 15.5 percent. There may be seasonal variations in union membership which are not yet apparent, so quarterly comparisons may not represent annual trends. Regarding coverage by a collective employment agreement, 19.5 percent of employees (391,800, which is larger than the estimated number of union members) said their employment agreement was a collective in September compared to 20.6 in June; 65.0 percent (1,305,100) said it was an individual agreement compared to 62.9 percent in June, and 7.9 percent or 158,600 said they had no agreement (which is illegal), compared to 8.6 percent in June. Perhaps after the publicity given to the large number of illegal employment arrangements when the June figures were announced some employers rapidly put those workers onto individual agreements. There is still a large number that flout the law however. A further 7.4 percent of employees didn't know what kind of employment agreement they had. Coverage by collective agreement was 16.6 percent for men and 22.5 percent for women. Again, these figures could be affected by seasonal variations in numbers.

- For the first time in June the HLFS also reported on "**employment relationship**". In the September 2016 quarter, 89.9 percent of employees (1,804,100) reported they were permanent, 4.8 percent casual (96,800), 2.9 percent fixed term (59,000), 1.3 percent seasonal (26,000), and 0.3 percent employed through a "temporary agency" (7,000). The proportion reporting they were permanent was up from 1,762,900 in June. Women were slightly less likely to be permanent employees: 88.4 percent of women were permanent compared to 91.4 percent of men. Instead, women were more likely to be casual (5.3 percent of them compared to 4.3 percent of men) or fixed term (4.0 percent of women compared to 1.9 percent of men). However somewhat more men were in seasonal work than women – 1.4 percent of men (14,200) compared to 1.2 percent of women (11,800). Of the temp agency employees, 3,400 were men and 3,700 women. Women make up 49.3 percent of employees. Employment relationships may have seasonal variations, so we should be cautious about seeing trends in quarterly comparisons. In addition, small differences may not be statistically significant.
- For the first time in June the HLFS also reported on **duration of employment (job tenure)**. In the September quarter, 23.8 percent of those in the labour force (including the self-employed) had been in their jobs for less than a year. Another 30.9 percent had been in their job for at least a year but less than five years, so a majority had been in their jobs less than five years. A further 19.1 percent had been in their job for at least five but less than ten years, and 26.2 percent had been in their jobs for 10 years or more. These figures were similar to the June quarter, though they suggest a 'hollowing out' compared to the Surveys of Working Life carried out by Statistics New Zealand in 2008 and 2012 – the proportion in their jobs less than a year and those in their jobs more than 10 years have grown at the expense of the middle group. However all the surveys were at different times of the year and there could be strong seasonal effects so the regular quarterly surveys will eventually shed much clearer light on this issue. In September, women appeared to be somewhat more likely to have been in their jobs for a shorter time than men. For example, 28.1 percent of men had been in their jobs for more than 10 years, but only 24.1 percent of women. But the differences may not be statistically significant. As would be expected, age is a significant factor as the graph below shows.



