Economic Overview

February 2013

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Note from Dominick

Back in May 2012 I closed this editorial by saying: *"If interest rates stay low for longer, house prices will go up further. In turn, that could spur a bit more consumer spending and less economic rebalancing."*

That is certainly the way things have panned out. The economy is starting to move as the Canterbury rebuild hits its straps. But the stratospheric exchange rate has kept inflation in check. So the Reserve Bank has been able to keep interest rates low – with predictable results for house prices and consumer confidence.

Our forecasts for 2013 follow the same formula, but with greater intensity on all fronts – we expect the exchange rate to go even higher, interest rates to stay low, and house prices to rise even faster, all in the context of accelerating economic growth.

In some respects this sounds like a Goldilocks moment, but there won't be a fairytale ending. The high exchange rate is hurting New Zealand's international competitiveness. Economic imbalances such as the current account and household indebtedness are going the wrong way. And the booming construction sector will impose inflation pressures on the economy. The eventual circuit-breaker will be higher interest rates. And when that happens, there could be a nasty downturn in house prices.

It's not all jam at moment, either. The labour market has been a conspicuous weak-spot – our special topic this quarter considers why.

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New Zealand Economy

A Goldilocks moment?

The New Zealand economy took a decisive step up in the last months of 2012 as the Canterbury rebuild continued to gather steam and confidence improved elsewhere. Inflation is low and the housing market is recovering. Many domestically-focused businesses will be feeling better about economic conditions. Economists and other professional worriers aren't quite so euphoric.

Three months ago we opined that the mid-year economic slowdown was in all likelihood a 'speed wobble' rather than a road block. That hunch has since been borne out by a raft of stronger economic data. At the same time, inflation has been benign, suggesting there's plenty of room for further growth – the economy is warming up, but it certainly has not overheated.

Accelerating growth and low inflation make this a Goldilocks moment for the economy – but there are reasons to worry that the story won't have a fairy tale ending. First, the economy is unbalanced. The Canterbury region may be booming as post-quake recovery and reconstruction ramp up, but many other regions continue to struggle. And an overvalued exchange rate is hurting export-oriented and import-competing businesses, while favouring domestic spending.

Second, this isn't a recipe for sustainable long-term growth. Activity generated by the Canterbury rebuild will be temporary, and the subsequent wind-down could be painful. And the current momentum in the housing market depends crucially on ultra-low interest rates. If – as we expect – the Reserve Bank begins to raise interest rates late this year house prices will start to look increasingly overvalued, and boom could eventually turn to bust.

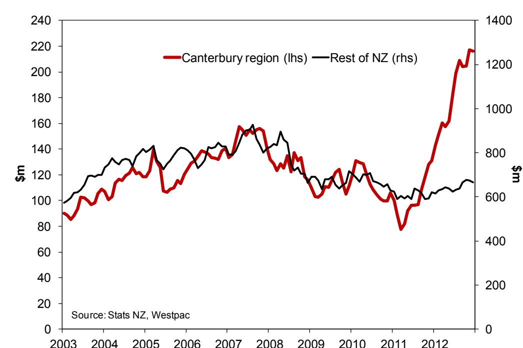
Recent developments

The latest GDP figures confirmed that the economy lost momentum through the middle part of 2012. GDP expanded by just 0.2% in the September quarter and 0.3% in the June quarter - though this was enough to lift the annual rate of growth to 2.5%, the fastest since early 2008. The only real bright spot in the September quarter was the construction sector - residential and non-residential building work rose 7.4% and 12.4%, respectively. Activity in most other parts of the economy slowed. Agricultural output and food manufacturing posted particularly large declines – reflecting the end to a bumper growing season – but there were also falls in non-food manufacturing, wholesale and retail trade, and transport activity, to name just a few.

Since then most economic indicators have improved. Business and consumer confidence have picked up significantly, and the housing market is showing renewed momentum. Consumer spending was particularly strong in the December quarter – we estimate that the volume of retail turnover rose 2%, more than unwinding its drop in the previous quarter. And the upturn in construction has continued.

The Canterbury rebuild continues to gather steam, and there are now signs that construction activity is ramping up in Auckland as well – the other region of New Zealand where housing shortages have been most apparent.

Figure 1: All building consents, by value



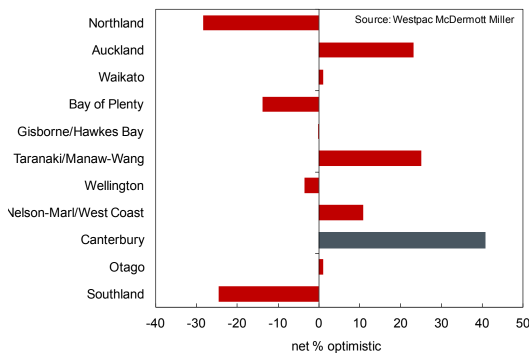
Global economic conditions have also picked up and world prices for agricultural commodity prices have continued to recover, supported by easy monetary policy across the world's major central banks. While this is ultimately a good news story for New Zealand exporters, for now the main impact has been to boost the New Zealand dollar.

