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Hawke's Bay Regional Council Investment Portfolio Mix: Strategic Positioning Review

Final Report to Steering Group
By McDermott Miller Limited

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PART I
REGIONAL ECONOMIC REVIEW

1. REGIONAL ECONOMIC PROFILE

1.1 INTRODUCTION

The Hawke's Bay Regional Council's terms of reference make it clear the review should consider more than the financial returns generated for the Council by the investment portfolio. The Council wants to review the economic, social and cultural contribution (if any) made by its investment portfolio to the Hawke's Bay Region. This requires an assessment of economic impacts of the underlying investments and evaluation of any impacts a change in investment mix might make to the region.

In this section we profile Hawke's Bay's regional economy; its total size in terms of GDP, the wealth of the region in relation to its population size, and the structure of the economy. To help put Hawke's Bay Region's situation into perspective we compare it with other non-metropolitan regions of New Zealand.

1.2 REGIONAL ECONOMIC BASE

The economy of Hawke's Bay remains firmly based on the produce of the region's land. While employment in the service industries has expanded, the growth and prosperity of the region continues to be driven by its export oriented industries.

Our assessment of the Hawke's Bay economy is founded on the theory of the regional economic base.

This theory holds that the primary factor determining the overall level of economic activity in a region is the level of production in those sectors which are sustained by demand from outside the region - either from elsewhere in New Zealand or overseas.

The Regional Economic Base theory is that there is a long run (and stable) relationship between a region's exports and its overall growth. The growth of a region depends upon the growth of its export industries, implying that expansion in demand external to the region is the crucial initiating determinant of growth within the region. An increase in the export base (all the exportable goods and services of a region) sets off a multiplier process. The presumption is therefore that all economic activities not for export, especially the intra-regional region's trade and service activities, are induced by expansion or decline of export industries

The tourism industry can be included among the base industries as demand for it is largely supported by demand from inter-regional and international visitors. While local residents also contribute, the growth and prosperity of the tourism industry depends on growing visitor spend.

The concept of the regional economic base has limitations (for example it does not distinguish inter-regional flows from international trade flows) but is a useful guiding concept given the time and budget constraints on the current project.

A region may grow either because it has industries which are growing fast nationally or because it is gaining an increasing share of a given industry or industry or industries, regardless of whether these industries are growing or not at the national level. For this reason we compare industry growth in Hawke's Bay with other, comparable regions to help identify the region's competitive strengths.

The economic activity essential to getting product to international or inter-regional markets in New Zealand is transport. Clearly transport also is essential to the tourism industry, as transport services enable visitors to come to the region. Transport is the activity that integrates the inter-regional, spatial economy. Importantly, transport defines the market catchment of a region. For example, the Port of Napier's catchment includes Gisborne District, Manawatu Region, and the Wairarapa, as well as Hawke's Bay (see also **Section 5.6**). Improvement in transport services, therefore, can be seen as a "special case" or exception, to regional economic base theory.

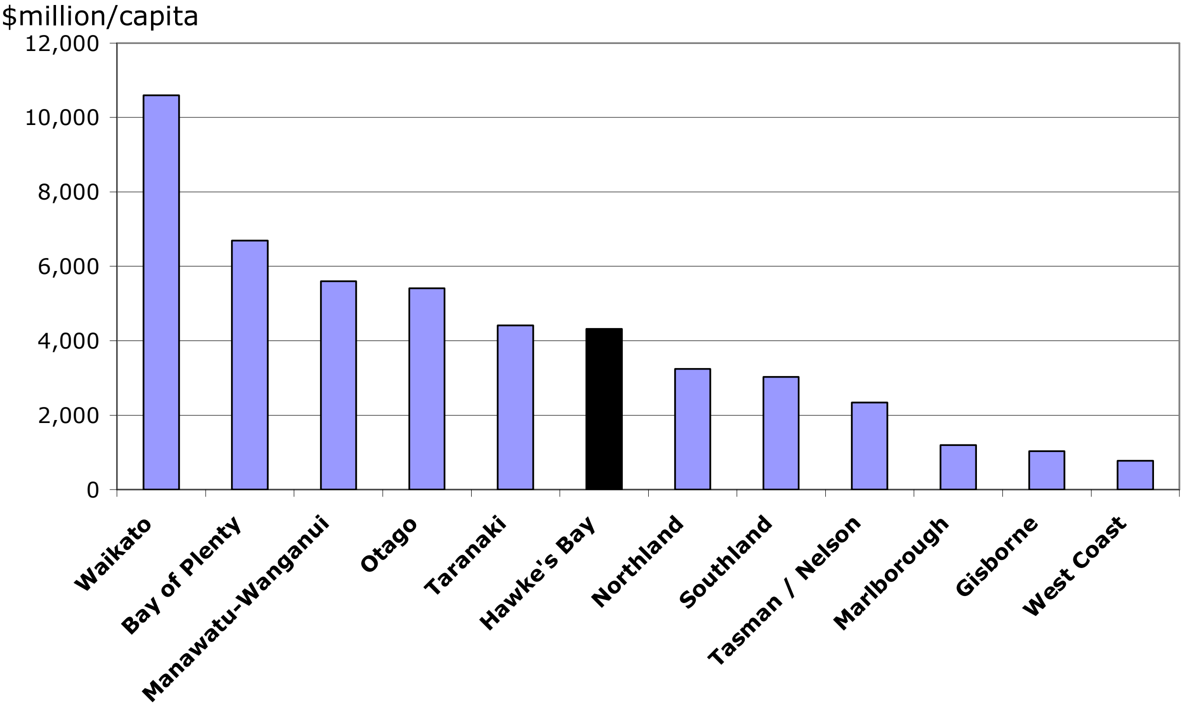
1.3 REGIONAL GDP

Figure 1.1 shows Statistics New Zealand's estimates of Regional Gross Domestic Product for 2003 (the most recent available) for the provincial regions (i.e. excluding Auckland, Wellington and Canterbury).

