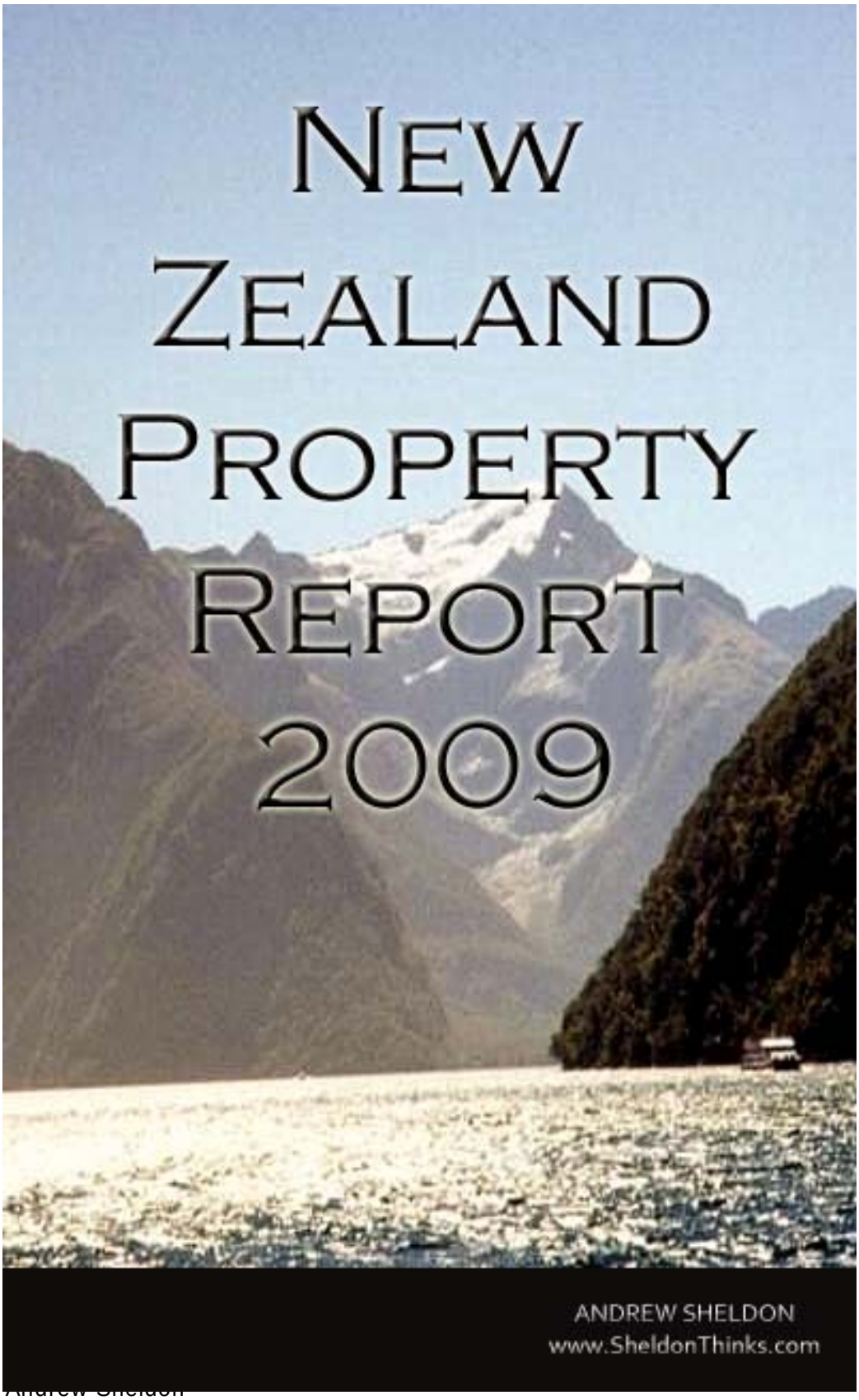

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The NZ economy

New Zealand is an interesting economy because the central government has considerably more power than other national governments. Despite being able to take some innovative approaches to public administration, its performance has nevertheless been lacklustre. It's easy to attribute its poor performance to its small geographic size (about the same as Japan), its small population (about the same as Singapore) and its isolation (about as remote as Easter Island), but really it has more to do with its unsavoury amalgamation of collectivist 'nanny' statism and 'detached' free market thinking, and voters who swing with reckless abandon. It's common to get a decade or more of social democratic rule followed by a decade or more of Conservative rule. In 2008, the country swung back to Conservative rule, which means more 'repressive' policy whilst the 'supreme' leadership of the USA is going the other way. Clearly Singapore shows the way with support for strategic industries, yet many commentators will argue that Singapore's success has resulted from authoritarian rule. I would however suggest that that need not be the case, and that there is no substitute for good leadership.

