Business|NZ

Business Planning Forecasts

17 February 2003

FORECASTS: MARCH 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
February 2003

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +3.9% for the year-ended September 2002.

The short-term forecasts for economic growth have strengthened further from the previous quarter, following the strong growth recorded over the first three quarters of 2002 and expectations of a further solid GDP result for the December quarter (result not due for release until 28 March). Annual growth is expected to peak in the March 2003 quarter at just over 4%.

There is, however, an increasing expectation that GDP growth will fall back in the remainder 2003 and 2004 – to around 3.0% for the year to September 2003 and 2.8% for the year to September 2004. The range of bank forecasts for the latter varies from a low of 2.4% to a high of 3.4%
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Forecasts: Real GDP % Growth

	Years Ending		
	March 03	*Sept 03*	*Sept 04*
Highest	4.2	3.6	3.4
Average	4.1	3.0	2.8
Lowest	3.8	1.8	2.4

Source: ANZ, ASB, BNZ, National and WestpacTrust

Key factors to influence this outcome will include:

Will there be war in the Middle East?

Much of the current global economic uncertainty is a result of concerns about the duration and impact of what appears to be, as this report is written, the increasing likelihood of war with Iraq. While most commentators are suggesting that any war will be short and successful for the United States and its allies, no one should dismiss the possibility that it goes badly and becomes longer, bloodier, more expensive, and more complicated than expected – with negative economic impacts, such as significantly higher oil prices, trade disruption, and lower business investment. The impact of post-war instability not only in Iraq, but impacting on its neighbours and other countries in the region could also be significant.

What will the Reserve Bank do with interest rates?

The Reserve Bank has maintained its Official Cash Rate (OCR) unchanged at 5.75% since mid-2002 and seems likely to retain it at around that level at least for the short-medium term. This is despite a domestic economy that is continuing to surge and fears that its strength is generating inflationary pressures, particularly with inflation remaining stubbornly in the upper-end of the Bank's 1-3% inflation target. Countering this cause for concern is the continued weakness of international markets and the strength of the NZD, which should be acting to suppress inflationary pressures. International uncertainty has caused the Reserve Bank to remain cautious and keep the OCR at its existing level, although in its January OCR review Dr Bollard held out some prospect for a cut in the OCR providing the exchange rate remains at present levels or appreciates further.

Will the Kiwi Dollar continue to rise?

Despite the occasional blip, the NZD has appreciated steadily against most of our significant trading partners since the start of 2002. While the NZD is at a historically high rate against the AUD (and is now probably overvalued against the AUD), it is still only around its long-run average rate against the USD. This is reflected in the trading banks forecasting the NZD to edge towards 'fair value' in 2003, which probably means higher still against the USD, but easing back against the AUD. The NZD is then forecast to depreciate again against most currencies in 2004. Forecasting currency movements with any degree of certainty is fraught with difficulty, however.

Will strong growth in tourism and net migration be sustained?

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 have helped maintain robust retail sales growth, and large migration inflows have 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). Dark clouds on the horizon though will be international uncertainty and war-risk causing potential tourists to have concerns about travelling overseas (notwithstanding New Zealand's safe reputation) and immigration policy changes which may restrict inwards migration.

Will farm incomes decline to the extent forecast?

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 4.6% for the year ended January 2003, but in New Zealand dollar terms prices are down 15%. Commodity prices in New Zealand dollar terms remain 27% 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.

Will economic growth pick up in our major trading partners?

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 are likely to remain so as long as uncertainty remains over war in the Middle East.

When will business confidence levels recover?

The latest NZIER Quarterly Survey of Business Opinion (released January 2003) found that economic activity remains strong, but business confidence remains subdued, reflecting concerns about overseas trading conditions and the rise in the exchange rate. On a seasonally adjusted basis a net 4% of respondents were pessimistic about conditions over the next 6 months (a deterioration from a net 15% expecting an improvement in the previous survey).

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 recorded a softening in the strength of manufacturing activity from 65.0 in November to 56.4 in December (any measure of over 50 indicates expansion). However, it is unclear at this stage whether softening was a seasonal phenomenon or an indication that sentiment is actually deteriorating.

Will strong consumer confidence levels be sustained?

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. Auckland remains confident though and its consumption led growth is likely to underpin the domestic economy in 2003.