- Hawke's Bay's regional GDP in 2003 was $4,318 million in nominal dollars ($5,015 million in 2008 dollars).
- This gave it a rank of 6th amongst the 12 provincial regions.
- Hawke's Bay economy comprised 3.3% of the national total of $131,690 million (2003 dollars).
- Applying the regional real GDP growth rates published by Hawke's Bay Incorporated in *Bay Track A compendium of key statistics for Hawke's Bay* Dec 2006 for the 2003-2006 period, and assuming (conservatively) the region's economy has grown since at the national rate, March Year 2008 GDP is around $6,300 million.

- Note that estimates of Hawke's Bay regional GDP vary between sources; estimates for nominal regional GDP in 2006 range from $5,060 million (BERL) to $6,200 million (Economic Solutions Ltd and Infometrics).

Figure 1.1: Regional GDP of Provincial Regions 2003



Source: *Research Report on Regional Gross Domestic Product*, Statistics NZ (December 2006).
Compiled by: McDermott Miller Limited, September 2008

1.4 STRUCTURE OF HAWKE'S BAY ECONOMY

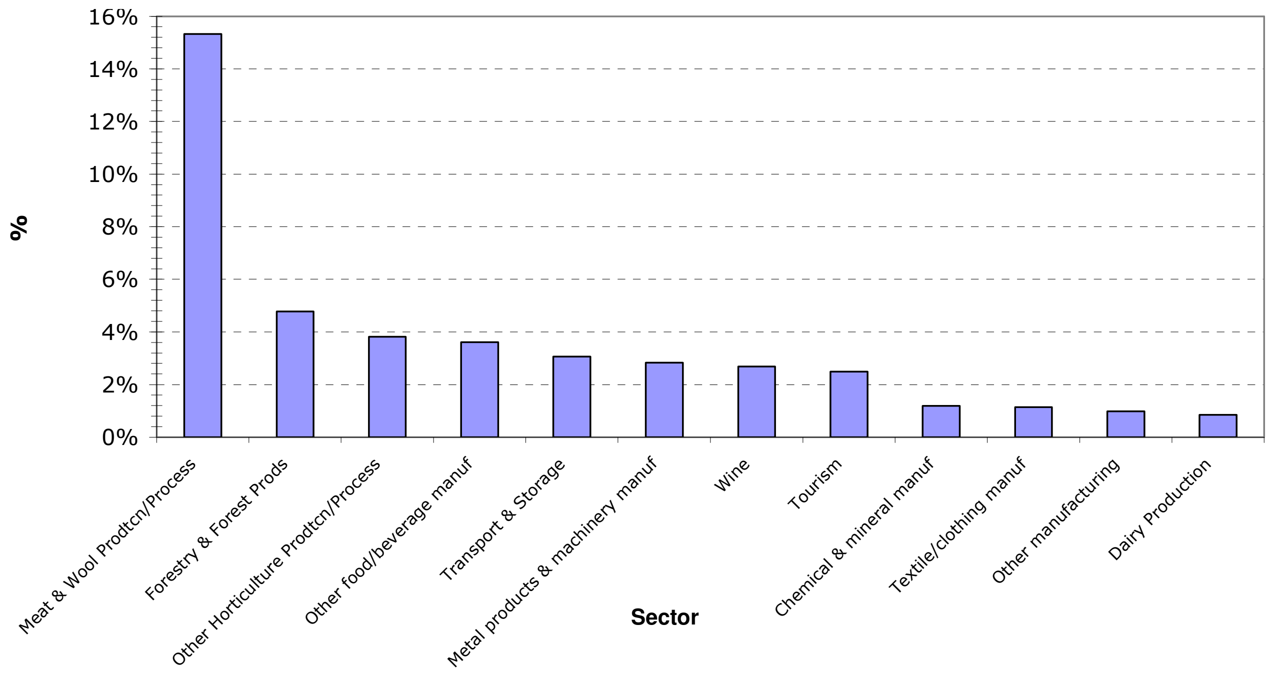
The contribution of economic sectors to Hawke's Bay's GDP is illustrated in **Figure 1.2** below.

To support our "regional economic base" approach to assessing the region's economy, we have used a structural definition of the region's economy which involves "vertically integrating" closely inter-related industries into "vertically integrated" sectors. These and their estimated contribution to the region's GDP (based on an input-output table of the Hawke's Bay economy provided by Butcher Partners) are as follows:

- The meat and wool production and processing vertically integrated sector contributed 15% of regional GDP.

- Forestry and forest products contributed 5% of regional GDP.

Figure 1.2: % Contribution to Hawke's Bay Regional GDP by Vertically Integrated Sector



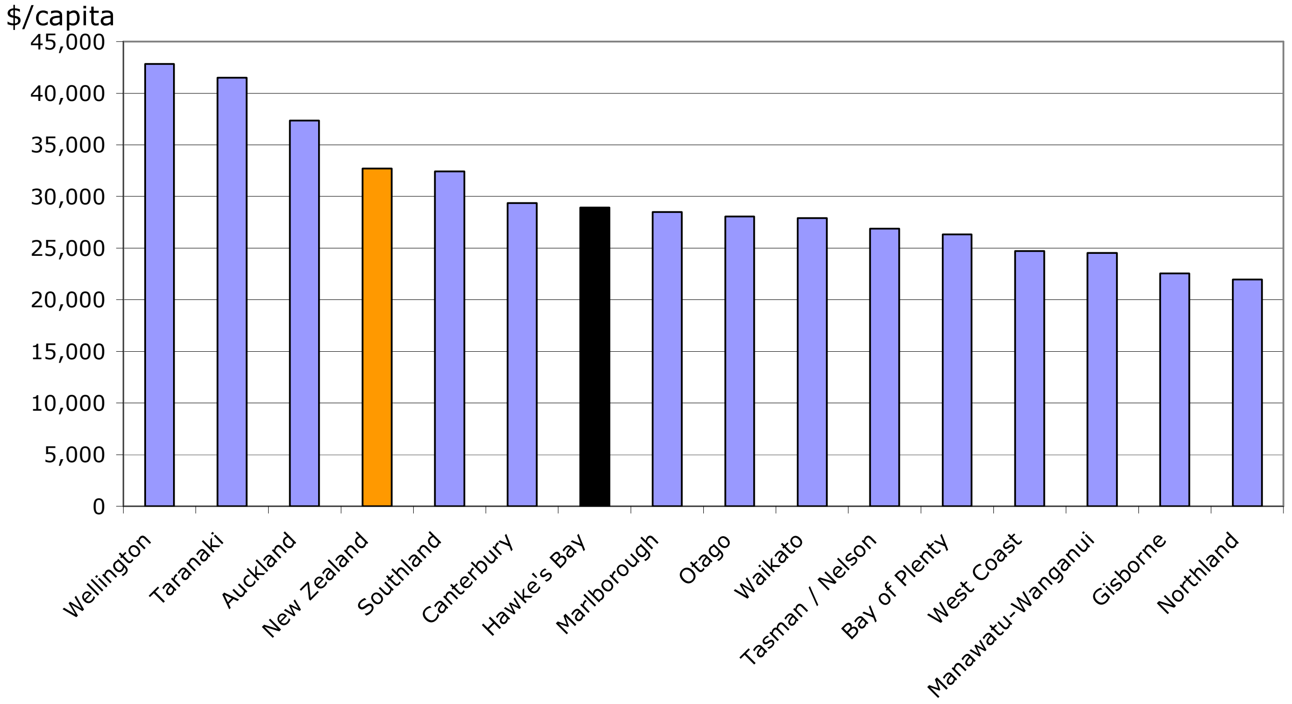
Source: McDermott Miller estimates
Compiled by: McDermott Miller Limited, September 2008

1.5 GDP PER CAPITA

Figures 1.3 and **1.4** below presents GDP per capita in 2003, a more useful indicator of the prosperity of Hawke's Bay compared to other regions and New Zealand as a whole.

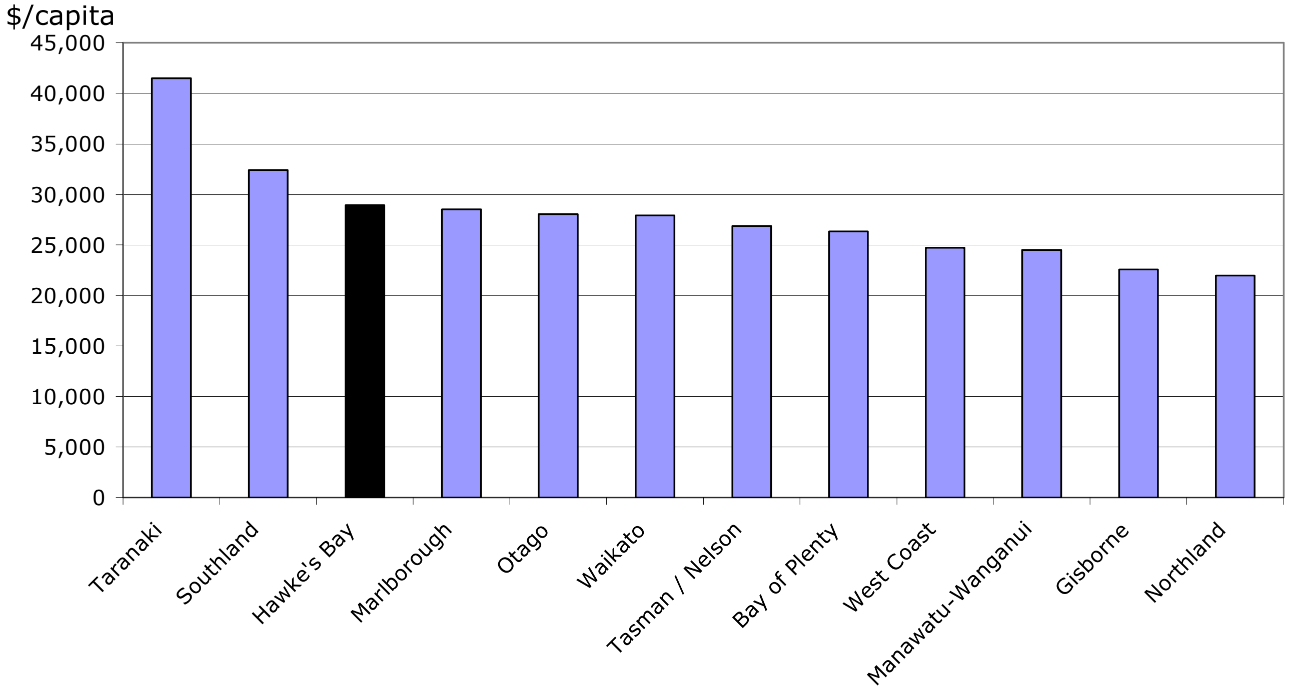
- Hawke's Bay's regional GDP per capita in 2003 was $28,940;
- This was 89% of the New Zealand average of $32,690;
- Hawke's Bay **ranks sixth among all New Zealand's regions** in term of regional GDP per capita;
- However **among the provincial regions Hawke's Bay ranks** third (**Figure 1.4**), with only Taranaki ($41,500) and Southland ($32,400) having higher GDPs per capita.