International comparison

The bad news for the NZ economy is that despite participating and benefiting from one of the strongest commodity price cycles on record, the New Zealand economy over the past decade, has fallen (2 places compared to 2005) in the OECD's ranking of GDP per capita to 22nd position (out of 30 member countries). New Zealand's ranking would be worse if not for its relatively high labour participation rate compared to other OECD countries. It's poor performance is the result of low labour productivity.

The problem as I see it is the lack of support that the NZ government and business give to new and strategic 'high value' business initiatives which value the country's technical skill base. The free market system is great if participants operate on a level playing field. It would be preferable for business to support new investment initiatives, but if they don't want to take that initiative, you can be certain that government's efforts will be less successful because government is political, bureaucratic, unaccountable and inexperienced. This of course makes you question whether government should administer the process at all. The answer is – not without a track record of success.

The other problem of course is the failure to instil a personal sense of responsibility and long term planning in the local population. By this I mean the low savings and investment levels in NZ. Compulsory superannuation is an ugly scheme because it attempts to force people to save. When someone is forced to do something it tends to force them into distortive decisions, or worse to disregard the scheme because they have no control over it. That is what repressed government's do. Collectivist governments will support such measures because it serves their purposes in as much as they would love to tax the proceeds. It will be interesting to see if the new NZ prime minister takes the same 'collectivist' path as former Australian prime minister John Howard.

Gross domestic product per capita is the most popular indicator for comparing national income levels, though there are two better indicators:

1. **Gross national income (GNI) per capita**. GNI is defined as GDP plus net receipts from abroad of wages and salaries and of property income.
2. **Net national income (NNI) per capita** is an economics concept to measure changes in national income. It is defined[i] as:

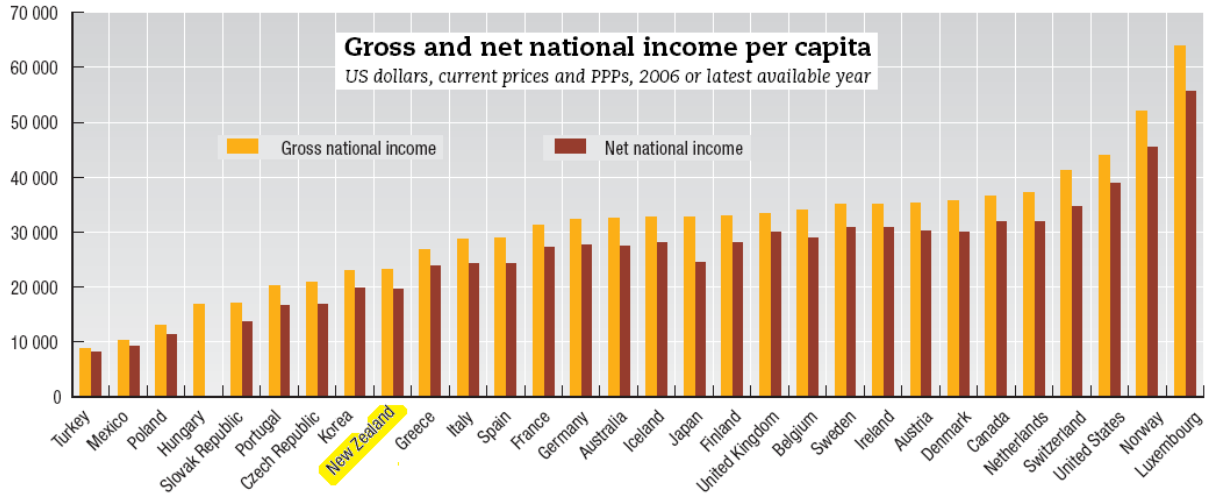
NNI = Private Consumption + Investment + Government spending + net exports + net foreign factor income - indirect taxes - depreciation

In the following chart, the measures are very similar, though GNI rankings are usually around 17% higher than NNI. Those countries which rank slightly lower based on NNI

include Japan, and Denmark, and those that rank slightly higher are Germany, Iceland, Sweden and the UK.

It is apparent that NZ's national income is one of the lowest among OECD countries. Even with a significant increase in population growth, it is apparent that NZ will need to invest in strategic high value industries in order to boost its national income.