The combination of rising construction activity and a high exchange rate is leading to an increasingly two-speed economy. Consumer and business confidence

Westpac

in Canterbury is far outstripping sentiment in some rural parts of New Zealand, and construction firms are far more confident than retailers, farmers or manufacturers.

Figure 2: Westpac McDermott Millar Regional Confidence Index, Dec 2012



The high exchange rate has also been a major factor keeping inflation low. Headline inflation has now undershot the RBNZ's target for two quarters running. We have long warned that the scale and duration of the Christchurch rebuild would generate significant inflation pressures over coming years. These pressures have indeed begun to emerge, but for now they remain largely contained within the Canterbury region. And to date these rising costs have been largely offset by very low inflation for internationally traded goods.

Low inflation has cemented financial markets' expectations of low interest rates for an extended period, helping push down fixed-term mortgage rates to historic lows. In turn, low mortgage rates have helped boost house sales and house prices. We estimate that nationwide house prices rose 6% in 2012, in line with the forecast we laid out in the May Economic Overview. Auckland and Canterbury have seen the biggest increases in the last year – reflecting their respective supply shortages – but prices are turning higher in most regions.

More buoyant housing market activity has been accompanied by a steady upturn in household borrowing. Indeed, the household debt-to-income ratio is no longer falling – meaning 'deleveraging' is no longer a term that can really be applied to New Zealand households.

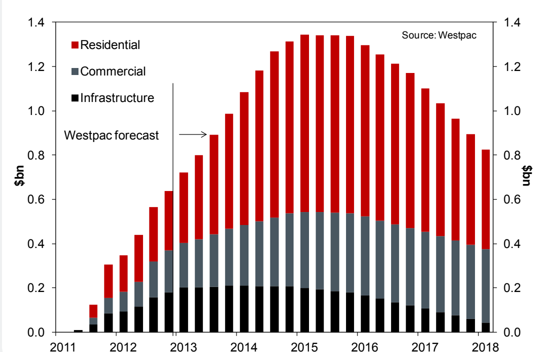
The economic outlook

The economy is evolving very much along the lines of the narrative we laid out last year. We have long expected the Canterbury rebuild to drive an upturn in growth, while a high exchange rate keeps inflation and interest rates low for a time. During that time house prices would rise and the domestically-focused parts of the economy would outperform. But by 2015 we expect reconstruction activity to reach its peak, and interest rates to be rising as domestic inflation pressures become increasingly widespread. That means stronger growth for now – we forecast 3% this year and 3.2% in 2014 – but slower growth from 2015 onwards.

The Canterbury rebuild is the lynchpin of this story, and its pace and timing remain uncertain. The overall quantum of reconstruction work to date has been broadly in line with our previous assumptions, but the mix has been slightly different: commercial rebuilding has proceeded faster than expected, but residential work has lagged behind. Given that residential work makes up the greater proportion of the rebuild, we now forecast a slower escalation in overall activity, with the level expected to peak in 2015 (previously 2014).

The RBNZ and Treasury have revised up their estimates of the overall cost of the rebuild, from $20bn to $30bn (in 2011 prices). These estimates are subject to wide margins of error - we have adopted a more cautious assumption of $27bn. The official estimates include allowances for new investment (over and above damage replacement), but we are sceptical that new investment will be so large

Figure 3: Quake-related construction estimates and forecasts

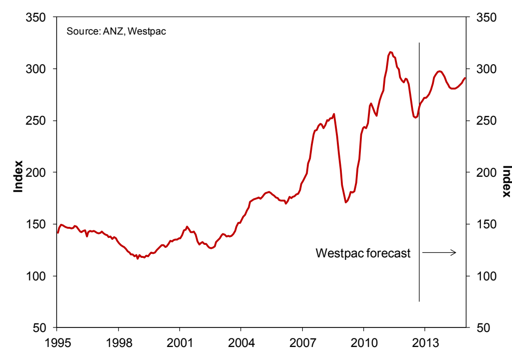


For the export sector, we see global demand continuing to improve over 2013, as the "sugar rush" of monetary easing continues to stimulate the global economy. The lingering effects of the US drought are providing an additional boost to global beef and dairy prices this year. Meanwhile conditions remain in

place for another decent agricultural growing season. Even with recent drier conditions, dairy output is still shaping up to be higher than last year.

However, 2014 could see a renewed global slowdown given the ongoing structural issues in the major developed economies. And in the interim exporters will continue to face the headwind of a high exchange rate. Indeed, the exchange rate has continued to appreciate in the past few months and, as we explain in the Financial Markets section, we think it could go higher still. As a result we expect export activity to lag behind the overall economy, growing just 1.9% this year and 3% next.

