Business|NZ

Business Planning Forecasts

19 May 2003

FORECASTS: JUNE QUARTER 2003

Introduction

This bulletin is designed to help plan your business. It brings together forecasts of important indicators to help you prepare budgets and business plans.

The forecasts are drawn from two main sources. The New Zealand information is based on a survey of the five main trading banks (ANZ, ASB, BNZ, NBNZ and WPT). The Australian information is based on consensus forecasts put together by the UK based magazine "The Economist". Sources of other information are as shown.

We stress that the information in this publication is by its nature uncertain. Your firm is unique, and you will need to make your own decisions. However, we believe the better informed you are about the way various business people see the future, the better decisions you can make.

Where appropriate we have not only included the average value across all forecasters, but also the highest and the lowest forecast. This gives some idea of the spread of forecasts, and therefore an idea of the uncertainty involved.

Business New Zealand
May 2003

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +4.4% for the year-ended December 2002.

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period.

The consensus among bank economists, which is shared by the Government, is that GDP growth has now peaked and we are likely to see a return to 2-3% growth rates that have been more typical for New Zealand.

The short-term forecasts for economic growth suggest that GDP will increase by 3.9% for the year ended June 2003, but the second half of the year is likely to see a more noticeable fall-off in GDP growth rates, with growth forecast to fall to around 2.6% for the year to December 2003.

It seems likely that growth will then settle at this lower level in 2004 – the range of bank forecasts vary from between 2.4% to 3.0% for the year to December 2004.

Forecasts: Real GDP % Growth

	Years Ending		
	June 03	*Dec 03*	*Dec 04*
Highest	4.0	2.8	3.0
Average	3.9	2.6	2.7
Lowest	3.9	2.4	2.4

Source: ANZ, ASB, BNZ, National and WestpacTrust

Key factors to influence this outcome will include:

Iraq and SARS…

As reported in our March forecast, much of the global economic uncertainty was a result of concerns about the duration and impact of the increased likelihood of a US-led invasion of Iraq. As it happened, the war was over very quickly and to date there has been little of the feared regional instability or upswing of terrorism that a war was predicted to encourage. Oil prices have also fallen significantly since it became clear that the war would be over quickly. That's all very good news, but it should be tempered by recognition that the impact on the US economy and its ability to be an engine for global growth is likely to be prolonged thanks to the short-term cost of the war (US$75 billion) and the longer-term costs that will be incurred in occupying and rebuilding Iraq. Terrorists can also strike at any time, as the recent Riyadh bombing illustrated.

As it would happen, as the war with Iraq drew to a close a new menace rose to prominence, Severe Acute Respiratory Syndrome (SARS). To date SARS has mainly affected China, Hong Kong, and Singapore and the number of infections and deaths remain relatively low compared to ordinary strains of the flu and it seems likely that it will eventually be contained. However, the impact in the meantime on our tourism and export industries could be significant. In the short term, airlines are cutting services, some meat and seafood exporters are reporting cancelled orders in Asia due to people declining to eat out, and there are reports that SARS is also hurting our lucrative export education industry as Asian students stay home.

The medium to longer-term prognosis will depend on how quickly SARS is contained and life returns to normal in the affected countries. However, Tourism NZ is warning that visitor arrivals could fall by 50,000 and the impact SARS will have on the GDP of the affected countries will inevitably impact upon their consumers' wealth and therefore their propensity to buy our exports.

…Impacting upon trading partner growth

New Zealand's small and limited domestic market makes exporting very important for many businesses. This makes the economic health of our trading partners very important to monitor. Although 2003 is expected to be a better year than 2002, GDP growth forecasts in our major trading partners remain relatively weak and have been pared back in recent times, not withstanding the quick Coalition victory in Iraq. It may well be 2004 before the international situation improves markedly.

Interest rates …

In April, the Reserve Bank reduced its Official Cash Rate (OCR) from 5.75% to 5.50%. This was despite a domestic economy that is continuing to exhibit strength and continued high capacity utilisation (manifested, for example, by continued shortages of skilled labour), both of which tend to be inflationary. Countering this has been the continued weakness of international markets and the strength of the NZD, which should be acting to counter inflationary pressures. Inflation also slipped slightly in the March quarter to 2.5%.

While most forecasters had been predicting an easing in the OCR in 2003, many were surprised that it came so soon. Significantly, the Bank has moved from *requiring evidence* of reduced inflationary pressures before acting to now *making a judgement* on future activity. This change in stance has not gone unnoticed, with most commentators now expecting that a further cut in the OCR to 5.25% in early June is more likely than not.