1.2 Inflation

Most recent outcome: +2.7% year-ended December 2002

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.

Forecasting inflation, even in the short-term, can be difficult. For example, in the March 2002 quarter the markets and the Reserve Bank both forecast the CPI to rise by 0.9%, whereas the actual outcome was significantly lower at 0.6%. More recently, however, expectations and outcomes have been more broadly in line.

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.

The 2002 Policy Targets Agreement between Governor of the Reserve Bank and the Minister of Finance may have an impact on future inflation outcomes. The main changes were to give the Bank a more explicit 'medium-term' focus and to increase the floor of the inflation target from 0-3% to 1-3%.

The annual increase in the CPI is expected to fall to around 2.4% by June 2004. The latter estimate is around 0.4% higher than forecasts made prior to the new PTA and may be a result of inflationary expectations having edged slightly upwards as a result.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	March 03	*Sept 03*	*Sept 04*
Highest	2.7	2.4	3.0
Average	2.6	2.1	2.4
Lowest	2.4	1.6	2.0

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.3 Labour Costs

Most recent outcome: +2.1% year-ended December 2002

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 rate of increase in the CPI.

Forecasts: Labour Cost Index % Change

	Years Ending		
	March 03	*Sept 03*	*Sept 04*
Highest	2.4	2.5	2.4
Average	2.3	2.2	2.1
Lowest	2.2	2.0	1.8

Source: ANZ, ASB, BNZ, National and WestpacTrust

An alternative measure of labour costs is the Quarterly Employment Survey. 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 also shows wage growth to be accelerating, up by 3.6% for the year-ended November, after a sharp rise during the August quarter (+1.8%).

1.4 Employment

Most recent outcome: +2.4% year-ended December 2002

Strong employment growth since 1999 continued throughout 2002, with 138,000 more people in employment in December 2002 compared to September 1999. Unemployment has fallen from 6.8% of the labour force in September 1999 to 4.9% in December, a 15-year low. 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.

Stronger net migration and increased labour force participation, particularly among those aged 60 years and over, are all factors impacting on the level of employment growth and composition of the labour force. However, the survey data can be volatile due to the impact of high sample errors, so the numbers for each quarter can be difficult to predict with any certainty.

Compared to December 2001, 44,000 more people were employed in December 2002, and the working age population had increased by 59,000, due in large part to a strong net migration gain.

Despite easing slightly compared to the September 2002 quarter the labour force participation rate remained relatively high in December at 66.3%. A low unemployment rate coupled with a high labour force participation rate indicates that the labour market remains tight, which is consistent with surveys carried out by the Department of Labour and NZIER, as well as the ANZ-Business NZ PMI.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	March 03	*Sept 03*	*Sept 04*
Highest	5.7	5.5	5.5
Average	5.4	5.3	5.1
Lowest	5.1	5.2	4.8

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 5.84% as at 14 February 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 5.75%). During the June 2002 quarter, forecasts suggested that the OCR would reach as high as 7.0% by mid-2003, but more recent developments have caused the Reserve Bank to pause and take stock, with the OCR now expected to remain unchanged for the remainder of 2002 and into 2003. Some of the banks are expecting rates to firm in 2004, however.

Last year's short but pronounced tightening episode (four consecutive OCR 0.25% increases over March-July) is now likely to be over, with the Reserve Bank recently suggesting that the balance of probabilities has shifted more towards a cut in the OCR later in 2003, providing the exchange rate remains at least at existing levels. Recovery in international markets and domestic inflationary pressures will also be important considerations for the Bank to weigh up in the coming months.

Forecasts: Interest Rates (90 day bills)

	Years Ending		
	March 03	*Sept 03*	*Sept 04*
Highest	5.9	6.2	6.7
Average	5.8	6.0	6.2
Lowest	5.7	5.9	5.9

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.6 Exchange Rates

Most recent outcome: NZD = USD0.5541 as at 14 February 2003
NZD = AUD0.9304 as at 14 February 2003
TWI = 61.1 as at 14 February 2003

The NZD is now considerably stronger than it was at the start of 2002, with it now being 33.3% higher against the USD, 14.5% higher against the AUD, and 21.5% higher against the Trade Weighted Index (TWI). Despite the strength in its gains over the year against the USD, most economists still regard the NZD as being at the lower end of its 'fair value' against that currency. However, the consensus view is that it is now overvalued against the AUD.