Figure 4: World prices of NZ export commodities



A higher NZ dollar will also keep inflation low for longer. Even with the growing pressures from the Canterbury rebuild, inflation now looks likely to stay below 2% until mid-2014. This means a somewhat later and slower pace of interest rate hikes from the RBNZ. With this in mind we have revised our forecast for house prices up another notch: we now forecast a further 9% increase in prices in 2013, slowing to 4% in 2014. A more persistent upswing in the housing market, and continued low import prices, will in turn stimulate stronger growth in consumer spending.

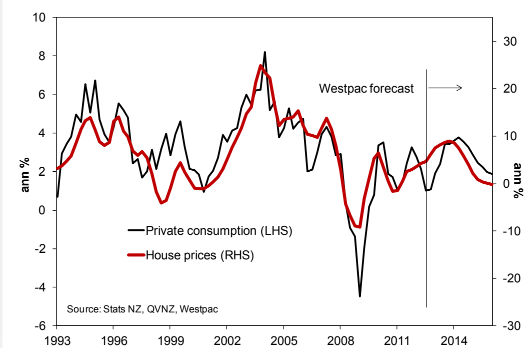
The Canterbury rebuild, rising consumer spending, and the high New Zealand dollar all imply a growing demand for imports and a rising current account deficit – we expect the deficit to widen to 7% of GDP by 2015. Granted, for now we aren't forecasting a return to last decade's conditions, when the current account deficit exceeded 8%, house prices rose 25% in a single year (in 2003) and consumer spending routinely grew at an annual rate above 4%.

One reason for this is government austerity. The Government remains firmly committed to its target of a budget surplus by 2015, and while the fiscal accounts have come in a little better than forecast lately, achieving that goal will remain a challenge. We expect government spending to make close to a zero contribution to growth over the next two years – in stark contrast to the strong positive growth contributions that were more or less a consistent feature of the past 20 years.

Secondly, unemployment has been stubbornly high and is likely to stay well above mid-2000s levels for some time yet. As we explain on page 11, we have reason to think that quake-related disruption in Canterbury has raised the 'trend' rate of unemployment, as employers in Christchurch need to pay a premium to attract and retain the right staff. This issue is likely to persist to a greater or lesser degree while the city remains a building site.

The final element keeping our forecasts in check is our view that interest rates will eventually have to rise further than markets are currently expecting, and that this will hurt the housing market. While current low mortgage rates are supporting house price increases, the market would already be overvalued if interest rates were sitting at more normal levels. The more house prices rise now, the greater the risk of house price declines in years to come.

Figure 5: House price inflation and consumer spending



Financial Markets

On rocks and hard places

The New Zealand dollar continues to outpace valuation metrics, clearly causing pain for some exporters. Yet with the New Zealand economy the best of a bad bunch, we may see the currency strengthen further through 2013. That will depress inflation for a while longer, a key reason that we have shifted out our forecast of the first OCR increase to December 2013. But low interest rates will also underpin the housing market, raising the tension between the Reserve Bank's primary goal of price stability and its more recent concerns around asset prices and debt growth.

Exchange rates

Global financial markets have started the year with a hiss and a roar. Market-based measures of investors' appetite for risk are improving, many sharemarket indices have reached five-year highs, and even long-term interest rates are creeping higher again. The New Zealand dollar has followed suit, verging on new record highs on a trade-weighted basis. And while the NZD reads as 'overvalued' on some of the usual valuation metrics, we suspect that the currency will stay in favour through 2013.

Relative growth prospects certainly look to be in the NZD's favour, at least over the next couple of years. In particular, the New Zealand economy is expected to outgrow Australia for the first time in many years, with New Zealand's investment boom (quake rebuilding) hitting its straps this year just as Australia's (mining investment) peaks.

Commodity prices and relative interest rates have generally matched the short-term ups and downs of the exchange rate. But on a broader view the relationships appear to have weakened – in particular, interest rate spreads have actually narrowed over the last few years, with NZ rates drifting lower while US rates have been stuck near the zero lower bound. This suggests that while these metrics still have some explanatory power – and we do expect both commodity prices and relative interest rates to move in the NZD's favour this year – there are intervening factors behind the exchange rate's strength.

Unconventional monetary easing in other countries is widely cited as a driver of currency movements (with the implication that if everyone else is doing it, New Zealand can't afford to abstain). As we detailed in the November 2012 *Overview*, there is no evidence that these countries are actually succeeding in debasing their currencies, even if that were the intention. Nevertheless, perceptions of a 'currency war' may matter as much as the reality for exchange rates.

The NZD may also be benefiting from new sources of capital inflow, though these are difficult to gauge. Foreign purchases of government bonds have soared in the last few years, with indications that 'official' investors, such as sovereign wealth funds, are more prepared to diversify into currencies such as the NZD. While the increased foreign holdings are partly a product of increased issuance as the government accounts have fallen into deficit, that in itself may be helping to overcome investors' concerns about the small size of the market.

Figure 6: Interest rate differentials and the exchange rate

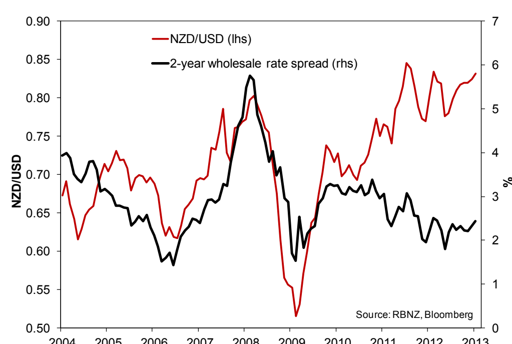
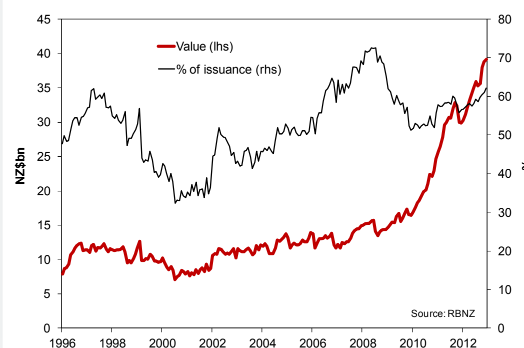


Figure 7: Overseas ownership of NZ Govt bonds



We now expect the NZD to average around 86c against the US dollar over this year, and to push towards the mid-80s against the Australian dollar. That will further dampen inflation pressures over the near term, and is a key reason why we have pushed out our forecasts for OCR hikes.

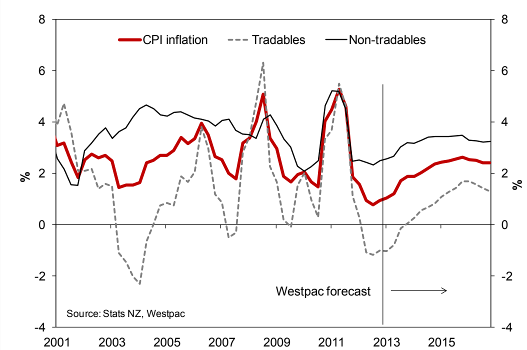
Inflation and interest rates

Annual inflation slowed to 0.9% by the end of 2012, below the RBNZ's medium-term target range of 1-3%. Notably, it has consistently undershot the RBNZ's forecasts for the last six quarters, with most of the surprise occurring in tradable goods prices. The NZ dollar has been both persistently stronger than expected, and may have seen an unusually high degree of passthrough to retail prices.

We expect annual inflation to rise only gradually towards 2%, excluding the impact of planned increases in fuel and tobacco excise in coming years. Within that forecast, we expect a persistent divergence between tradable goods (with the high NZD continuing to have a dampening effect) and non-tradable goods and services, particularly with the housing market heating up and the Christchurch rebuild making an increasing draw on the nation's resources. To date, rebuild-related price pressures have been contained, but that story will evolve over time: the experience of previous housing cycles has been that housing-related inflation has tended to spread more widely over the course of several years, continuing even after the housing boom has peaked.

The tension between low consumer price inflation and an overvalued exchange rate on the one hand, and rising house prices and the impending rebuild on the other, has stayed the RBNZ's hand on interest rates for now. But we believe that the balance of these forces will nudge the RBNZ in the direction of higher interest rates by December, with OCR hikes continuing into 2014-15.

Figure 8: CPI inflation forecast



Recent RBNZ statements have also brought the market's attention to the possible use of 'macroprudential' tools, such as loan-to-value limits or increased bank capital requirements. Indeed, we highlighted this many months ago (see for instance our August 2012 *Overview*); it would be remiss of us not to comment now. We note that the RBNZ has consistently said that such tools would primarily be aimed at addressing risks to the stability of the banking system, not monetary policy or social goals. RBNZ Governor Wheeler has also stated that "it may be appropriate to use monetary policy to lean against the build-up of financial imbalances". That is, interest rates are also a 'macroprudential' tool – and maybe even the first cab off the rank.

Financial Markets Forecasts (end of quarter)

	OCR	90 day bill	2 year swap	5 year swap	NZD/ USD	NZD/ AUD	NZD/ EUR	NZD/ GBP	NZD/ JPY	TWI
Mar-13	2.50	2.70	2.90	3.40	0.85	0.80	0.64	0.52	72.3	75.7
Jun-13	2.50	2.70	3.00	3.50	0.86	0.80	0.64	0.51	71.4	75.7
Sep-13	2.50	2.75	3.10	3.60	0.87	0.83	0.66	0.52	70.5	77.0
Dec-13	2.75	3.20	3.30	3.80	0.87	0.84	0.67	0.52	69.3	77.2
Mar-14	3.25	3.50	3.60	4.00	0.85	0.84	0.67	0.52	66.3	76.4
Jun-14	3.50	3.75	3.90	4.30	0.83	0.84	0.67	0.49	65.6	75.4
Sep-14	3.75	4.00	4.20	4.50	0.82	0.85	0.67	0.49	64.8	75.1
Dec-14	4.00	4.25	4.50	4.70	0.81	0.85	0.68	0.48	64.0	75.0
Mar-15	4.25	4.50	4.80	4.90	0.80	0.84	0.67	0.47	63.0	73.9
Jun-15	4.50	4.75	5.00	5.10	0.78	0.83	0.66	0.47	62.0	72.8