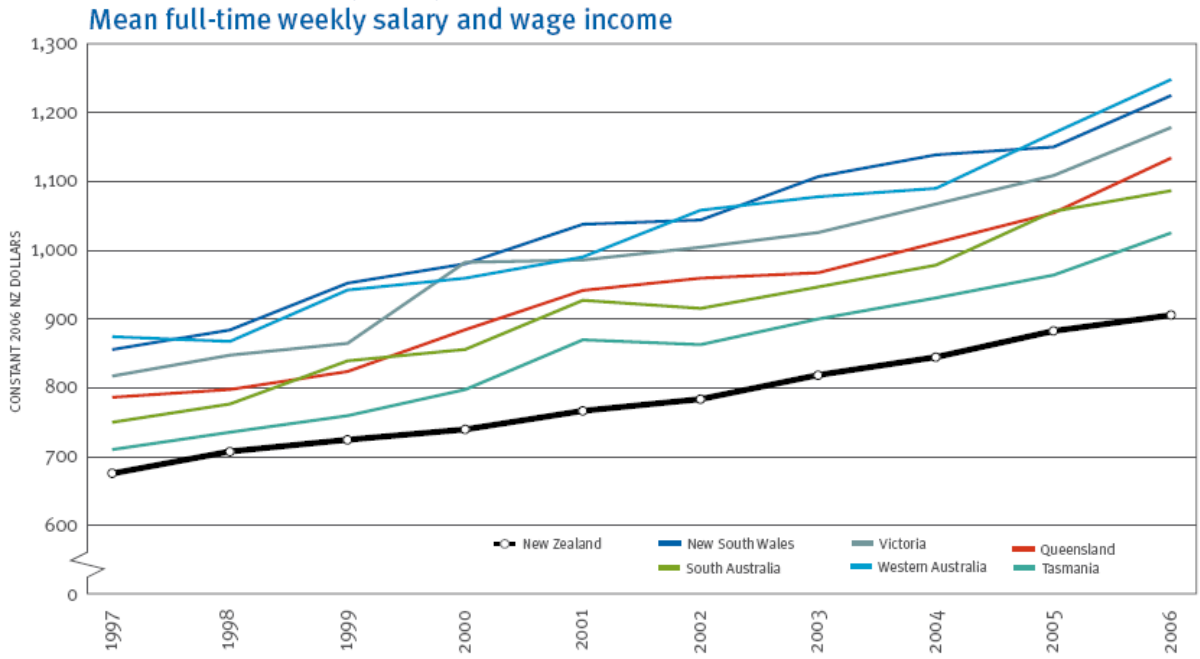
The performance of NZ is far better if you focus on the major cities. The bulk of the wealth and prosperity of NZ is generated in the cities. It is however the farm sector that has traditionally accounted for most of the country's exports. The low NZD should actually be a boon for the competitive standing of NZ skilled labour.



Source: OECD-NZ report[ii]

Salary & wage income

The following chart highlights the fact that NZ salary and wage income levels lag Australia. Comparison with Australia is useful because of the Closer Economic Relationship (CER) established between these countries in 1988.[iii] The two countries are closely integrated, perhaps more than any other two countries, though of course NZ will have greater regulatory and freight penalties creating business in Australia, although they do have a currency advantage. Evidence suggests that NZ does have a disadvantage competing in Australian states. Regardless the shared benefits of integration are applauded. The following chart shows that NZ has a similar rate of income growth compared to the southern-most state of Australia, though in absolute terms NZ's average income lags.



Source: Statistics NZ & ABS[iv]

Labour participation & employment

For the past 5 years the NZ unemployment rate has remained under 5%, though that can be expected to rise as a result of the recessed state of the global economy. It has since risen to 4.2% in Dec'08. The global recession will have a mixed impact on NZ. The weakness of the NZ dollar should stimulate some import substitution as well as offset the lower US dollar receipts from falling commodity prices. New Zealand's food export industry should also benefit because food exports should hold up better than more discretionary trade items, though NZ is a premium food supplier, so there will be considerable price sacrifice. We have already seen this with a fall of 50% in the annual price of Fonterra milk from $7.40 to $7.10 in early 2009.

Positive factors will be cancelled somewhat by the high levels of indebtedness. Households with large mortgages can be expected to struggle with a higher cost of imports (particularly petrol), and eventually inflation can be expected to increase their mortgage repayments. The implication is that the rural sector will be less exposed to the recession than other sectors or urban regions. Rural regions also have a high number of retirees on fixed pensions and with high savings rates.