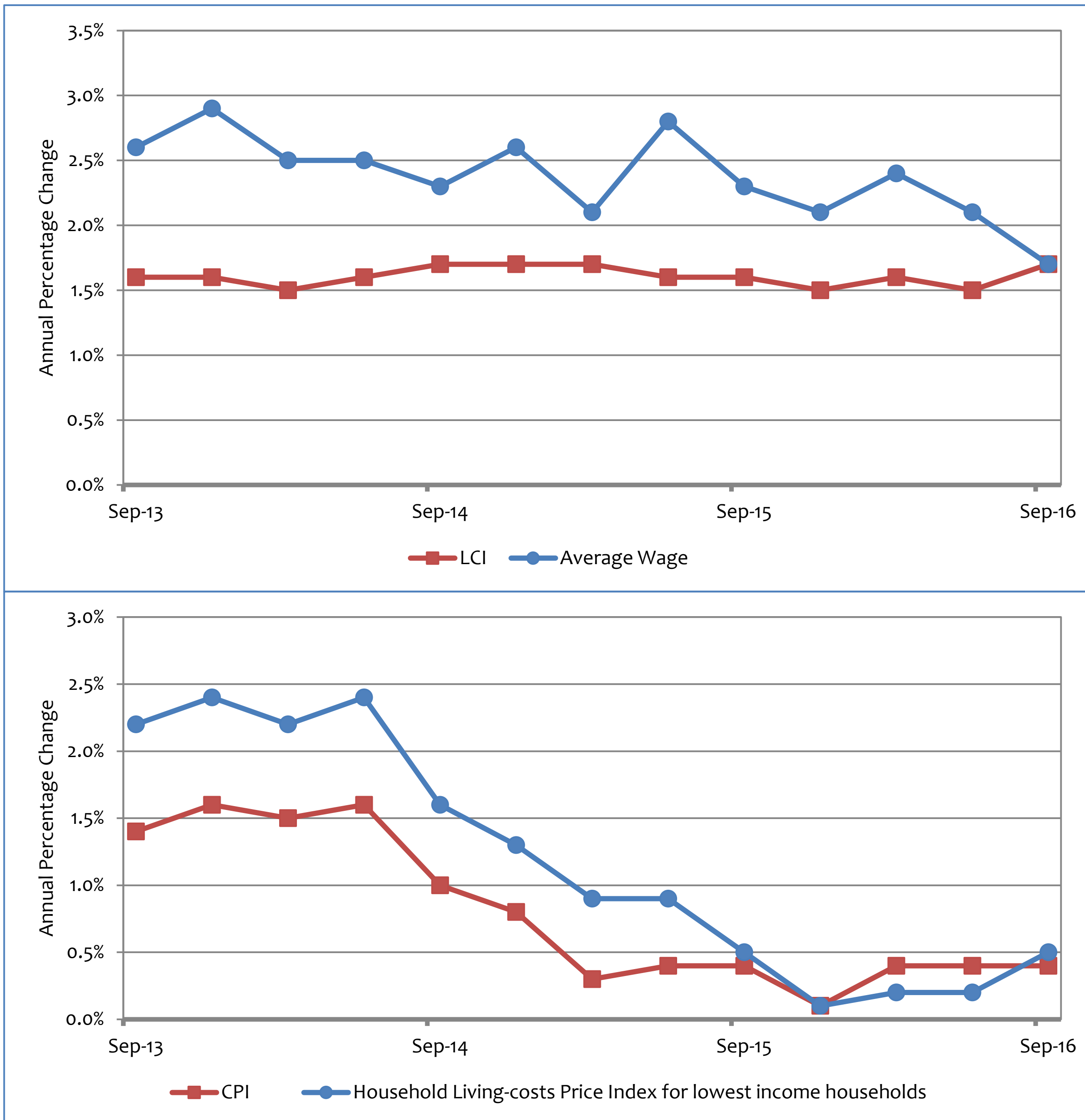
★ The Ministry of Social Development reports that at the end of December 2016 there were 124,311 working age people on the Jobseeker benefit, 1,384 more than a year before and a rise of 2,027 from 122,284 in September. At December 2016, 67,502 were classified as 'Work Ready', and 56,809 were classified as 'Health Condition or Disability'. A total of 297,010 were on 'main' benefits, 4,339 fewer than a year before, mainly due to 3,410 fewer on Sole Parent Support, but 13,135 higher than September, mainly because of over 10,000 going onto a 'Jobseeker Support Student Hardship' benefit during the three months. It was 12,797 more than in December 2007. Of the 37,733 benefits cancelled during the three months to December, 17,604 or 46.7 percent obtained work, 14.1 percent transferred to another benefit and 1.4 percent became full time students.

★ Job Vacancies Online for December 2016 showed the number of job vacancies rose by 1.1 percent in the month and rose 12.9 percent over the same month a year previously, in seasonally adjusted terms. Over the year, vacancies in Auckland rose 16.5 percent, Wellington rose 1.4 percent, the rest of the North Island rose 24.2 percent, Canterbury fell 4.5 percent and the rest of the South Island rose 21.8 percent. Over the month, vacancies rose in Auckland by just 0.5 percent, Wellington by 3.2 percent, the rest of the North Island by 2.0 percent, Canterbury by 0.6 percent and the rest of the South Island by 5.0 percent. By industry, the fastest annual increases were in Education and training (up 23.0 percent), Hospitality and tourism (up 17.6 percent), Construction and engineering (up 13.3 percent), Sales, retail and marketing (up 11.2 percent), and Healthcare and medical (up 11.0 percent). IT (Information Technology) fell 4.8 percent. Over the month, changes ranged from falls of 7.0 percent in IT (Information Technology) and 3.9 percent in Construction and engineering to increases of 5.2 percent in Hospitality and tourism and 10.9 percent in Education and training. By occupation, the fastest rises over the year were for Machinery Drivers (up 25.5 percent), Labourers (up 17.0 percent), Sales (up 15.2 percent), Technicians and Trades workers (up 15.2 percent), and Managers (up 14.0 percent). Over the month, vacancies rose between 0.2 percent (for Technicians and Trades workers) and 6.1 percent (for Labourers). All these are in seasonally adjusted terms.