International Outlook

Right place at the right time

Monetary stimulus has slowed the runaway train of global financial system stress. While this stimulus may help avoid a financial system train wreck, it cannot restore long-term growth. Thus, the recent signs of improvement in developed economies may not last. Meanwhile, China is back on the growth horse, lifting prospects for growth globally and in the Asia-Pacific region. New Zealand, as a seller of food in this region, may find itself in the right place at the right time.

Global monetary easing is dominating the developed world growth outlook. These bold measures have seen stability return to financial markets and the global financial system in general. With this sigh of relief, increased confidence has seen a stabilisation, if not a pick-up, in developed world growth.

However, extreme monetary easing is the economic equivalent of pain relief – it masks the symptoms but does not cure the disease. Reducing private and public debt levels is a prerequisite for the developed world to return to sustained growth. That will be a painful process, and it has a long way to run.

Meanwhile, developing economies are back on the long-term growth horse. This growth story is underpinned by long-term trends such as industrialisation and urbanisation. Accordingly, developing country growth, particularly in China, is broadly sustainable into 2014 and beyond.

This divergence in prospects is borne out by the fact that the bulk of our 3.5% world growth forecast will come via China and other emerging economies. Moreover, as the developed world stabilises rather than grows over 2013, developing countries account for most of the step up in growth from 2.9% in 2012.

For New Zealand Inc. as a trader of food, this growth combination is encouraging. As incomes rise in China and the rest of developing world, demand for food – the majority of our merchandise exports – will rise. In turn, this rising demand will support prices of our (food) commodity exports over 2013.

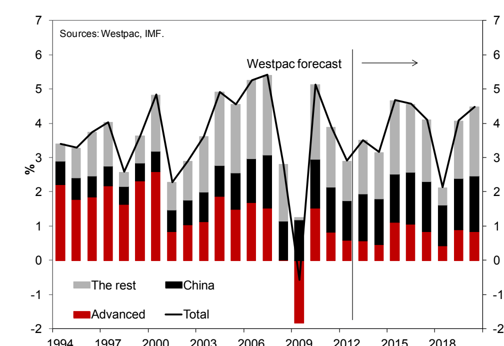
Overall this leaves New Zealand in a position of relative strength, particularly compared to other developed countries. Our largest trading partner, Australia, is in a similar position to benefit. New Zealand may, it turns out, be in the right place at the right time.

Australia

Australian growth continues to outpace most other developed economies. However, the Reserve Bank of Australia (RBA) is prepping the economy for a move away from the mining-led growth of the last few years. With this transition in mind, we expect another rate cut in March.

The biggest mining investment boom since the gold rush is coming to an end. Mining investment is likely to add 2 percentage points to growth in 2013, before subtracting 1 percentage point in 2014. This will leave an iron ore mine size hole in economy.

Figure 9: Contributions to world growth

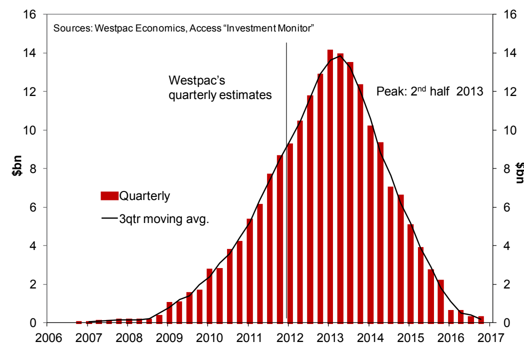


Meanwhile, the non-mining economy is stuck in second gear. The Australian consumer remains in saving mode. And firms remain cautious, particularly in the exchange rate sensitive sectors – manufacturing, tourism and retail.

Fiscal stimulus appears largely out of the question. While the Federal government is ready to ease off the brakes, State government balance sheets – where the bulk of jobs and public works reside – require rebuilding.

To fill the gap the RBA is ready to lower interest rates further. So far business and consumer confidence has been stubbornly low, while the unemployment rate has ticked up off record lows. However, lower interest rates have improved housing affordability and the construction sector has picked up after being in the doldrums for most of 2012.

Figure 10: Australian gas projects: $186bn of construction



The RBA's challenge of transitioning smoothly away from mining-led growth is daunting. A world awash in monetary easing complicates matters, with Australia's relatively higher growth and accompanying tighter monetary policy manifesting in a higher exchange rate. Restarting the interest rate and exchange rate sensitive parts of the economy will be a delicate balancing act. Timing will be everything.

Whatever transpires, New Zealand may be able to draw lessons from Australia's experience as it heads into a boom of its own in Canterbury.

China

The slowdown in the Chinese economy over 2012 largely evolved as we expected. Relatively tight policy settings stunted growth in the first half of the year, while industrial production growth slowed as inventories were cleared. China's modest stimulus package kicked in over the second half of 2012, and Chinese growth ticked up at year end.

Recent data point to the improvement continuing into 2013. The pace of infrastructure construction is progressing in line with expectations, although the mix is weighted more towards transport projects than utilities than we had anticipated. Also, industrial production is increasing in line with demand as the rundown industrial stocks appears complete.

We expect Chinese growth to accelerate to 8.8% in 2013 from 7.7% in 2012. This is a more measured response to the weak global growth of 2012. In comparison, the post-Global Financial Crisis stimuli saw growth almost spike to 12%.

Japan

Under the brazen leadership of Shinzo Abe, Japan has made breaking free of the deflation shackles its number one goal. To this end, Japan has belatedly joined the global monetary easing party and thrown in some good old-fashioned government spending for good measure.

Abe's government has mandated a 2% inflation target for the Bank of Japan (BoJ). So far, the BoJ has announced an "open-ended" monetary easing package which increases the BoJ's asset purchases this year by an additional ¥10 trillion to ¥101 trillion. While this is a step in the right direction, we expect asset purchases will need to increase further to have effect. Moreover, Abe's government may need to reaffirm this path by appointing a new BoJ governor (and deputies) who is more sympathetic to its policy goals.

In a back to the future move, the Abe government has announced its intention to boost public works and switch the nation's nuclear power plants back on. While the latter move will prove massively unpopular with the public, it will reduce Japan's reliance on imported energy. In turn, lower imports will boost Japan's growth and further widen its current account surplus.

The moves to date have weakened the yen, which should give Japan's export sector the desired shot in the arm. This together with the other stimulus measures has been enough for us to revise up our 2013 growth forecast for Japan from 0.8% to 1.4%. This revision is the major change to our 2013 world growth outlook numbers since November.

United States

The little growth that the US sees over 2013 will largely come on the back of its monetary easing "sugar rush". We have forecast 1.6% growth in 2013, down from our November pick of 1.7%. Federal Reserve Chairman Bernanke remains fully committed to effectively zero interest rates and large purchases of financial assets. Indeed, he has stated that these measures will remain in place until the unemployment rate drops to 6.5%.

Compromises over the first the fiscal cliff and then the debt ceiling have improved financial market sentiment and have spared the US economy the worst scenario of spending cuts and tax hikes in 2013. However, any boost may be short-lived.

The housing market is recovering, but the pick-up is not strong enough to pull the economy out of its slump. Household balance sheets require further strengthening. Similarly, financial institutions are

reducing rather than increasing their exposure to the housing market.

We remain concerned around high private and public debt and the fragile labour market. And with these concerns in mind, we expect that a sustained pick up in US growth will remain elusive as ever.

Europe

2013 may be a year of consolidation for Europe. The European Central Bank (ECB) has done a good job of backing European commitment to the euro. Moreover, European politicians and technocrats continue to manage through crises as they arise, particularly in Spain, Italy and Greece.

Confidence is returning to European markets. Growth is bottoming in Italy, Spain and Greece, while the euro is strengthening. The ECB's moves have seen Spanish yields, for example, fall from over 7.5% towards 5%. Also, over the last four months of 2012 almost €100 billion of private funds flowed back into Spain, Italy, Portugal, Ireland and Greece. In comparison, roughly €400 billion flowed out in the opposite direction over first eight months.

However, while the rot may have been stopped, returning the eurozone economy to growth in 2014 and beyond remains a huge challenge. Necessary economic and political reforms remain a long way off, and the unwinding of years of excess will take time. So much so that we expect the eurozone economy to contract by 0.5% in 2014.

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012f	2013f	2014f
New Zealand						
Real GDP % yr	-1.6	1.7	1.5	2.4	3.0	3.2
CPI inflation % annual	2.0	4.0	1.8	0.9	1.9	2.4
Unemployment %	6.9	6.7	6.4	6.9	6.0	5.0
Australia						
Real GDP % yr	1.4	2.6	2.4	3.5	2.7	2.5
CPI inflation % annual	2.1	2.7	3.0	2.4	2.1	3.0
Unemployment %	5.6	5.2	5.2	5.3	5.5	5.5
China						
Real GDP %yr	9.2	10.4	9.3	7.8	8.8	8.1
Consumer Prices %yr	-0.7	3.3	5.4	2.6	3.4	3.3
United States						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.7	1.7
Consumer Prices %yr	-0.3	1.6	3.1	2.0	2.0	2.0
Unemployment Rate %	9.3	9.6	9.0	8.1	8.0	8.0
Japan						
Real GDP %yr	-5.5	4.9	-0.4	2.1	0.8	1.0
Consumer Prices %yr	-1.3	-0.7	-0.3	-0.1	-0.4	-0.4
Unemployment Rate %	5.2	5.1	4.5	4.3	4.3	4.3
Euroland						
Real GDP %yr	-4.4	1.9	1.5	-0.5	-0.4	-0.1
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.4
Unemployment Rate %	9.5	10.0	10.1	11.5	12.0	12.5
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	-0.1	0.8	0.3
Consumer Prices %yr	2.2	3.2	4.0	2.5	1.8	1.5
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5

Forecasts finalised 7 February 2013

Why has unemployment been so high?

We have long been expecting the jobs-intensive Canterbury rebuild to generate a surge in demand for labour. But so far, New Zealand's labour market has stayed weak. Here we suggest some reasons why

The labour market has been a conspicuous laggard in New Zealand's recent economic recovery. A year ago we were expecting the unemployment rate to fall below 6% by the end of this year, and most others' forecasts weren't too different. Instead, official estimates of the unemployment rate still sat at 6.9% in the December quarter, the second highest in more than two years. New Zealand's official unemployment data are volatile and need to be taken with a grain of salt, but other labour market indicators have also been soft.

To some extent the recent labour market downturn is a reflection of the mid-year economic slowdown, and may yet reverse as the economy picks up speed. However there are a number of other reasons why employers may have been reluctant to take on staff.

- Employers are increasing hours for existing workers rather than hiring new workers. By the standards of previous downturns there was only relatively mild job shedding after the 2008/2009 recession. Employers kept staff on their books, reducing work hours rather than laying people off. We may now be seeing the reverse of that process, with businesses making greater use of existing workers before hiring new staff.

- Workers have been reluctant or unable to move away from the weak regions and industries of New Zealand and into the Canterbury construction industry, where they are needed. There is certainly evidence that serious labour shortages have emerged in Canterbury since the earthquakes. The fact that they've persisted despite high unemployment in other parts of New Zealand reflects the challenge of getting people to where the jobs are. Since late 2010 job vacancies in Canterbury have shot up, a rising number of businesses have been complaining that it's getting harder to find the right staff, and wages have risen faster in Canterbury than elsewhere (especially in the construction sector).

  A recent study by RBNZ staff found that this two-speed labour market is suffering from the lowest 'matching efficiency' (the speed with which job vacancies and additions to the labour force translate into jobs) in more than 15 years. The implication is both higher overall wages (as employers in Canterbury have had to pay a premium to attract the right staff) and higher unemployment than normal.

- The high exchange rate may also be playing a role, by encouraging expanding businesses to choose imported capital in favour of labour. In the latest business confidence surveys we were struck by a sharp increase in firms' intentions to invest in plant and equipment – which has a high imported component – whereas they remained reluctant to invest in new buildings or workers.

Figure 11: Unemployment and ease of finding labour

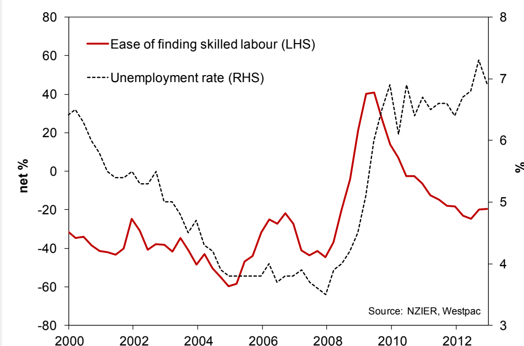
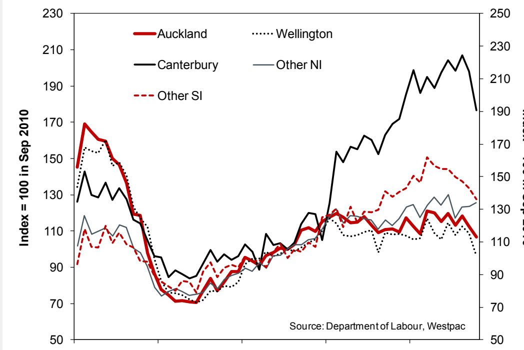
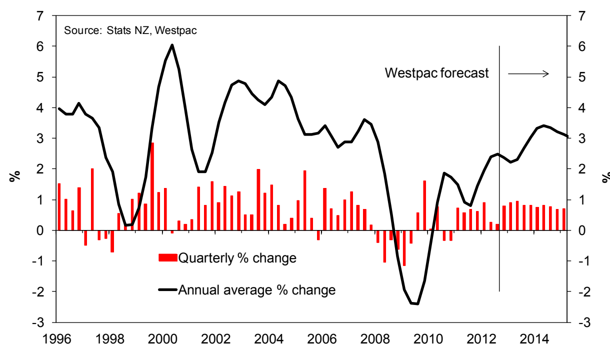