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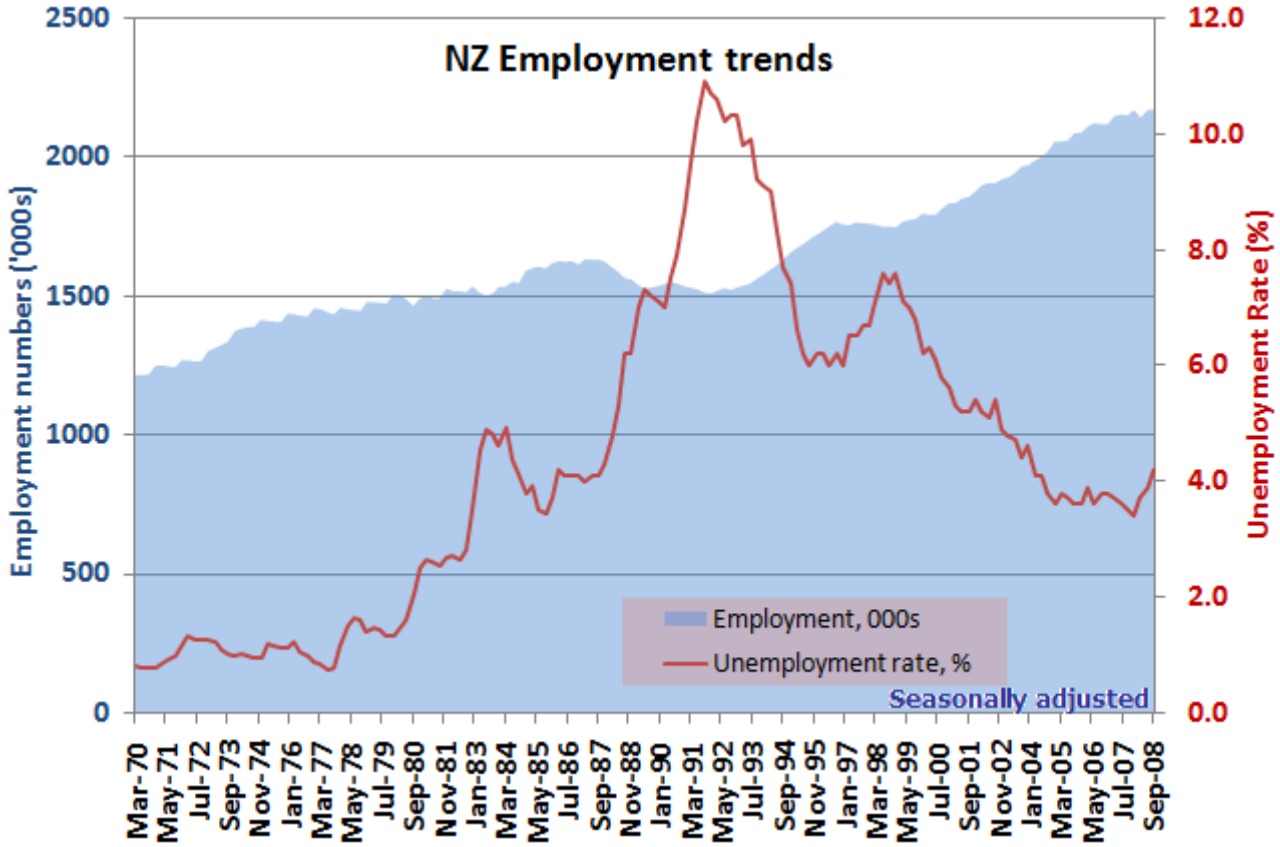

Source: Reserve Bank of NZ & Datastream NZ

The unemployment rate for New Zealand fell to 3.6% in the June 2007 quarter, its lowest level in 20 years, and was one of the lowest in the OECD. We can see from the following chart that NZ tends to fare better than most countries in economic downturns, and it's also one of the first to recover.

