BNZ Weekly Overview

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Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Growth and Employment

We economists like to talk about the speed of growth in the economy, how fast we think it will grow, how fast other economies are likely to grow, and the things we think will drive growth, retard it, and put the ups and downs at risk. This takes up a lot of time and probably frustrates a lot of people but it needs to be done because unless you have a view on where growth is going you will struggle to deliver any reasonable view on where the things people really are interested in are likely to go. Namely interest rates, exchange rates, house prices, commercial property yields, profits, and of interest to more people than anything else, wages and employment.

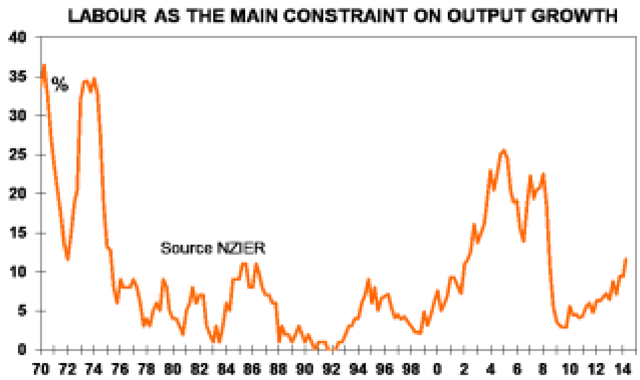
Not that this means that the pace of growth is the main determinant of some of these things. Business profitability in particular while in aggregate heavily influenced by the speed of growth ultimately depends upon the competence of the people running the company. That is why when people go and do their MBAs no-one says to them that they should take things easy because the fate of their company is in the hands of the economy.

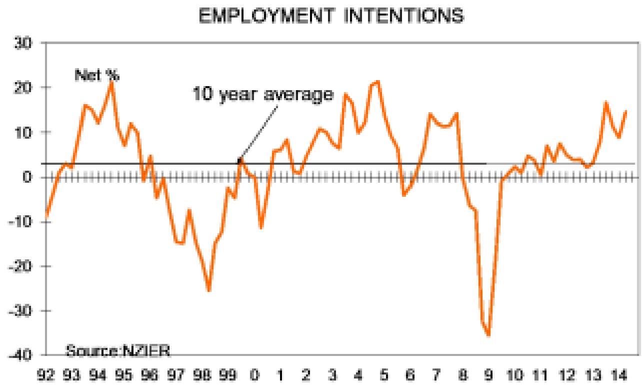
Back to the labour market though, with our economy having grown by 3.2% in the year to March following growth of 2.2% the previous year and 2.4% before that it is unsurprising that businesses are hiring people and that the unemployment rate has fallen from a peak of 7.2% in the second half of 2012 to 5.6% this June quarter. The 2014 March quarter rate was 5.9% so this is good progress. There are still however 137,000 people unemployed though this is well down from the peak of 164,000. Before our recession in 2008-09 when the economy shrank about 3.6% there were just over 80,000 unemployed people and the unemployment rate hit a low of just 3.5%.

That was an interesting time because businesses were really struggling to find staff and were changing the way they grew their profits away from producing more output toward less production with better people better remunerated, and of course with prices increased to customers desperate to get the goods and services being produced. For some companies this change in focus was forced by employees – or mainly contractors – choosing to work four rather than five day weeks so they could more enjoy their higher hourly rates. Makes sense.

We are not at that stage yet as evidence in the NZIER's Quarterly Survey of Business Opinion for the June quarter released a few weeks ago. It showed that a gross 12% of non-farm businesses consider a lack of staff to be the main constraint on their ability to grow. This is equal to the long term average and well below levels of 20% over 2006 into early-2008. But the labour market is tightening up and the question is when will businesses shift toward using their pricing power and boosting inflation? To answer that you need to take a view on whether strong growth in labour demand will continue (we think yes), and when wages growth will pick up.

So can we look at the data releases accompanying yesterday's Household Labour Force Survey and see any increase in the pace the wages growth as yet? The answer is not really. The analytical Labour Cost Index series put together by Statistics NZ to try and track an unchanging mix of jobs shows that wages rose by 0.7% during the June quarter. This was only 0.1% better than the 0.6% growth in the June quarter of 2013 and means the annual pace of growth in this measure sits at 2.9% from 2.8% in the March quarter, 2.8% a year ago, and rates close to and above 5% from 2005 into early-2009.





This slow pace of wages growth probably reflects a lack of willingness by employees to put the hard word on the boss because memories remain strong of the GFC and people are still more focussed on employment retention than remuneration growth. That will change but the evidence so far internationally post-GFC is that the link between employment growth and wages growth is more drawn out than before.