…and the Dollar

Despite the occasional blip, the NZD has appreciated steadily against most of our significant trading partners since the start of 2002, driven by New Zealand's relatively strong economy and higher short-term interest rates. In our March forecast we suggested that the NZD was probably overvalued against the AUD and since that time it has obliged by falling back below AUD0.90. We also suggested that the NZD would remain relatively strong against the USD, and by and large it has (part of this is a reflection of a large US current account deficits which is beginning to drive a fall in the USD against most currencies).

The trading banks are forecasting the NZD to edge further towards 'fair value' in 2003, which probably means higher still against the USD, but easing back further against the AUD. The NZD is then forecast to depreciate again against most currencies in 2004. However, it should be noted that forecasting currency movements with any degree of certainty is fraught with difficulty.

Tourism and net migration flows

Short-term overseas visitor arrivals were strong in 2002, with over 2 million arrivals for the year (up 7%) and with December 2002 being a record high for any month. 2002 was also a good year for permanent and long-term migration inflows, with 96,000 permanent and long-term arrivals and a net migration gain of over 38,000. Strong tourism numbers helped maintain robust retail sales growth, and large migration inflows boosted domestic consumer spending, car sales and house building. Migration has also, to an extent, helped mitigate some of the pressures that have built in the labour market (although a significant contributor to net migration has been a large inflow of foreign students who will not be in the labour force).

However, although 2003 started reasonably well and the Iraq war was over quickly, international economic weakness and SARS are all likely to cause potential tourists to have concerns about travelling overseas (notwithstanding New Zealand's safe reputation), while the loss of the America's Cup may also have a negative impact (although this is more likely to be felt in three years time when the event is not held in Auckland). Immigration policy changes could also restrict inwards migration.

Commodity prices and farm incomes

Confidence in the agricultural sector was weaker throughout 2002 due mainly to lower forecast prices at the farm gate following falls in agricultural commodity prices and the increase in the New Zealand dollar. Although commodity prices have recovered slightly in more recent times, the New Zealand dollar returns remain down – for example, ANZ Bank's Commodity Price Index rose by 4.1% for the year ended April 2003, but in New Zealand dollar terms prices are down 14%. Commodity prices in New Zealand dollar terms remain 29% below their April 2001 peak and this will have implications for the domestic economy as lower farm incomes work their way through provincial and eventually metropolitan economies.

Infrastructure constraints

Energy shortages are likely to have a negative impact on GDP, not just directly through less electricity being produced, but also indirectly as businesses cut back on production to make savings. Winter 2001 resulted in a relatively small negative impact on GDP, but indications are that this winter could be more severe. Transport infrastructure is also of concern – for example, Auckland's traffic congestion has been estimated to cost the national economy almost $1 billion per annum. The Government has identified infrastructure as a priority and has launched a stocktake on infrastructure needs and how they can be met.

Business confidence

The latest NZIER Quarterly Survey of Business Opinion (released in April 2003) recorded a slump in business confidence remains, reflecting concerns about overseas trading conditions, the rise in the exchange rate, and the looming electricity shortage. On a seasonally adjusted basis a net 56% of respondents were pessimistic about conditions over the next 6 months (a deterioration from a net 9% pessimists in the previous survey). Business confidence is now at its lowest level since December 1985.

The ANZ-Business New Zealand Performance of Manufacturing Index (PMI) has shown a healthy expansion in manufacturing activity since its inception in August 2002. However, the most recent PMI results have recorded a softening in the strength of manufacturing activity from a peak of 65.0 last November to 52.7 in March (any measure of over 50 indicates expansion).

Consumer confidence

Consumer confidence has helped to underpin strong growth in retail sales since 1999, with sentiment improving first in rural areas and then spreading first to provincial centres and lastly to metropolitan areas. Strong employment growth, low unemployment and higher house prices, particularly in Auckland, should help maintain consumer confidence into 2003. Over recent months retail sales growth has begun to ease (although remaining solid), perhaps an indication that lower rural incomes are beginning to bite in the provinces. Aucklanders remain relatively confident though and its consumption led growth is likely to underpin the domestic economy in 2003.

1.2 Inflation

Most recent outcome: +2.5% year-ended March 2003

The rate of inflation, as measured by the Consumer Price Index (CPI), provides an indication of the extent to which price levels have increased and a benchmark for wage demands.

Government policy changes can have a major impact on the CPI. For example, in 2000 the increase in the excise on tobacco, coupled with higher petrol prices helped push the CPI to peak of 4.0%. The December 2000 reduction in state housing rentals was then a major contributor to the slowing in annual inflation to 1.8% by December 2001. Local government rates can also be an inflation driver, with rates having increased on average by around twice the rate of inflation over the past decade.