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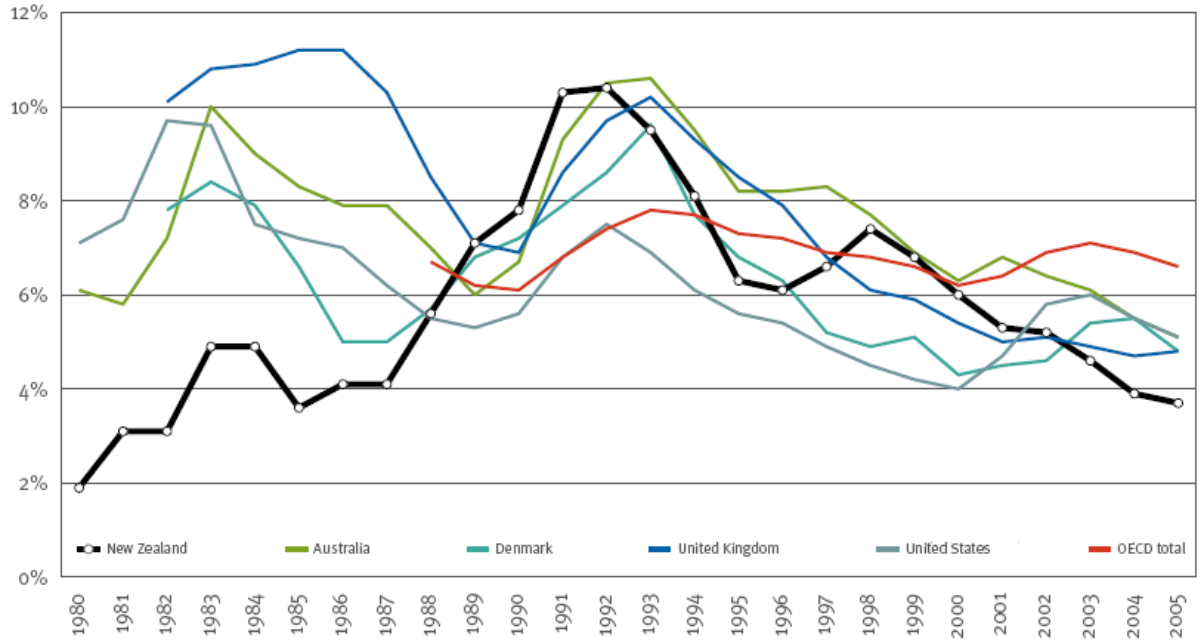
Unemployment Rate – international comparison



Source: OECD[v]

Labour productivity

Despite New Zealand's subdued economic performance, one of the positive factors is the strong growth in labour utilisation. New Zealand's labour utilisation rate is one of the highest in the OECD, reflecting a combination of high participation rates (currently around 68%), low unemployment and a high average number of hours worked relative to other OECD countries. The problem of course is that there is limited scope to improve labour utilisation further, so further gains in national output and income per capita will have to come from increases in labour productivity.

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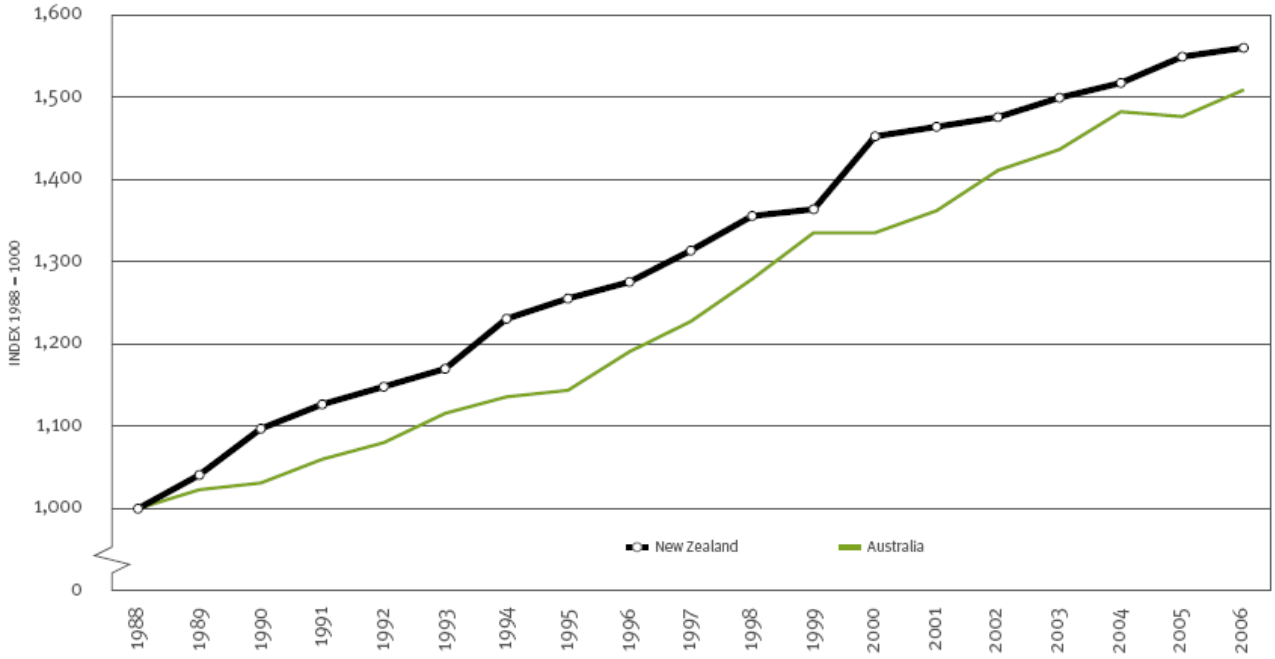
Labour productivity Index – comparison with Australia



Source: Australian Bureau of Statistics & Statistics NZ

New Zealand's labour productivity performance is poor by OECD standards. It has recorded modest increases, but it still lags Australian productivity, which has been close to the OECD average. Looking at Auckland in isolation and the performance is far better. It is the rural sector which has trailed the city, and that can in part be attributed to the 'lifestyle' priorities. Too many rural businesses don't function as businesses given the high level of family ownership of farms. The decision of farm children to walk off the farm in pursuit of an urban life can only leave rural productivity in the hands of 'old hands' less accustomed to change. Eventually such properties will be transformed by corporate interests.
Statistics NZ and the Australian Bureau of Statistics assert that New Zealand's labour productivity growth has been similar to that of Australia over the past 20 years. They apply a narrower measure of labour productivity which places them close to parity.

The next chart shows that New Zealand falls in the lower band of countries in terms of labour productivity when considered in the context of labour participation rates.

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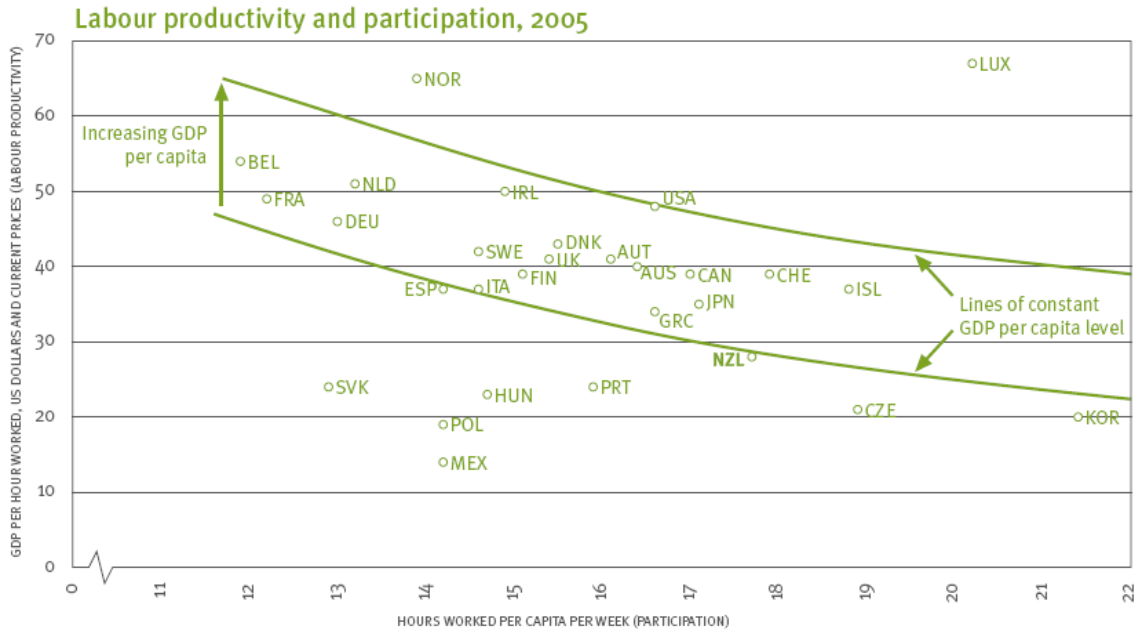
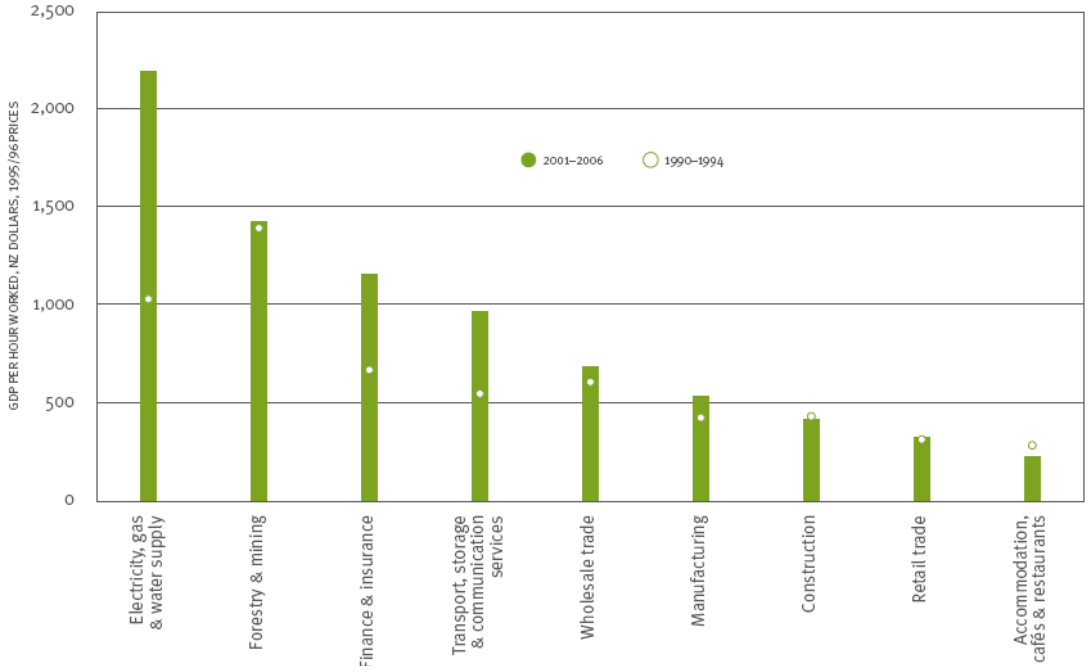


