New Zealand economy lurches sharply into reverse

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Economic data released in recent weeks confirms that the New Zealand economy swung rapidly into reverse during the opening months of the year. Gross Domestic Product shrank 0.3 percent in the March quarter, with economists predicting another fall of at least 0.5 percent for the June quarter. This would mean the country is officially in recession.

Agriculture and construction were the main contributors to the decline. Primary industry, which accounts for over 50 percent of New Zealand's export trade, recorded its largest quarterly decline in a decade—down 4.1 percent—despite booming returns in dairy farming. A 5.2 percent fall in construction and 1.2 percent fall in manufacturing were responsible for a total 1.9 percent decline in the goods producing sector—the largest fall since June 2000.

The rapid onset of recession has produced a rash of gloomy headlines. "Economy on the skids", "The only good news—it wasn't any worse", "Cracks open in property sector", "Current account deficit soars", "Shares slump over 50 percent" "The sorry list of finance company failures", "Wellington building firm collapses", "Sharemarket bashed in the bear pit" summarised the outlook for one single week in June.

The grim figures confirm what working people have been experiencing, with increasing alarm, for the past six months—a brutal and rapidly deepening assault on their standard of living. As the economy has shrunk, households have simultaneously been hit by soaring petrol and food prices, the highest interest rates in the OECD and falling house prices.

Detailed research published in May by Bernard Hickey of the financial web site www.interest.co.nz, put a precise figure on these processes. Skyrocketing prices mean the average family is going into the red simply to cover everyday expenses.

Where four years ago, a family on the average income could each week expect to earn $23 more than it spent on bills, that figure has now fallen to minus $15. People wanting to maintain their previous living standard are being forced into debt or to sacrifice day-to-day items. Hickey claims weekly expenses for a household on the average income have risen by $193 since April 2004, while net income has increased by just $156 a week (based on gross incomes rising from $63,400 pa to $72,000). The Labour government's recently announced tax cuts, estimated to give average earners an extra $16 a week, will barely make a dent.

A recent *Weekend Herald* survey found an average trolley of food costs 28.5 percent more now than a year ago, mainly because of huge price increases in dairy products. Corn/maize was up 48 percent, wheat 76 percent and oil 58 percent. The food producers under the most pressure to pass on costs are those who rely on increasingly expensive grain to feed their stock. Chicken has risen by up to 25 percent. Goodman Fielder, New Zealand's biggest bread producer, said it expected its costs to increase by $220 million this year—the same amount as last year's profit.

Consumer spending has slowed, with retail sales falling at their steepest rate in more than 11 years during the March quarter. Spending on durable items was down 3.4 percent, with reductions in sales of motor vehicles, furniture and appliances the largest contributors. Retailers, particularly those specialising in everyday household goods in working class areas, have been hard hit.

The Briscoe Group last week slashed its interim net profit forecast for the second time in a month, pushing its shares down 12.7 percent to a record low. The company warned its first half net profit could halve from last year's $10.5 million, which in turn was down 12 percent on a year earlier. Same store sales were 9 percent below the previous year. The country's biggest retailer, the Warehouse Group, also revised downwards its expected annual after-tax earnings by 10 percent, driving a drop in the sharemarket to a two and a half year low.

According to a Westpac bank survey published in June, consumer confidence is the bleakest it has been in 17 years, plunging to its lowest level since the recession of 1991. Westpac economist Donna Purdue told the *New Zealand Herald* that the survey figures were "jaw-dropping". Thirty percent of respondents said they no longer had any money to spare, and that living costs were rising faster than income. Purdue noted that even in the few weeks since the March survey was conducted, oil prices had risen by around $US35 a barrel, causing pump prices to rise to an all-time high of $NZ2.109 a litre for 91 octane petrol.

Other grim indicators also reveal an economy in deep trouble.

The Household Labour Force survey found the economy had shed 29,000 jobs in the March quarter, the steepest fall in 19 years. The figure takes employment back to the levels of early 2007, and goes against economists' earlier forecasts that job numbers would hold steady.

Employment has fallen from a record high in the December quarter, when the 3.4 percent unemployment rate was the lowest since the survey started in 1986. Not only did the number of people working drop in the March quarter, it was also down in annual terms, falling on a seasonally adjusted basis by 5,000, or 0.2 percent, over the year.

Major job losses either foreshadowed or implemented during the quarter included 430 local jobs at white-goods manufacturer Fisher and Paykel, the transfer of up to 500 jobs by the ANZ National bank to India, the immediate closure of the Oringi freezing works (abattoir), which has 466 staff, the closure of the Burnside venison processing plant involving 136 jobs, 320 jobs from the Sealord mussel plant in Nelson and 100 jobs at the Auckland Museum.