Inflation eased slightly to 2.5% for the year ended March 2003. This would have given the Reserve Bank some comfort when it made its OCR cut. However, on the downside, the proportion of items in the CPI 'basket' that are rising in price continues to cause some commentators concern.

The CPI is forecast to fall further in the June quarter to around 2.1%, as a particularly high quarterly figure for June 2002 falls out of the reckoning and is replaced by what is likely to be a more modest outcome for June 2003. In the medium-term, the annual increase in the CPI is expected to average around 2.0% to 2.2% for the years to December 2003 and 2004.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	June 03	*Dec 03*	*Dec 04*
Highest	2.5	2.6	2.7
Average	2.1	2.0	2.2
Lowest	1.7	1.6	1.9

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.3 Labour Costs

Most recent outcome: +2.3% year-ended March 2003

Statistics NZ produces an index that measures movements in the total cost of employing labour, the Labour Cost Index (LCI). The LCI has fixed industry and occupation weights and measures changes in wages and salaries for a fixed quantity and quality of labour input.

Short-term forecasts for growth in labour costs have increased over recent times due to the higher CPI and stronger growth in the labour market causing skills shortages in a number of industries and regions. Stronger net migration has tended to mitigate some of the pressure on wage costs though.

While real wages (as measured by the LCI) have fallen over recent years, they should recover should there be a slowing in the rate of increase in the CPI.

Forecasts: Labour Cost Index % Change

	Years Ending		
	June 03	*Dec 03*	*Dec 04*
Highest	2.4	2.4	2.4
Average	2.3	2.2	2.1
Lowest	2.2	2.0	1.7

Source: ANZ, ASB, BNZ, National and WestpacTrust

An alternative measure of labour costs is the Quarterly Employment Survey (QES). It tends to be more volatile than the LCI, mainly because it not only measures changes in pay rates, but also measures compositional changes in the labour force. The most recent QES release shows wages grow by 2.3% for the year-ended February 2003, down sharply from 3.6% for the year-ended November 2002.

1.4 Employment

Most recent outcome: +1.5% year-ended December 2002

Since 1999, employment growth has been strong, with 147,000 more people in employment in March 2003 compared to September 1999. Unemployment has fallen from 6.8% of the labour force in September 1999 to 5.0% in March 2003, consolidating on 15-year lows. However, little further progress in reducing the rate of unemployment is expected over the next two years, with most commentators suggesting unemployment will remain at or over 5% of the labour force.

Compared to March 2002, 28,000 more people were employed in March 2003, but the working age population had increased by 67,000, due in large part to a strong net migration gain. This has resulted in the labour force participation rate falling from 66.8% to 66.2% over the year to March, with most of the fall in participation being among males (female participation rates remaining largely unchanged).

Forecasts: Unemployment % (HLFS)

	Years Ending		
	June 03	*Dec 03*	*Dec 04*
Highest	5.5	5.6	5.7
Average	5.4	5.4	5.3
Lowest	5.2	5.1	4.7

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 5.45% as at 15 May 2003

In general, overdraft and mortgage interest rates move in line with the 90-day bill rate, which is in turn heavily influenced by the Reserve Bank's OCR (currently set at 5.50%). This time last year, forecasts suggested that the OCR would reach as high as 7.00% by mid-2003. Those forecasts have clearly been proved wrong by subsequent events, but they illustrate how difficult it can be to forecast economic outcomes with any certainty. With the Reserve Bank clearly showing an easing bias, many now expect the OCR to be cut to 5.25% at its next review in June. The trading banks are expecting rates to firm in 2004, however.

Forecasts: Interest Rates (90 day bills)

	Years Ending		
	June 03	*Dec 03*	*Dec 04*
Highest	5.5	5.6	6.7
Average	5.4	5.4	6.1
Lowest	5.2	5.1	5.6

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.6 Exchange Rates

Most recent outcome: NZD = USD0.57.51 as at 15 May 2003
NZD = AUD0.8899 as at 15 May 2003
TWI = 61.3 as at 15 May 2003

The NZD rose strongly in 2002, driven by relatively high GDP growth and relatively high short-term interest rates (both factors making New Zealand a more attractive place to invest). 2003 has so far seen the NZD rise 9.2% against the USD, but fall 4.5% against the AUD, and overall it is up 4.3% against the Reserve Bank's Trade Weighted Index (TWI) (the TWI measures the NZD against a basket of currencies).