★ International Travel and Migration statistics showed 10,930 permanent and long-term arrivals to New Zealand in December 2016 and 4,920 departures in seasonally adjusted terms, a net gain of

6,010. There was an actual net gain of 70,588 migrants in the year to December, the highest ever. Net migration to Australia in the year to November was 1,563 arrivals, with 24,220 departures and 25,783 arrivals. However there was still a net loss of 3,869 New Zealand citizens to Australia over the year and a net loss of 1,818 to all countries. For the month of December, there was a seasonally adjusted net gain from Australia of 40, compared to a gain of 200 a year before. In December, 13.0 percent of the arrivals had residence visas, 7.5 percent student visas, 27.9 percent work visas, and 5.6 percent visitors. A further 45.5 percent were New Zealand or Australian citizens.

Wages and prices



- The Labour Cost Index (LCI) for salary and ordinary time wage rates rose 0.5 percent in the three months to September 2016 and increased 1.7 percent in the year, ahead of the 0.4 percent increase in the CPI. It increased 0.7 percent in the public sector and 0.4 percent in the private

sector in the three months to September. Over the year it rose 1.7 percent in the public sector and 1.6 percent in the private sector. During the year, 45 percent of jobs surveyed did not receive a pay rise, and 47 percent of private sector jobs got no rise. For the 55 percent of those jobs surveyed which received an increase in their salary or wage rate during the year, the median increase was 2.3 percent and the average increase was 3.1 percent. For those jobs that received increases, the median increase in the public sector was 2.0 percent and in the private sector 2.5 percent; the average increase in the public sector was 2.5 percent and in the private sector 3.2 percent. We estimate that jobs on collective employment agreements were 2.2 times as likely to get a pay rise as those who were not, and are more likely to get a pay rise of any size ranging from less than 2 percent to 5 percent but are 10 percent less likely to get one of more than 5 percent. Only 45 percent of jobs that were not on a collective got a pay rise during the year whereas the Centre for Labour, Employment and Work reports 99 percent of those on a collective got a pay rise. In the construction industry, salary and ordinary time wage rates in Canterbury are rising considerably more slowly than in the rest of the country: 0.3 percent in the quarter in Canterbury but 0.6 percent in the rest of the country; and over the year to September, 1.1 percent in Canterbury compared to 2.3 percent elsewhere. For those getting a rise, Canterbury wage rates rose 3.3 percent in the year compared to 4.2 percent elsewhere.

- The Quarterly Employment Survey for the three months to September 2016 found the average hourly wage for ordinary-time work was $29.78, up 0.5 percent on the previous quarter and up 1.7 percent over the year (the lowest increase since 2010 when the country was just coming out of recession). Female workers (at $27.56) earned 13.0 percent less than male workers (at $33.57) for ordinary time hourly earnings. The average ordinary-time wage was $27.81 in the private sector (up 0.3 percent in the quarter and up 1.6 percent in the year) and $37.45 in the public sector (up 1.4 percent in the quarter, after a 0.8 percent fall in the previous quarter, and up 3.0 percent in the year).

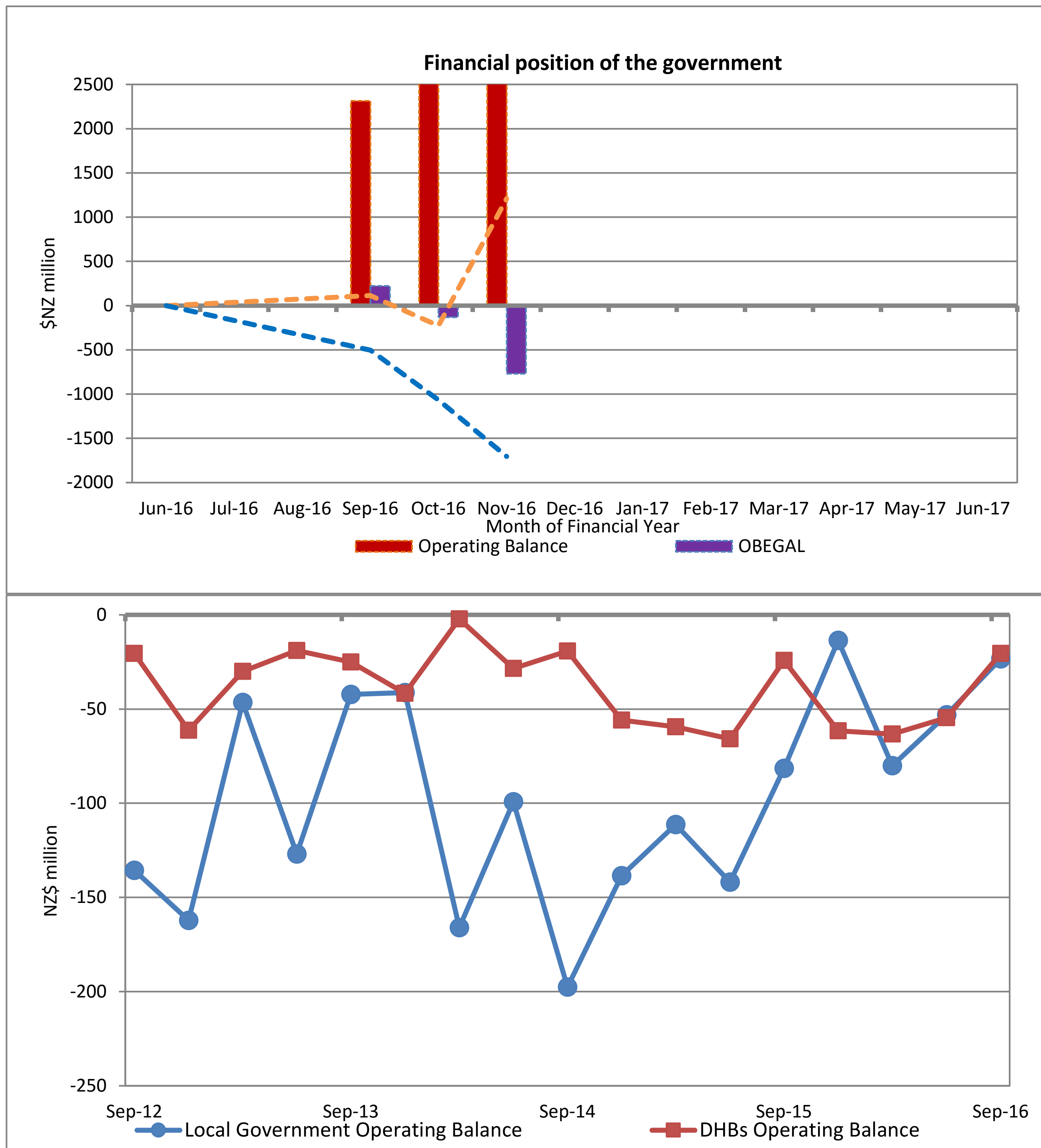
- ★ The Consumer Price Index (CPI) rose 0.4 percent in the December 2016 quarter compared with the September quarter, or 0.7 percent in seasonally adjusted terms (it is often negative in the December quarter), and increased 1.3 percent for the year to December, the first time it has been 1.0 percent or more since September 2014. For the quarter, the largest upward influence was Transport (up 3.7 percent) which by itself would have accounted for the total rise, pushed up by rising prices for petrol, passenger transport (especially international air travel) and new cars. However Housing and household utilities rose 0.6 percent, worth nearly a third of the rise, mainly due to rents rising 0.5 percent and new houses up 1.4 percent. They were offset by falls in Food (down 1.2 percent, mainly due to a 9.9 percent fall in Fruit and vegetable prices) and Household contents and services (down 1.4 percent, the largest contributor being costs of furniture and furnishings which fell 2.3 percent). Over the year however, Housing and household utilities was easily the biggest driver in the rise, up 3.3 percent and contributing almost two-thirds (60 percent) of the increase, led by rents up 2.0 percent and new housing up 6.5 percent but rises above average inflation in Property maintenance (up 3.1 percent), Property rates and services (up 3.2 percent), and Household energy (up 2.4 percent). Not part of the Housing group but also related to housing are house insurance (up 3.5 percent – but contents insurance was down 0.3 percent), and Real estate services (up 12.1 percent). Not part of the CPI (though in Household Living Cost Indexes) is Interest, which was still falling in December (down 2.2 percent in the quarter and 10.0 percent over the year) though there are now signs it is beginning to rise again. In seasonally adjusted terms, the