Figure 1.3: GDP/Capita: All Regions and NZ



Source: McDermott Miller estimates based on Statistics NZ Data
Compiled by: McDermott Miller Limited, September 2008

Figure 1.4: GDP/Capita: Provincial Regions Only:



Source: McDermott Miller estimates based on Statistics NZ Data
Compiled by: McDermott Miller Limited, September 2008

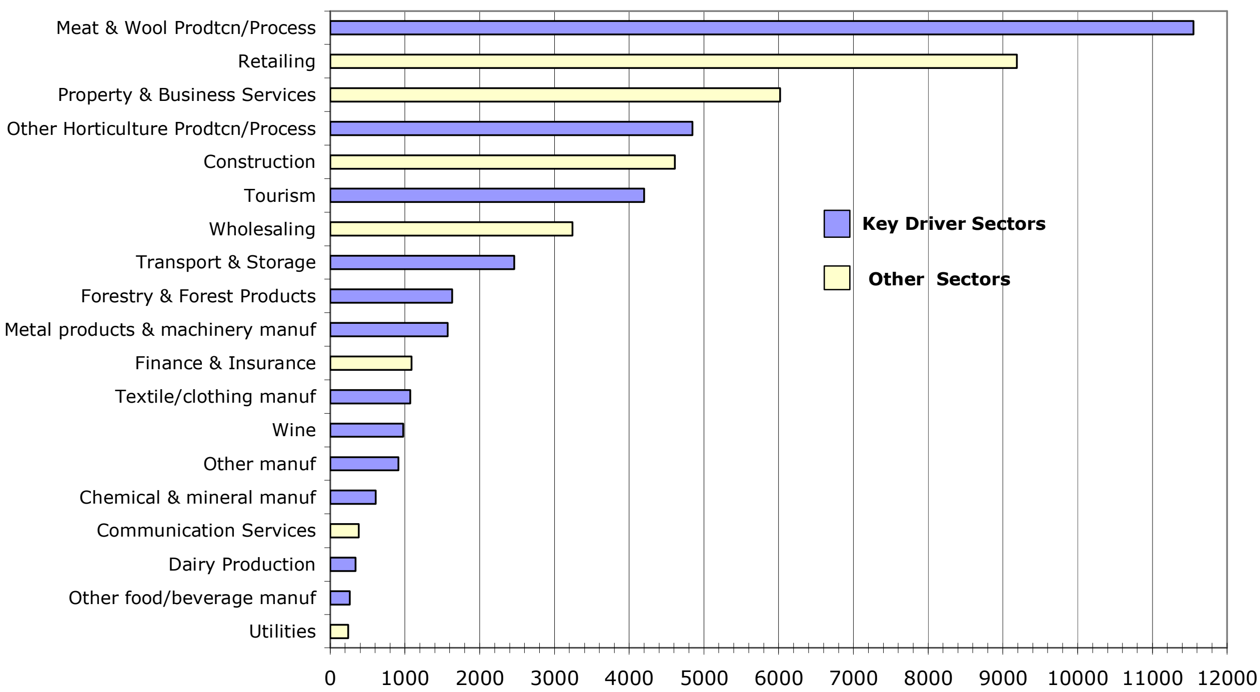
1.6 EMPLOYMENT BY SECTOR

Another indicator of the contribution made by vertically integrated Economic Base sectors within the Hawke's Bay economy is employment. **Figure 1.5** below shows employment within the Hawke's Bay commercial sectors (Government administration and other public sector industries omitted). Total employment in 2007 in these sectors was 55,200, or 73% of total employment.

Figure 1.5 differentiates the Economic Base sectors between the "Key Driver" sectors and other commercial sectors.

- Employment in the meat and wool production sector (combining on-farm and processing industries) total 11,550 or 21% of total employment in the commercial sectors.
- Horticulture Production and processing (excluding wine) employed 4850, or 9% of commercial sector employment.
- The Tourism sector (comprising employment in accommodation, cafes and restaurants, and cultural/recreational industries) employed 4200, or 8% of commercial employment.

Figure 1.5: Employment Counts: 2007



Source: McDermott Miller estimates based on Statistics NZ Data
Complied by: McDermott Miller Limited, September 2008

2. HAWKE'S BAY ECONOMIC PERFORMANCE

2.1 INTRODUCTION

In this section we consider indicators of the growth of the Hawke's Bay regional economy.

2.2 GROWTH IN REGIONAL GDP

The Hawke's Bay regional economy has been growing at more than the national rate over most of the last eight years.

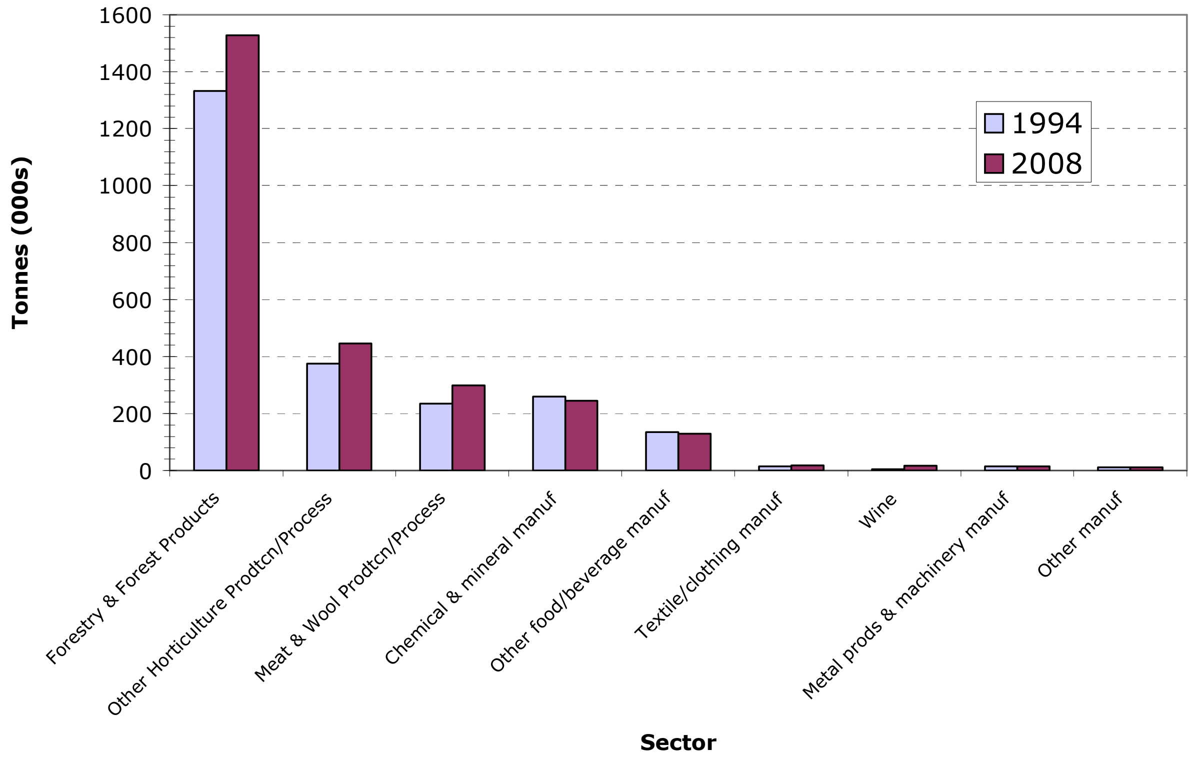
- Over the four years 2000-2003 for which Statistics NZ estimated regional GDP, Hawke's Bay's economy grew at an average annual rate of 4% in real terms.
- This was above the national growth rate of 3.5% over this period and
- Was the fourth highest of all the regions (including metropolitan regions)
- According to Economic Solutions and Infometrics data published by Hawke's Bay Incorporated in *Bay Track A compendium of key statistics for Hawke's Bay* Dec 2006, Hawke's Bay's real GDP growth peaked at 7.2% over the year to June 2006, compared to only 4% at the national level.

2.3 VOLUME OF PRODUCTION

Figure 2.1 below shows estimates of the physical output of the Hawke's Bay regional economy in 1994 and 2008 (June year)

- Total production increased from 2.4 to 2.7 million tonnes, a 13% increase
- Largest increase in absolute terms was in Forestry and Forest Products, up 200,000 tonnes to 1.5 million, a 15% increase (includes logs for export and timber products, not logs only processed in Hawke's Bay).

Figure 2.1: Hawke's Bay Regional Production, 1994-2008 (000 tonnes)



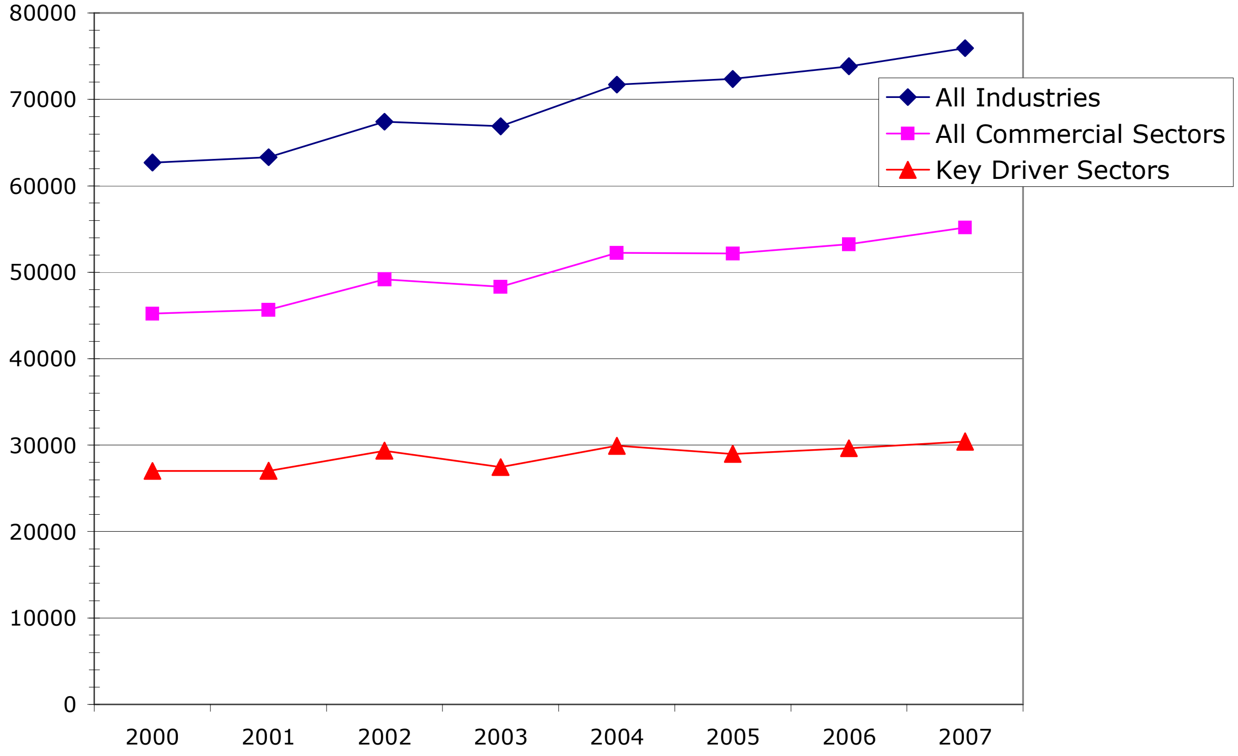
Source: McDermott Miller estimates
Compiled by: McDermott Miller Limited, September 2008

2.4 EMPLOYMENT GROWTH 2000-2007

Figure 2.2 below shows growth in Hawke's Bay employment over 2000-2007:

- Total employment (employment counts) recorded in Statistics New Zealand's Business Statistics database grew from 62,700 in 2000 to 75,900 in 2007, and increase of 13,200.
- This represented an increase of 21%, or an annual average of 2.8%, over the seven year period.
- Employment in commercial sectors grew from 45,200 in 2000 to 55,200 in 2007, an increase of 10,000.
- This growth in commercial employment represented 22% growth, or an annual average of 2.9%, over the seven year period.
- Employment in "Key Driver" sectors grew from 26,700 in 2000 to 30,400 in 2007, an increase of 3430.
- This growth in employment represented 13% growth, or an annual average of 1.7%, over the seven year period.

Figure 2.2: Employment Counts 2000-2007



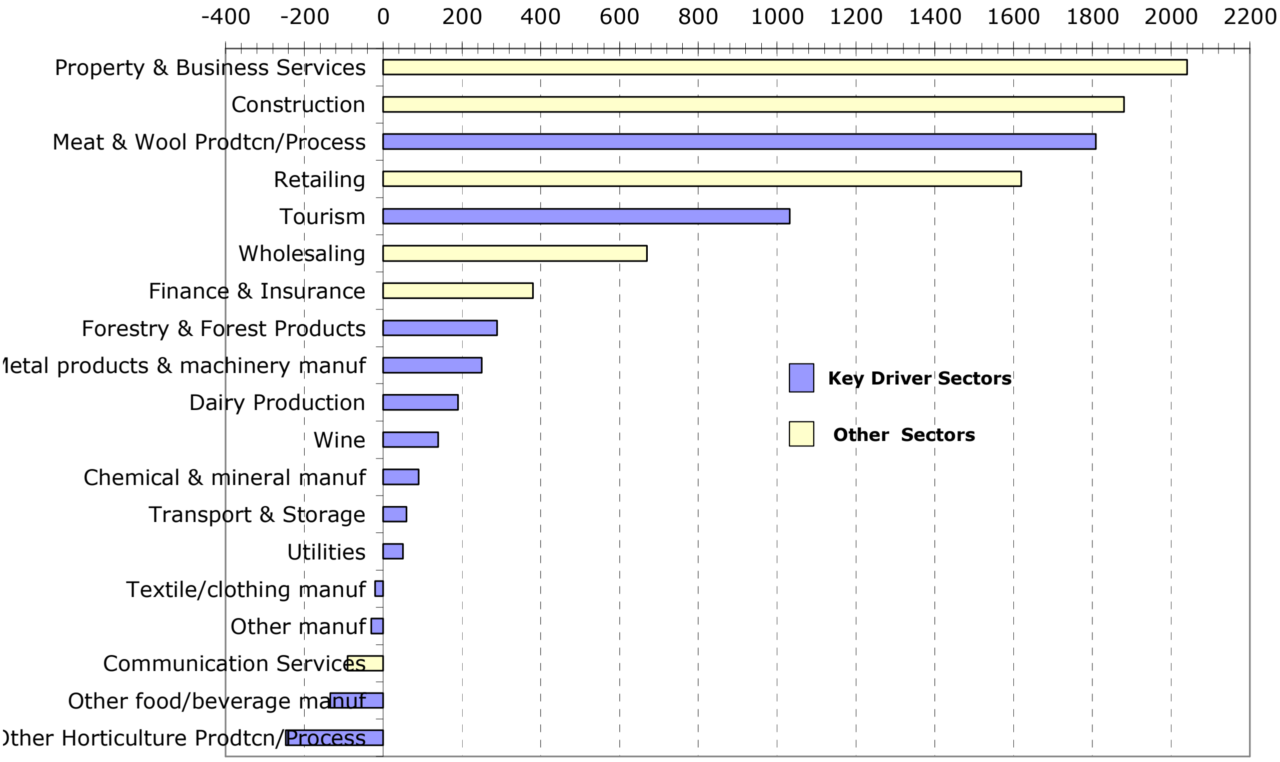
Source: McDermott Miller estimates based on Statistics NZ Data
Compiled by: McDermott Miller Limited, September 2008

Figure 2.3 below illustrates contributions to employment growth by vertically integrated sectors over the period 2000-2007.

- The largest contribution to employment growth came from property and business services, which added some 2000 jobs. (This rapid expansion occurred in all regions, and is partly due to the popularity of owning residential property for investment purposes);
- Construction employment grew by some 1900 jobs;
- Employment in the meat and wool production and processing sector grew by 1800 jobs, an average annual increase of some 2.5% per year;
- Employment in Tourism grew by an annual average of 4.1%, resulting in an increase of 1300 jobs over the 2000-2007 period.; Employment in Forestry and forest products processing grew by nearly 300 jobs, an annual average increase of 2.8% p.a.; and,
- Employment in dairy production grew by an extremely rapid annual average of 12.4% p.a, as employment grew from the

low base of 150 in 2000 to 340 in 2007 – an increase of 190 jobs.

Figure 2.3: Employment Counts: Shift in employment 2000-2007



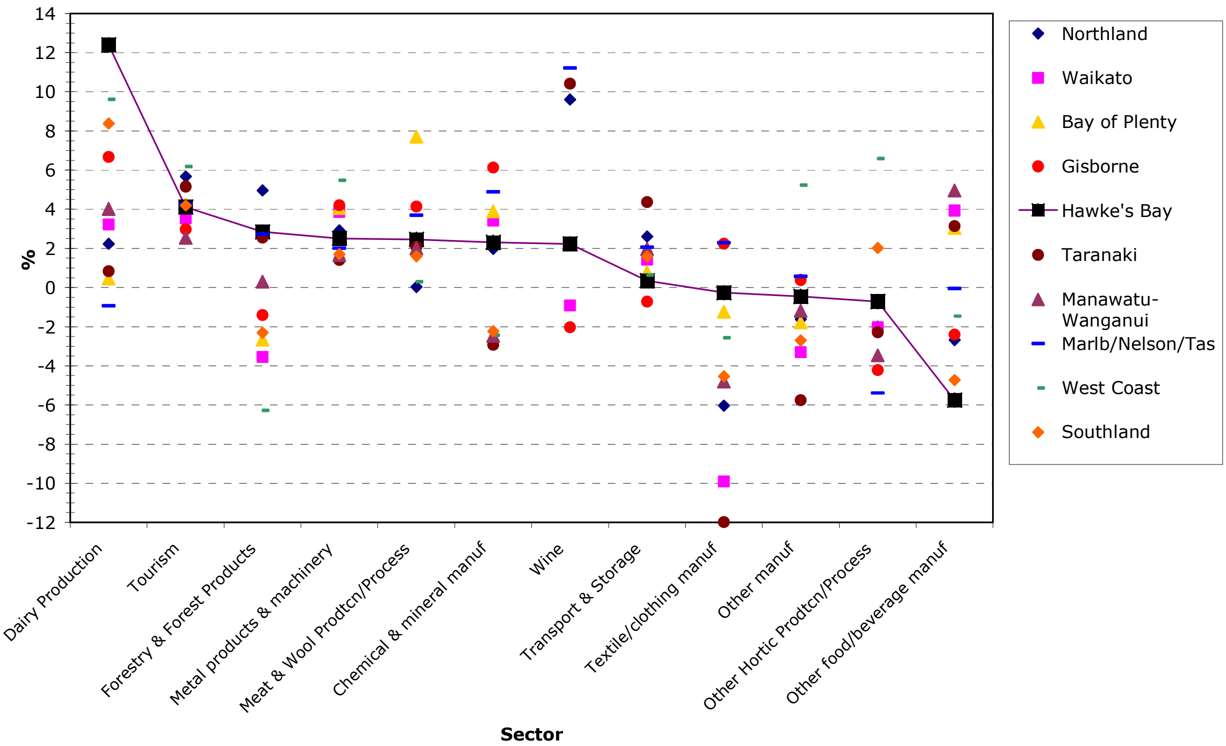
Source: McDermott Miller estimates based on Statistics NZ Data
Compiled by: McDermott Miller Limited, September 2008

Figure 2.4 below shows the average annual growth of the vertically integrated sectors over 2000-2007 compared to other regions.

Growth in percentage terms has been strongest in dairy production (annual average growth 12.4%), but from a low base.

Other sectors in which Hawke's Bay employment has been growing strongly compared to other provincial regions include Tourism (average annual growth rate 4%), forestry and forest products (3%) and textiles/clothing manufacturing (0.3% compared to -4% in nationally).