Businesses however should be preparing for this environment to come along and not anticipate the tight labour market/higher wages growth situation changing back in their favour again for quite some time.

There are many factors driving the labour market into territory which businesses need to pay attention to. First there is the simple cyclical upturn in growth we are experiencing. Second there is the fact that this cycle is likely to last quite some time given the strength and longevity of some factors such as rebuilding Christchurch, catching up on building houses in Auckland, boosting infrastructure, earthquake strengthening and so on.

Third there are demographic changes which for the moment may be getting outweighed by the migration boom. The aging population means a slower average pace of growth in the labour force than was the case in the past.

Fourth, the current migration boom won't last. It probably has not yet peaked, but it will turn again once things look a lot better in Australia maybe two years from now. Businesses should not think that migration will solve their coming hiring problems. It takes different skills from those they have accumulated to date to effectively manage and integrate migrants, and the assumption many employers have about skilled people just aching to work here is usually wrong. There is massive demand for skilled people on the east and west coasts of Canada and frankly people thinking about working overseas would prefer to be there rather than here – though not all of them thank goodness.

Nevertheless, all up our labour market is in good health and I would not read too much into the fact that employment growth actually slowed in the quarter to 0.4% from 0.9% in the March quarter, 1.1% in the December quarter, and 1.2% in last year's September quarter. The employment numbers can be highly volatile at times for reasons not even Statistics NZ have ever been able to explain.

Another thing we learnt this week is that the fall in dairy prices from extraordinarily high levels is not yet complete. Average prices fell 8.4% at this fortnight" Global Dairy Trade auction after falling 8.7% two weeks ago and are now 41% down from their peak and at levels of two years ago. Dairy farmers are facing a likely payout this season closer to $5.50 than the $6 recently indicated by Fonterra and the $8.40 of last season. With 20% of dairy operators already apparently facing losses at $6 more will now be in that situation.

Does this mean the economy's economic recovery is over? Of course not. Since the start of the year we have emphasised that there are at least eight factors driving our growth rather than just one or two. They include
Rebuilding Christchurch
Catch-up house construction in Auckland

Dairy sector investment (note, not income)
Infrastructure spending
Earthquake strengthening of commercial buildings
Water-tightness remediation work
Slightly faster world growth
A migration boom

However at the margin the fall in dairy incomes will sap growth and this means some extra mild downward pressure on the NZD and more space for the Reserve Bank to pause before they seriously give thought to raising the cash rate again.

Speaking of housing, the main thing I took away from the Barfoot and Thompson Auckland residential data this week is that listings are once again drying up. New listings in July were down by 15% from a year ago. However stock was still 15% up on last July so the market is not really all that much in favour of sellers. Or at least you would think so until you find yourself trying to buy. Then you will find that high awareness among sellers of the worsening housing shortage in Auckland means they are in no hurry to sell – especially as they don't want to be caught having sold then scrambling to find something to buy before settlement date.

Finishing off with the currency. Measured against the USD the NZD has lost nothing and still holds just under 85 cents in spite of better than expected data in the United States on the factory and services sectors, and locally the further fall in international dairy prices. Why is the NZD holding up? As we have stated here for a number of years – maybe four or five – a lot of the rest of the world looks like rubbish. In Portugal a bank just avoided failure, Italy is back in recession, indicators for Germany have worsened, even UK indicators this week have been weaker than expected, and Russia appears on the verge of invading Ukraine. In Japan recently data showed a surprisingly large fall in industrial production. In Australia numbers for house building were weaker than expected. In the Middle East – well it is just going up in flames. Africa has Ebola. China has a still weakening housing market, millions of people running scared due to the deepening crackdown on corruption, and a measure of the manufacturing sector has just dropped sharply to a five year low.

This all adds up to global interest rates not going anywhere for a still long period of time while ours will rise again next year – hence more support eventually coming for the NZ dollar. Barring either a collapse in world growth or an outbreak of foot and mouth disease one struggles to see a scenario in which the NZD will weaken much in the coming year or so.

If I Were A Borrower What Would I Do?

Wholesale interest rates have not changed much in the past week but competition between banks for home lending appears to have strengthened. By all means take into account the cash bonuses which lenders may offer if you sign up. But stay focussed mainly on the interest rates being offered. I personally would remain willing to hop out of a floating rate and move most of my debt to a three year term. Maybe I would also fix some for two years given the strong competition currently in that term.

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz