INFOMETRICS

newsletter

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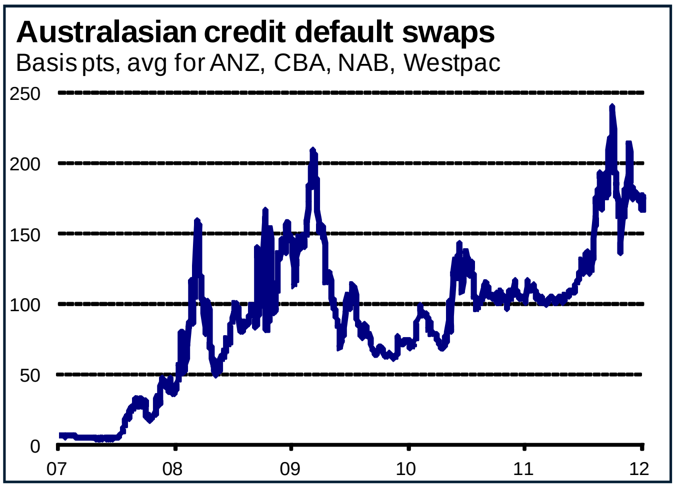
From the beach 2012

New Zealand businesses and consumers have ended 2011 less confident about their prospects than they were at the end of 2010. The risks posed by the European debt crisis have eroded much of the optimism that was building in the middle of last year. There's also a worrying disconnect between business and consumer confidence – consumer confidence is well below that of businesses and raises questions about how patchy spending growth will be this coming year.

Last year was the fourth consecutive one where New Zealand's economic growth has fallen short of expectations. So the general lack of confidence is not surprising given the history of below-par growth during the last four years.

The economic outlook for 2012 will be dictated by Europe's problems and the possibility of further financial market fall-out from the debt crisis. Our preferred indicator of the effect of the European crisis on New Zealand's financial markets is the average credit default swap (CDS) rate across the four major Australasian banks – these rates effectively measure the perceived risk of default by these banks. CDS rates remain well above the very low levels that prevailed until the second half of 2007, but they have pulled back from their October and November 2011 peaks. The easing suggests that, at least for now, market concerns about the crisis are not as serious as they were 2-3 months ago.



Disappointingly, though, it is still not certain that Europe's problems will be resolved in an orderly fashion. There seemed to be little urgency about decision-making by European officials last year, and a close eye will need to be kept on developments in Europe throughout much of 2012 as well.

Against this backdrop, activity within New Zealand is likely to be driven by region-specific and industry-specific factors, rather than there being a synchronised pick-up across the entire country. As a result, we have decided to briefly examine a range of issues, many in the primary sector, that are likely to influence pockets of growth over the next 12 months.

Agricultural action

Commodity prices for **dairy products** in New Zealand dollar terms, according to ANZ's index, are currently 19% below their peak recorded in March last year. Fonterra's forecast payout for the current season is \$6.95/kgms, down from the final payout of \$8.25/kgms for 2010/11. But dairy prices will still be good by historical standards, with only two years (2000 and 2001) between 1986 and 2007 recording higher prices after adjusting for inflation. We expect spending by

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dairy farmers to gradually pick up throughout 2012 in response to persistently good returns. This spending will particularly boost the Waikato and Taranaki economies, but returns to the expanding dairy sector in Otago and Southland may be weakened by dry weather conditions.

It's not just dairy farmers who are enjoying strong returns. ANZ's index shows that average prices for **meat, skins, and wool** are just 2.9% below their March 2011 peak and remain at very high levels. Farmers from areas as far apart as Northland, Manawatu-Wanganui, and Otago have the opportunity to restore their balance sheets after struggling with rising costs, modest returns, and difficult growing conditions at times over the last decade. Although more on-farm spending is likely in these areas, the flow-on effects of strong meat and wool returns may be less pronounced than in the dairy sector.

The news is not so good for some of the other primary producers. **Forestry prices** have fallen 12% since their peak in mid-2010 and may fall further given Russia's admittance to the World Trade Organisation at the end of last year. WTO membership requires tariff reductions, so there is some likelihood that reduced export tariffs on Russian logs will free up a cheaper supply of wood. The boost from high wood prices to regions with a strong forestry presence, including Northland, Waikato, Bay of Plenty, and Tasman, may not be as strong later in 2012 and into 2013.

Also in northern regions, particularly the Bay of Plenty, kiwifruit growers continue to struggle with the **PSA virus,** which has damaged vines and hit production since late 2010. Conversely, the **wine industry** is still grappling with an oversupply of product, the strong exchange rate, and an environment of weak demand internationally. Areas down the east coast of the North Island, from Gisborne to Wairarapa, will be negatively affected by the soft market, along with Tasman, Marlborough, and parts of Otago.

Away from the farm

Although the varying fortunes across the primary subsectors will be a major determinant of regional growth over the coming year, activity in some regions will be influenced by other, less "agricultural" factors. For example, demand pressures in **Auckland's housing market** have been mounting throughout 2011 and are likely to intensify further during 2012. The likelihood that mortgage rates will remain on hold throughout much of this year will facilitate upward pressure on property prices in the region. These price rises, in turn, should translate into more residential building activity in Auckland by the second half of this year.

Auckland will not be the only region where construction plays an increasingly important role as the year unfolds. **Earthquake rebuilding work** in Christchurch, particularly residential activity, should gain momentum later in 2012 as damage assessments are completed, claims are processed, and insurance money becomes available.

However, the significant aftershocks just before Christmas, and the risk of more aftershocks to come, threatens to further delay the acceleration in building activity around Christchurch. As a result of the unstable ground, it may now be the final quarter of this year, rather than mid-2012, before construction work picks up.

Furthermore, the continuing aftershocks also threaten to exacerbate Christchurch's population loss. There were signs at the end of 2011, from international migration data, that the outflow of people from the city was starting to ease. It is possible that the latest round of shakes will once again boost the number of people leaving Christchurch, either for Australia or for other parts of New Zealand. At the very least, the ongoing aftershocks are likely to discourage people from moving to Christchurch.

But continuing pressure on Christchurch's population is likely to be anomalous when compared with other regions. The softening in Australia's labour market during the second half of 2011 has seen the number of people heading to Australia ease over the last few months. With Australia's labour market not expected to improve significantly this year, we expect departure numbers from New Zealand to bottom out and **net migration** to move firmly back into positive territory. Lower departure numbers and stable arrival numbers should see improving population growth across almost all of the country.

Wellington looks set to maintain its air of pessimism as central government continues its drive for **cost savings in the public sector**. The lack of growth in government employment, on which the city is strongly reliant, will keep confidence weak and dampen economic growth in the region.

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