The current account deficit for the March quarter was much worse than previously expected. The deficit of $2.16 billion exceeded the median forecast by economists by nearly half a billion dollars. Seasonally adjusted export volumes fell 3.5 percent in the quarter, the biggest decline since the 2006 December quarter, led by weaker dairy and oil products. The annual deficit equated to 7.8 percent of GDP.

Reserve Bank governor Alan Bollard warned last month that ordinary workers could expect a 22 percent decline in house values in real terms over the next 12 months. At the same time the Reserve Bank has kept its official cash rate at a record high 8.25 percent since July last year, adding to the severe pressures on mortgage rates.

The number and value of building consents plunged in May. Permits issued for new dwellings, including apartments, fell 42.3 percent for the month, compared with April. The total value of consents for all residential buildings in May, including alterations and additions, was $553 million, down $181 million from May 2007. The value of consents for all buildings in the year through May was $909 billion, down 19 percent from the previous year.

The property slump has driven about 10 percent of Auckland's real estate agents out of the business. Some have gone months without income. Nearly 700 agents, many of whom work solely on commission, have left the real estate industry since December. In another sign of things to come, prominent commercial construction firm, Wellington Construction, went into liquidation in June, owing almost $3 million to some 100 separate companies and contractors. Most are unlikely to get any of it back.

Power prices have risen by up to 10 percent in the past year, and analysts warn more increases are likely at the end of winter. Almost half a million people in the main urban centres are struggling to keep warm during the winter months. A government study examined the extent of "fuel poverty"—households that spend more than 10 percent of their income on power bills. Predictions are that up to 46 percent of households in Dunedin, 40 percent in Christchurch, 24 percent in Wellington, and 14 percent in the Auckland region fall into this category. Retail electricity prices have risen almost 50 percent since 2002, while electricity companies made collective profits of $500 million last year, after even higher profits in 2006.

A continuing crisis decimating the finance sector has now seen 23 finance companies either fold or fail to meet obligations in the last two years. Some $2 billion in investors' savings is involved, mostly money ordinary people had invested for their retirement. This year alone, four finance companies have collapsed while another six have sought moratoriums on payments to investors. The chief executive of Lombard Finance, which froze investors' cash in April, blamed the company's troubles on "the systematic failure of an entire industry". Because borrowers were now finding it impossible to repay loans, the finance companies could not meet repayments falling due.

The gathering sense of fear now gripping the business elite was indicated in a lead article in the business pages of the *Dominion Post* of June 28. The article noted that the finance market was "awash with speculation" as to the amount of damage being sustained by the NZX50, and "how long the misery will last". According to the report, the wealth destruction that has occurred in less than a year is "massive and ongoing", a product of "continuing carnage" in the finance sector, falls in stock and the housing markets and the impact of high energy and interest costs.

The key question preoccupying analysts is whether the current downturn signals the beginning of a "big bear market", a portent of a "recession with bite". Since its high point in October last year, the NZX has lost about 25 percent in value, level with the fall of the benchmark Australian index. It has now slumped to a 28-month low, "fuelled by multi-year lows for several stocks", the most notable being the country's major construction company, Fletcher Building. By comparison, the US Dow Jones Industrial Average index is down 21 percent since its October peak.

Spokesmen for the ruling elite have been quick to demand workers tighten their belts and lower their wage demands, despite the steep increase in the cost of living. Reserve Bank Governor Bollard first issued the call in early June, bluntly saying that any "over-exuberance" when it came to wage negotiations this year would meet with a response from the central bank, probably in the form of interest rate rises.

Statistics NZ's labour cost index showed salary and wage rates climbing 0.7 percent in the March quarter, taking the year to date increase to 3.4 percent, its sharpest rise since 1992. However, the Reserve Bank forecast that inflation would hit 4.7 percent this year, well above any recent pay rises.

Business leaders immediately insisted that in the current climate they could "not afford" pay increases. Business New Zealand chief executive Phil O'Reilly claimed price increases meant companies had less capacity to increase pay. Alasdair Thompson, Employers and Manufacturers Association chief executive, warned that it was difficult to get business credit from banks, interest rates were high, and the high exchange rate was eating into exporters' profits. "So if an employee says, 'The cost of living has risen, give me more money,' that's not going to work."

Finance Minister Michael Cullen also ruled out any significant pay increases in the state sector, saying big rises for public servants were unrealistic. According to Cullen, "expectations in the public sector on wages and salaries haven't caught up with the changing economic and fiscal situation". Cullen went on to denounce workers who were preparing to claim double-digit salary increases as having lost "contact with reality".

The Labour government itself, however, is facing its own dose of reality. With an election due in four months' time, Labour is experiencing entrenched and ever-deepening popular hostility. In the absence of a progressive alternative, the main beneficiary of this widening disapproval with Labour is the conservative National Party opposition. From an average lead over National of 10 percentage points early in 2005—the last election year—Labour goes into the final months of this election year 25 percentage points behind: 30 percent to the National Party's 55 percent.