Source: OECD[vi]

Labour productivity levels differ substantially across New Zealand's measured sectors. The biggest improvements have come from electricity, gas and water utilities; finance and insurance; as well as transport and communication.

NZ Average annual labour productivity by sector



Source: Statistics NZ

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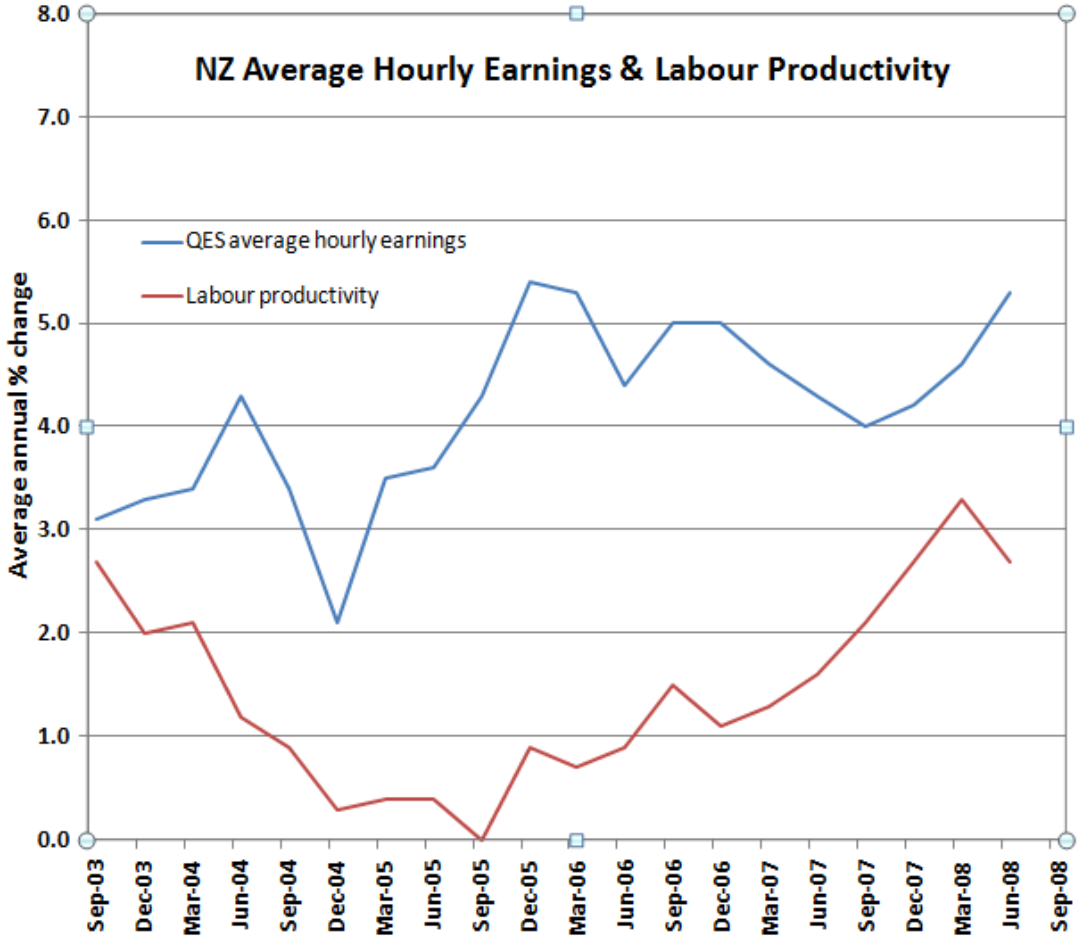
The following chart shows that annual growth in NZ labour productivity, whilst poor, has nevertheless improved over the last 2 years. Consistent earnings growth of 4-5% in recent years should provide the means to fund further gains in labour productivity.