Accurately forecasting changes in currency exchange rates is fraught with difficulty. Despite the strength in its gains against the USD, most economists still regard the NZD as being around its 'fair value' against that currency and expect it to rise further in 2003 before falling back in 2004. However, the consensus view is that the NZD is still overvalued against the AUD and it is expected to fall further in 2003 and 2004. The TWI is generally expected to rise slightly in 2003 before easing back in 2004.

AUD (cents)	*June 03*	*Dec 03*	*Dec 04*
Highest	89.7	88.2	86.6
Average	89.3	87.3	84.9
Lowest	88.5	86.0	83.1

USD (cents)	*June 03*	*Dec 03*	*Dec 04*
Highest	58.0	60.0	59.0
Average	57.2	58.1	55.2
Lowest	56.5	57.0	50.0

TWI	*June 03*	*Dec 03*	*Dec 04*
Highest	62.5	62.3	61.8
Average	61.4	61.7	59.3
Lowest	60.6	60.7	57.2

Source: ANZ, ASB, BNZ, National and WestpacTrust

In practice, buying forward foreign currencies can reduce the risk in cross rate movements. Forward cover rates are based on the exchange rate when it is bought, so it pays to watch daily movements and buy at the right time, particularly in light of recent movement in the exchange rate with Australia and the US. Forward cover rates can be obtained from banks.

Part 2: The Australian Economy

The performance of the Australian economy impacts on New Zealand in two ways: It provides a measure of how well New Zealand exporters are likely to fare (a stronger Australian economy will be generally 'suck in' imports) and an indication of the likely strength of competition from Australian sourced products.

2.1 Economic Growth (GDP)

Most recent outcome: +3.2% for the year-ended December 2002.

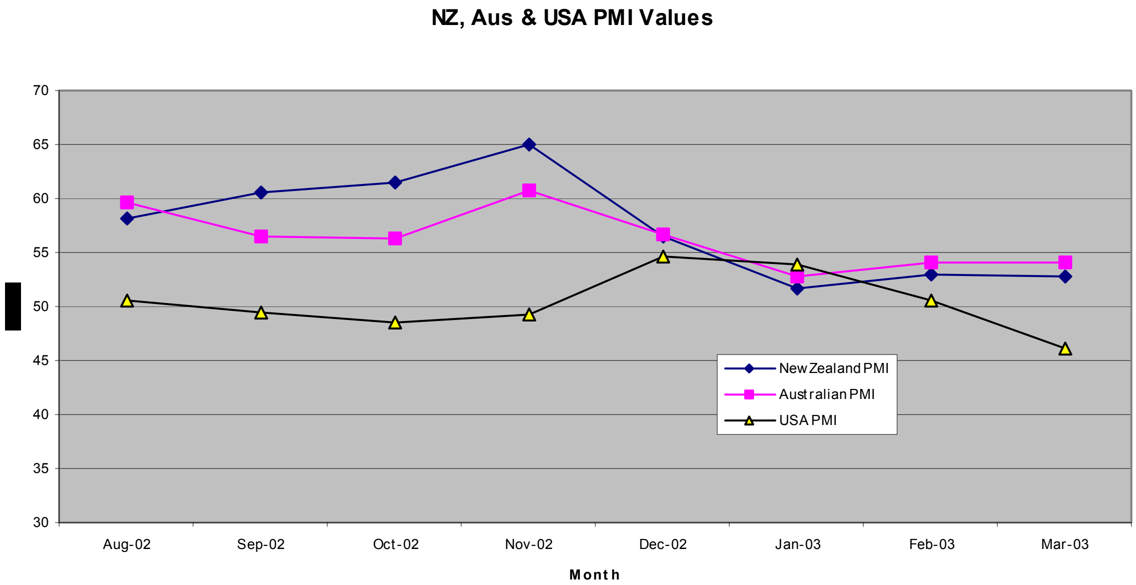
Forecasts:
- December 2003: +3.0%
- December 2004: +3.5%

Source: The Economist

Forecasts for Australian GDP growth have been reduced from those made in the previous quarter, down from 3.2% to 3.0% for the year ended December 2003. It seems likely that the drought and the global weaknesses are the main reasons for the slowdown from trend growth, although domestic demand remains strong – for example household lending is currently growing by 20% per annum. However, even a reduced rate of growth of 3.0% would still be quite healthy by international standards.

The latest Australian PMI results show manufacturing activity remaining positive, but the overall index has eased slightly in March to 54.0 from 54.1 in February.

Although it is early days with the New Zealand PMI survey, it has been interesting to note that the two surveys have so far tended to move in tandem, as the chart below indicates. This reflects the importance of the Australian economy to New Zealand manufacturers. The relationship between the US and the Australian and New Zealand PMI surveys is less close, however.