Figure 12: Skilled job vacancies by region

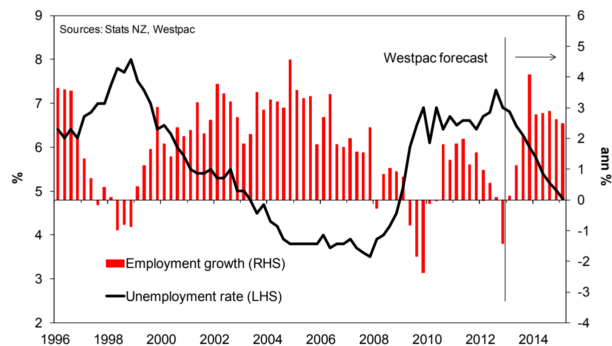


Annual Average % change	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012f	2013f	2014f
Private consumption	2.5	1.5	3.2	3.4	2.1	1.7	2.8	3.5
Government consumption	1.8	0.5	-0.2	0.7	2.0	0.4	-0.1	0.6
Residential investment	-10.7	18.9	18.7	18.0	-11.2	12.6	19.5	19.0
Business investment	5.9	1.9	3.2	4.4	7.9	2.8	1.8	4.7
Stocks (% contribution)	0.7	-2.3	1.5	0.2	-0.3	-1.2	0.6	0.6
GNE	3.3	1.0	4.2	3.9	2.7	2.1	2.9	4.4
Exports	2.6	1.1	2.5	3.0	2.7	1.4	1.9	3.0
Imports	6.1	-0.1	7.3	5.3	6.6	1.6	5.1	6.3
GDP (production)	**1.9**	**2.2**	**3.3**	**3.1**	**1.5**	**2.4**	**3.0**	**3.2**
Employment (% annual)	1.0	0.1	2.8	2.5	1.5	-1.4	4.1	2.6
Unemployment rate (% s.a. end of period)	6.7	6.8	5.8	4.8	6.4	6.9	6.0	5.0
Labour cost index (all sectors, % annual)	2.0	1.6	1.5	2.1	2.0	1.8	1.4	2.0
Inflation (% annual)	1.6	1.0	1.9	2.4	1.8	0.9	1.9	2.4
Current account balance (% of GDP)	-4.4	-4.9	-5.0	-6.3	-4.0	-5.0	-4.8	-6.1
Terms of trade (% annual)	-2.1	-1.5	3.8	-1.9	1.0	-6.5	7.4	-1.8
90 day bank bill (end of period)	2.74	2.70	3.50	4.50	2.71	2.64	3.20	4.25
5 year swap (end of period)	3.59	3.40	4.00	4.90	3.62	3.07	3.80	4.70
TWI (end of period)	72.5	75.7	76.4	73.9	68.7	73.6	77.2	75.0
NZD/USD (end of period)	0.82	0.85	0.85	0.80	0.78	0.82	0.87	0.81
NZD/AUD (end of period)	0.78	0.80	0.84	0.84	0.77	0.79	0.84	0.85
NZD/EUR (end of period)	0.62	0.64	0.67	0.67	0.58	0.64	0.67	0.68
NZD/GBP (end of period)	0.52	0.52	0.52	0.47	0.49	0.51	0.52	0.48

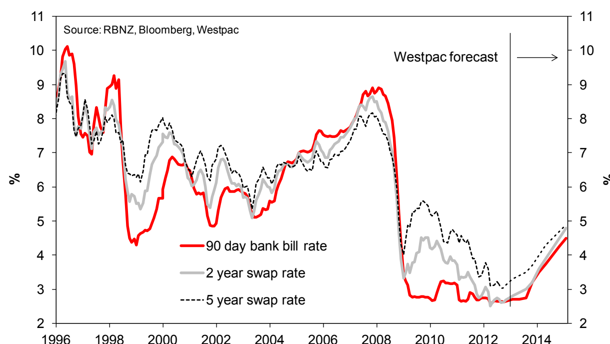
New Zealand GDP growth



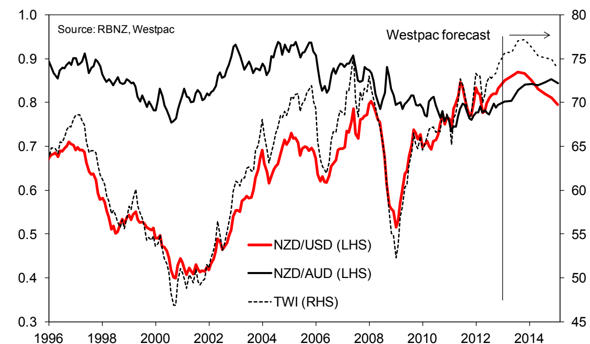
New Zealand employment and unemployment



90 day bank bill, 2 year and 5 year swap rates



NZD/USD, NZD/AUD and TWI



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