Economic Research
J.P. Morgan Securities Inc.
August 6, 2009

New Zealand Economic Update

Employment, June quarter

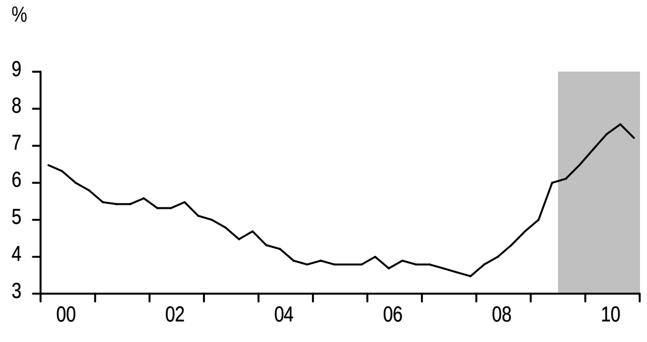
- **Employment contracted 0.4%q/q in 2Q, as expected**
- **Elevated labour force participation inflated the unemployment rate**
- **Next RBNZ move to be a hike, but not until mid-2010**

Employment in New Zealand contracted 0.4%q/q in 2Q (J.P. Morgan -0.4%, consensus -0.5%), after tanking 1.4% in the previous quarter. Marking a prolonged period of deterioration in the New Zealand labour market, employment now has contracted for six straight quarters, pushing the jobless rate from just 3.8% in 1Q08 (when the recession got underway) to 6.0% in 2Q09.

In recent days, we had flagged upside risk to our unemployment rate forecast of 5.5% in 2Q after data showing wage growth slowed more sharply that expected over the quarter. Indeed, the unemployment rate jumped a full percent in 2Q to the highest rate since late 2000. This marked the largest rise since 3Q88 and, to a large extent, can be explained by elevated labour force participation. The participation rate was unchanged at 68.4% in 2Q. Owing to positive net permanent migration of 1,400 persons over the quarter, the working-age population expanded again, rising 0.3%q/q.

With our forecast calling for the labour force participation rate to remain high, unemployment will continue to rise, even if only modest falls in employment are recorded in coming quarters. With that in mind, we see the unemployment rate peaking at 7.6% in 3Q10. The risks to the number are now, however, skewed to the upside.

New Zealand: unemployment rate



Even more indicative of the weakness in the labour market in 2Q, though, was the increase in the number of people underemployed. According to Statistics New Zealand, the number of people underemployed soared by 20.6% to 138,000 in the June quarter, the highest level since 2Q99. This was largely owing to a slump in the number of hours worked, which were down 1.9%q/q.

With the number of unemployed already at a 10-year high, the unemployment rate set to rise for a while yet, and wage growth subdued, private consumption will remain weak. On our forecasts, household spending will fall by 1.6% this year, but if labour market indicators deteriorate even further than expected, the risks to our private consumption growth forecast will be skewed to the downside.

Recent RBNZ comments have highlighted the need for a shift away from debt-driven consumption to boost growth; thus, a higher unemployment rate may provide some form of comfort to the central bank. Governor Bollard has said that the key to a long lasting recovery in New Zealand is a shift away from consumption-led growth to export-led growth. Any attempt to rebalance growth, however, is being challenged by the stronger NZ dollar. Not only is the currency hampering a prospective export-led recovery that could emerge in sync with a global demand pickup, but it is contributing to tighter domestic monetary conditions. Just last week, the RBNZ explicitly said that if financial conditions fail to ease, the RBNZ would “reassess policy settings.”

That said, while there undoubtedly is scope for further policy easing—financial conditions remain tight, the terms of trade are falling, and inflation pressures have eased—we believe the OCR has bottomed. The aggressive pace at which the RBNZ cut the cash rate in this easing cycle means the RBNZ Governor probably will be wary of leaving the cash rate too low for too long. It will, in our view, take a material deterioration in the global outlook to trigger a further reduction in the cash rate. Our forecast calls for rate hikes from 3Q10.

New Zealand: employed

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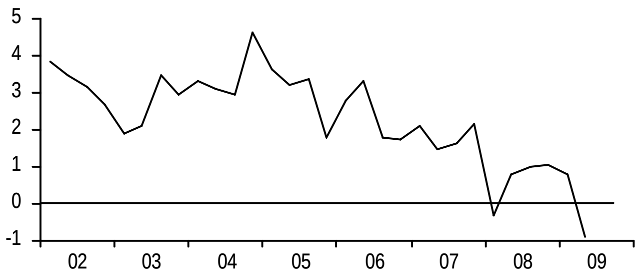

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New Zealand: employed and unemployed