2.2 Headline Inflation

Most recent outcome: +3.4% for the year-ended March 2003

Forecast:
- December 2003: 2.7%
- December 2004: 2.5%

Source: The Economist

Inflation has breached the higher limit of the Reserve Bank of Australia's 2-3% target and although it is forecast to ease this year as the economy slows, it is likely to remain at the upper end of the target. The wage cost index was up 3.4% for the year ended December 2002, and unemployment remains stubbornly over 6%. The recent appreciation in the AUD (particularly against the USD) and a softening domestic economy are likely to ease inflationary pressures caused by the drought's impact on higher food prices and higher oil prices caused by fears of war in Iraq.

2.3 Interest rates (90 day bills)

Most recent outcome: 4.75% as at 9 May 2003

Forecasts:
- September 2003: 4.95%
- September 2003: 5.10%

Source: HSBC

The Reserve Bank of Australia (RBA) has kept its OCR at 4.75% for nearly a year. Although it has in the past taken a more gradualist approach to changing interest rates than its New Zealand counterpart, the RBA has until recently continued to signal a need to tighten monetary conditions, if not immediately, then later in 2003.

Like the RBNZ, the RBA is currently concerned about weakness and uncertainty in international markets, but it is more concerned about rapid growth in domestic demand. Few commentators in Australia expect any RBA easing in the near future.

Part 3: Rest of the World

The economic picture in the rest of the world is very important for a small, open trading nation, such as New Zealand. Generally speaking, the international climate has not been particularly favourable over the past three years.

Adding to this recent weakness, short-term developed country growth forecasts for 2002 and 2003 have each been pared back since the previous quarter, particularly in Europe and the United States. This is not surprising considering the crisis in confidence in global equity markets caused in part by fallout from the high profile collapses of Enron and WorldCom. These events have shaken confidence in an already fragile post-2001 recovery, and more recently uncertainty about war and SARS have taken centre-stage.

Even disregarding the war (which in any event was over quickly), the signs have not been overly positive. Despite highly expansionary fiscal and monetary conditions over the past two years, the United States economy continues to show only a few signs of recovery from a downturn that is in its third year. Its version of the PMI (ISM PMI) has slumped so far this year. The US Federal Reserve has cut its equivalent of the OCR almost to zero, the point where monetary stimulation becomes impossible (as Japan has found).

The Japanese economy has continued to stagnate and is moving into a deflationary spiral. Its economy is showing few signs of life after a decade of barely moving in and out of recession caused at least in part by a continued political unwillingness to make meaningful economic reforms. South East Asia and China (which has been one of the few engines for growth over the past few years) are being hit hard by the impact of SARS.

Europe is also failing to live up to hopes when the Euro was launched that it would take on the United States as an economic superpower, due mainly to weakness in France, recession in Germany, and a European Central Bank which remains overly hawkish on inflation.

Although global growth was fairly stagnant in 2002 and looks likely to remain so in 2003, most economists are predicting that 2004 should be a slightly better year. Many are suggesting that the prospects for the United States economy must surely soon improve, pointing to highly stimulatory monetary and fiscal policy and a falling exchange rate. This should in turn provide the much-needed ‘engine’ to kick-start global economic growth that has been lacking over the past three years.

We are yet to see any concrete evidence of this, however. It is also worth recalling that in both 2001 and 2002 economists were saying that 2002 and 2003 respectively would be better years.

An improved global outlook would obviously be good news for New Zealand, although war worries have caused some of the forecasts to be downgraded since the previous quarter.

Forecasts: World GDP Growth (Selected Trading Partners)

Country	*2003*	*2004*
Australia	3.0%	3.5%
Canada	2.7%	3.2%
Japan	0.7%	0.8%
United Kingdom	1.8%	2.4%
United States	2.2%	3.2%
Euro Area	1.1%	2.1%

Source: Economist

Meanwhile, forecasts for inflation in developed countries remain relatively subdued for 2003, although they have been revised upwards since the previous quarter, possibly due to higher oil prices in the first quarter. Global inflation is expected to ease slightly in 2003, but remain at moderate levels, as economies begin to recover (there is likely to a fair bit of unused capacity which will allow for non-inflationary growth in many countries).

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

Country	*2003*	*2004*
Australia	2.7%	2.5%
Canada	3.1%	2.2%
Japan	-0.6%	-0.5%
United Kingdom	2.8%	2.4%
United States	2.3%	1.7%
Euro Area	1.9%	1.5%

Source: Economist