Source: NZ Treasury

Economic growth

NZ has been a strong growth market in recent years. Increased incomes have been matched by rising prices, and as a consequence real income levels have trailed other countries. Income numbers can be expected to fall over the next few years in response to, and in accordance with overseas trends, despite any positive foreign exchange impact on export earnings.

New Zealand's GDP growth has been on par with other major OECD countries and Australia over the last 2 decades. We can see that its growth is more volatile, highlighting the fortunes of commodity prices. In times of low commodity prices, GDP growth soars markedly, and it soars in the good times. We see here that NZ is set for a deterioration in its GDP growth.

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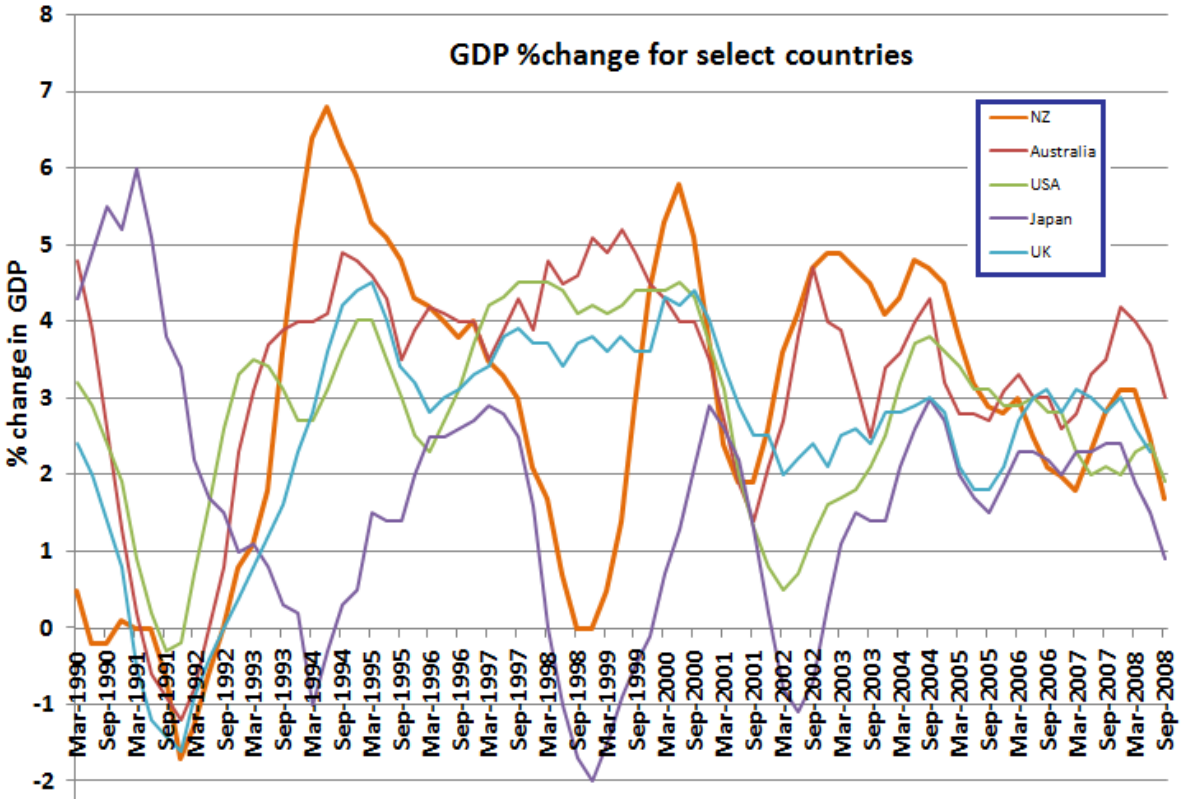

Source: Reserve Bank of NZ & Datastream NZ

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[i] Definition of Net National Income, Wikipedia, website.
[ii] OECD Factbook 2008, ISBN-978-92-64-04054-0, website
[iii] Department of Foreign Affairs & Trade, Australian Government, website.
[iv] Statistics New Zealand, Customised Income Survey Data; Australian Bureau of Statistics, 6310.0 Earnings, Benefits and Trade Union Membership, Table 1
[v] OECD Factbook 2007
[vi] OECD Country Profile 2007; OECD Productivity Database

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