CPI rose 0.7 percent from September, Food rose 0.4 percent, Alcoholic beverages and tobacco rose 1.3 percent, Clothing and footwear rose 0.8 percent, Housing and household utilities rose 0.8 percent, Communications fell 0.7 percent, Recreation and culture rose 0.2 percent, and Education rose 0.8 percent. Inflation in Canterbury for the year was 1.2 percent and it was 1.5 percent in the rest of the South Island. In Auckland prices rose 1.2 percent, Wellington 1.6 percent and 1.4 percent in the North Island other than Auckland and Wellington. Auckland's housing costs rose 3.9 percent over the year, the fastest in the country; Wellington's rose 2.6 percent, the North Island (outside Auckland and Wellington) rose 3.2 percent, Canterbury's rose 2.0 percent and rest of the South Island rose 2.9 percent, with the national average movement of 3.3 percent exceeded only by Auckland.

- In November, Statistics New Zealand published its first quarterly release of several new price series, The **Household Living-costs Price Indexes** (HLPIs). These show price increase like the CPI (above) but are designed to be better at showing the costs faced by households, and to show the different costs faced by different types of households. There is a total of fourteen indexes: for "all households", Beneficiary households, Māori households, Superannuitant households, five for households ranked by income (five "income quintiles"), and five for households ranked by expenditure ("expenditure quintiles"). The incomes and expenditures are calculated to take account of household size and composition ("equivalised"). They are not strictly comparable to the CPI because they used different a methodology. See the commentary in the November 2016 Bulletin for more detail. The September release shows that over the year to September, the All households HLPI index rose 0.1 percent, the Beneficiary households index rose 0.8 percent, the Māori households index rose 0.2 percent, and the Superannuitant households index rose 0.4 percent. By income quintile, the index for the lowest income households (quintile 1) rose 0.5 percent, quintile 2 rose 0.3 percent, quintile 3 rose 0.0 percent, quintile 4 rose 0.0 percent, and quintile 5 fell 0.2 percent. By expenditure quintile, the index for the lowest expenditure households (quintile 1) rose 0.6 percent, quintile 2 rose 0.3 percent, quintile 3 rose 0.1 percent, quintile 4 fell 0.1 percent, and quintile 5 fell 0.3 percent. Over the September quarter, the All households HLPI index rose 0.3 percent, the Beneficiary households index rose 0.2 percent, the Māori households index rose 0.2 percent, and the Superannuitant households index rose 0.3 percent. By income quintile, the index for the lowest income households (quintile 1) rose 0.3 percent, quintile 2 rose 0.4 percent, quintile 3 rose 0.2 percent, quintile 4 rose 0.3 percent, and quintile 5 rose 0.4 percent. By expenditure quintile, the index for the lowest expenditure households (quintile 1) rose 0.2 percent, quintile 2 rose 0.3 percent, quintile 3 rose 0.4 percent, quintile 4 rose 0.3 percent, and quintile 5 rose 0.4 percent. The next release is on 9 February.

★ The Food Price Index fell by 0.8 percent in the month of December 2016 (and fell 0.5 percent in seasonally adjusted terms). Food prices rose 0.6 percent in the year to December. Compared with the previous month, fruit and vegetable prices rose 0.1 percent (but were down 0.4 percent seasonally adjusted); meat, poultry, and fish prices fell 1.5 percent; grocery food prices fell 0.9 percent (down 0.6 percent seasonally adjusted); non-alcoholic beverage prices fell 3.1 percent; and restaurant meals and ready-to-eat food prices rose 0.1 percent. (There are no significant seasonal effects for the categories without a seasonal adjustment.)