Accurately forecasting changes in currency exchange rates is fraught with difficulty. However, the broad consensus is that the NZD should continue to appreciate against the USD in 2003, and either consolidate or ease back in 2004. In contrast, there is broad agreement that the NZD should depreciate against the AUD in 2003-04. On balance, the Reserve Bank's TWI (which measures the NZD against a basket of currencies) is generally expected to rise slightly in 2003 before easing back in 2004.

AUD (cents)

	Mar 03	*Sept 03*	*Sept 04*
Highest	93.2	93.5	88.3
Average	92.7	91.2	86.4
Lowest	91.7	87.9	84.6

USD (cents)

	Mar 03	*Sept 03*	*Sept 04*
Highest	55.0	59.2	56.8
Average	54.8	57.7	54.4
Lowest	54.3	55.5	50.0

TWI

	Mar 03	*Sept 03*	*Sept 04*
Highest	60.5	64.1	61.9
Average	60.2	62.3	59.4
Lowest	60.0	60.2	57.6

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: +3.7% for the year-ended September 2002.

Forecasts:
- December 2002: +3.7%
- December 2003: +3.2%

Source: The Economist

Forecasts for Australian GDP growth have been reduced from those made in the previous quarter, down from 3.5% to 3.2% for the year ended December 2003. Partly this is a result of the severe drought, weaker residential building activity, softer retail sales, and weak international market, which combined with the drought resulted in a very large December trade deficit. However, even a reduced rate of growth of 3.2% would still be quite strong by international standards.

The latest Australian PMI results show manufacturing activity remaining positive, but the overall index has eased in January to 52.7 from 56.7 in December, mainly affected by softer growth in production, new orders, and deliveries.

2.2 Headline Inflation

Most recent outcome: +3.1% for the year-ended December 2002

Forecast:
- December 2003: 2.7%

Source: The Economist

Inflation is expected to remain at the higher end of the Reserve Bank of Australia's 2-3% target. Wage growth continues to remain moderate, with unemployment forecast to remain over 6% during 2002 and 2003, limiting the opportunity for higher wage growth. 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 14 February 2003

Forecasts:
- June 2003: 4.75%
- September 2003: 4.95%

Source: HSBC

The Reserve Bank of Australia (RBA) has kept its OCR at 4.75% for several months – a full percentage point less than New Zealand's. 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 it is currently concerned about weakness and uncertainty in international markets. It is also concerned about the ongoing impact of the drought on economic growth.

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 concerns about the impact of any war in the Middle East has taken centre stage.

Even disregarding the possibility of war, 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 (although its ISM PMI showed a lift in manufacturing activity in December). The Japanese economy has continued to stagnate and is showing few signs of life after a decade of barely positive economic growth and a continued unwillingness to make meaningful economic reforms. Europe is also failing to live up to initial hopes that it would take on the United States as an economic superpower, due mainly to weakness in France and Germany. Australia has been a bright spot over recent years, but the drought is causing concern about its ability to keep growing at 4% plus.

It is these concerns about the rest of the world that have primarily caused the RBNZ and the RBA to pause and take stock.

Although global growth was fairly stagnant in 2002, most economists are predicting that 2003 should be a slightly better year. Many are suggesting that providing war with Iraq is short and successful, the prospects for the United States economy must 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.

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	*2002*	*2003*
Australia	3.7%	3.2%
Canada	3.3%	3.1%
Japan	-0.3%	0.4%
United Kingdom	1.6%	2.4%
United States	2.4%	2.5%
Euro Area	0.7%	1.3%

Source: Economist

Meanwhile, forecasts for inflation in developed countries remain relatively subdued, and largely unchanged from the previous quarter. They also remain generally lower than for New Zealand (the exception being Australia, where inflation expectations are similar). Global inflation is expected to pick up slightly in 2003, but remain at moderate levels, as economies begin to recover. The impact of higher oil prices may cause upward revisions though.

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

Country	*2002*	*2003*
Australia	3.0%	2.7%
Canada	2.2%	2.5%
Japan	-0.9%	-0.7%
United Kingdom	1.9%	2.5%
United States	1.6%	2.0%
Euro Area	2.2%	1.7%

Source: Economist