Figure 2.4: Annual Average % Employment Growth: 2000-2007



Source: McDermott Miller estimates based on Statistics NZ Data
Compiled by: McDermott Miller Limited, September 2008

3. HAWKE'S BAY ECONOMIC PROSPECTS

3.1 INTRODUCTION

In this section we examine the prospects for growth of the Hawke's Bay region economy if no major investments occur to accelerate economic growth.

3.2 GROWTH UNDER *CONTINUATION* SCENARIO

We have developed an economic development scenario for Hawke's Bay which is driven by exports of the land-based industries. We base this on the forecasts for 2008-2012 published in *Situation and Outlook for New Zealand Agriculture and Forestry* (SONZA) by the Ministry of Agriculture and Forestry in August 2008.

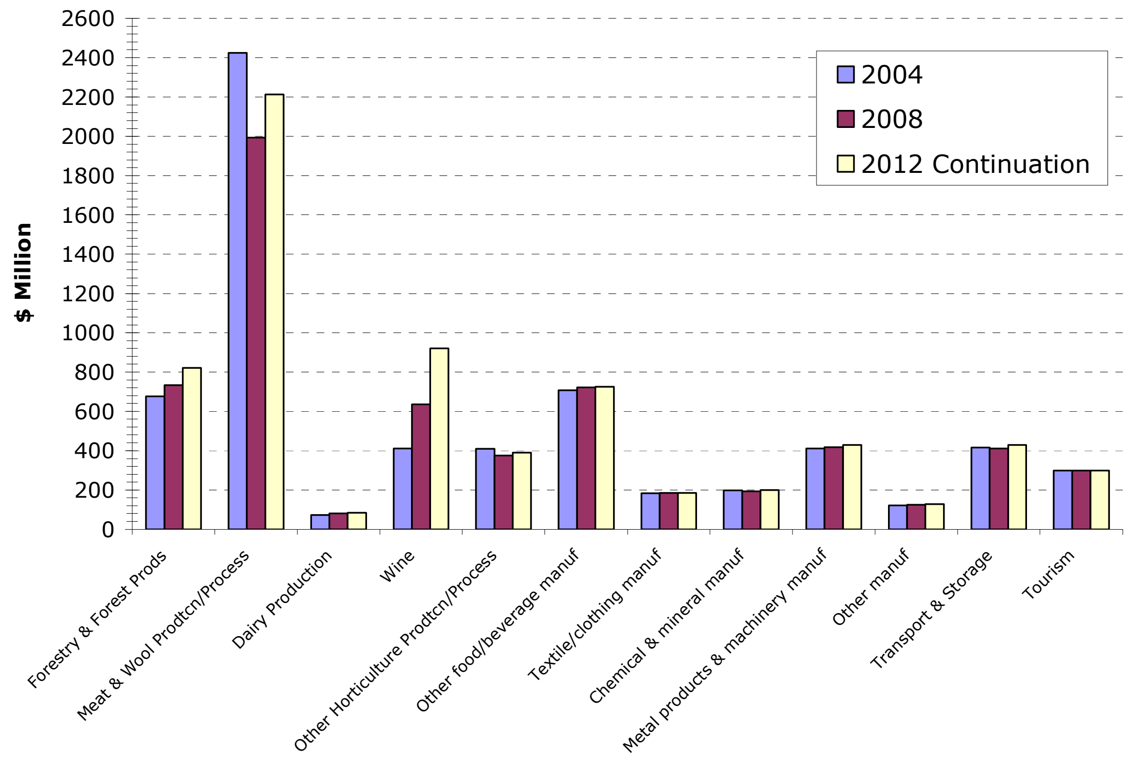
SONZA includes export volume and price projections for the following commodities:

- Wine
- Apples and pears
- Vegetables
- Arable
- Forestry/Forest products
- Lamb
- Wool
- Beef
- Dairy

We projected the value of these exports from Port of Napier assuming they grow at the national rate (i.e. Port of Napier retains its current share). We then used an input-output model of the Hawke's Bay regional economy to estimate the changes in output by industry that would be required to support the expansion in exports. Under this *Continuation* scenario, we find:

- Total output of the Hawke's Bay economy would be some $760 million higher by 2012 than at present;
- Of this, some $655 million of the increase would be in the vertically integrated sectors shown in **Figure 3.1** below;
- The value of output of the Meat and Wool production/processing sector would be $220 million higher (accounting for 29% of growth);and,
- The value of output of the Forestry/Forest Products sector would be $88 million higher by 2012 (12% of growth).

Figure 3.1: Regional Economic Development Evaluation: Output Projection under *Continuation* Scenario



Source: McDermott Miller estimates
Compiled by: McDermott Miller Limited, September 2008

3.3 CONCLUSIONS OF PART I

- The concept of the regional economic base is useful for considering which sectors support the prosperity of Hawke's Bay.
- The Hawke's Bay regional economy has grown strongly in recent years, and the region is one of the wealthiest provincial regions in the country, on a per-capita basis.
- The prosperity of the region remains based on export-oriented base economic sectors, such as forestry and forest products, meat and wool production and processing, and viticulture and wine.
- Transport is important as the activity that integrates the inter-regional, spatial economy and because it enables Port of Napier's market catchment to extend to Gisborne District, Manawatu Region, and the Wairarapa, as well as Hawke's Bay itself.

[END]

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