Public Sector



★ According to Treasury's Financial Statements of the Government of New Zealand for the five months to 30 November 2016, core Crown tax revenue was $460 million (1.6 percent) higher than forecast in the 2016 Half Year Economic and Fiscal Update (HYEFU 16). Treasury states: "The preliminary estimated fiscal cost of the Kaikōura earthquakes is expected to be between $2 billion and $3 billion. As a result, $1 billion was added to the HYEFU 16 forecasts in relation to estimated costs that could not be met by insurance proceeds, reprioritisation or existing budget allowances." The results reported need to be read in this light. Corporate tax revenue was $87 million or 2.5 percent above forecast, and GST was $252 million (3.3 percent) above forecast. Overall core Crown

revenue was consequently $413 million or 1.3 percent higher than forecast. Core Crown expenses were $266 million (0.8 percent) below forecast. As a result, the Operating Balance before Gains and Losses (OBEGAL) was $768 million in deficit, $0.9 billion better than forecast. The Operating Balance was a $4.7 billion surplus, $3.5 billion higher than expected. Most of this came from an increase in the valuation of ACC's net assets as a result of actuarial gains of $3.5 billion due to unforecast changes in discount rates; in all, net gains were $2.6 billion above forecast. Net debt at 24.8 percent of GDP ($63.5 billion) was $62 million better than forecast. Gross debt at $87.1 billion (34.0 percent of GDP) was $1.1 billion less than forecast. The Crown's net worth in financial terms was $3.5 billion higher than forecast at $94.1 billion.

★ District Health Boards had 849 full time equivalent staff fewer than planned in September 2016 (61,891 compared to 62,741 planned). While all categories of staff were affected, the largest shortfalls were in Medical Personnel (doctors – 350 short) and Allied Health staff (249 short). Average costs per full time equivalent staff were greater than planned in all categories except Management/Administration staff, whose costs were as planned. The DHBs recorded combined deficits of $20.5 million in the three months to September. This is $8.0 million worse than their plans. The Funder arms were in surplus by $25.9 million, and Provider arms (largely their hospitals) in deficit by $47.6 million, $34.8 million worse than planned. The Northern region was $11.5 million behind plan with a deficit of $15.0 million and all DHBs in deficit. The Midland region was $15.3 million behind plan with a deficit of $17.3 million and all DHBs in deficit. Central region was $4.2 million behind plan with a combined $2.1 million surplus but all in deficit except Capital and Coast at $0.4 million surplus, and Hawke's Bay at $3.5 million surplus. The Southern Region was $3.9 million behind plan with a $17.4 million deficit and all but Nelson Marlborough DHB in deficit, with Canterbury showing a $10.1 million deficit and Southern $4.9 million. In all only three of the 20 DHBs were in surplus. The DHB furthest ahead of plan was Southern by $0.6 million, and Waikato was furthest behind, by $10.3 million, although Auckland was a fast follower being $9.0 million behind plan. Capital expenditure across all DHBs was far behind plan – only $93.0 million spent out of $345.1 million planned.

★ Local Government recorded a 2.8 percent ($66.0 million) rise in operating income and a 1.5 percent rise in operating expenditure ($36.3 million) including a 2.5 percent rise in employee costs ($13.5 million) for the September 2016 quarter compared to June 2016. This resulted in an operating deficit of $23.3 million in the June quarter, compared with a deficit of $53.0 million in the June quarter, and deficits in all the quarters back to June 2007 with the exception of June 2010, all in seasonally adjusted terms. Note that the latest quarter results are provisional and seasonally adjusted figures are revised with each release.

Notes

1 For the Performance of Manufacturing Index (PMI) and Performance of Services Index (PSI) a figure under 50 shows the sector is contracting; above 50 shows that it is growing. Previous month's figures are often revised and may differ from those published in a previous Bulletin.

This bulletin is available online at http://www.union.org.nz/economicbulletin185.

For further information contact Bill Rosenberg.