

Business Planning Forecasts

18 August 2003

FORECASTS: SEPTEMBER 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
August 2003

Business|NZ

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +4.3% for the year-ended March 2003.

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 annual GDP growth peaked in the March quarter and that the June quarter outcome (not due for release until 26 September) is likely to signal a slowdown. The June quarter saw the effects of long-standing global economic weakness and higher New Zealand Dollar (NZD) finally being felt domestically, but also reflected a series of nasty, albeit temporary, economic shocks, such as SARS, Iraq War, and electricity shortages.

As a result of these factors, some commentators have been suggesting close to zero growth in the June quarter. However, more recent data releases have indicated somewhat surprising resilience in the domestic economy, with retail sales, residential construction, and employment all continuing to show strength.

The short-term forecasts for economic growth suggest that GDP will increase by 3.2% for the year ended September 2003. Growth is then likely to ease further to around 2.1% for the year to March 2004, before settling at this lower level during 2004, with the range of bank forecasts vary from between 1.9% to 2.7% for the year to September 2004.

Forecasts: Real GDP % Growth

	Years Ending		
	Sept 03	March 04	Sept 04
Highest	3.3	2.4	2.7
Average	3.2	2.1	2.3
Lowest	3.1	1.9	1.9

Source: ANZ, ASB, BNZ, National and WestpacTrust

Key factors to influence this outcome will include:

Continued global economic weakness...

Although the sharp economic shocks caused SARS and the Iraq War were relatively short, their medium-term impact persists. With regard to SARS, the ongoing impacts on consumer and business confidence and reduced incomes in Asia will take some time to recover. This impact is reflected in the latest external migration statistics, which show visitor arrivals from Asia down 26% in the month of June 2003 compared to June 2002, with visitors from China and Taiwan down 64% and 58% respectively. However, the 26% fall is an improvement on the month of May, when Asian visitor arrivals were down 47% on May 2002. Meanwhile, the Iraqi situation appears to be

Business|NZ

developing into a drawn out, potentially costly occupation, which could put further strain on the United States economy.

...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 was 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. It may well be 2004 before the international situation improves markedly.

Interest rates ...

Since April, the Reserve Bank has reduced its Official Cash Rate (OCR) from 5.75% to 5%, bringing it more into line with Australia's OCR of 4.75%. Opinion is divided among economists on whether the Reserve Bank will continue to cut the OCR this year, particularly as the domestic economy continues to show strength (see discussion under section 1.5 on page 7).

...and the Dollar

Despite the occasional blip, the New Zealand Dollar (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. This rise has understandably caused considerable concern among exporters, both of primary products and manufactured goods. Despite volumes holding up reasonably well, export values were 14% lower for June 2003 compared to June 2002.

In the short term, the trading banks are forecasting the NZD to edge higher still against the US Dollar (USD), but easing back further against the Australian Dollar (AUD). The NZD is then forecast to depreciate again against most currencies in 2004 (see discussion under section 1.6 on page 8).

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, global economic weakness, the Iraq war, and SARS have all caused potential tourists to have concerns about travelling overseas, notwithstanding New Zealand's safe reputation. Immigration

Business|NZ

policy changes could also restrict inwards migration in the medium to longer term, although a combination of continued high inflows and somewhat lower outflows have resulted in a rise in the net migration gain to 42,500 for the year ended June.

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 NZD. Although commodity prices have recovered in more recent times, the NZD returns remain weak. For example, ANZ Bank's Commodity Price Index rose by 7.1% for the year ended July 2003, but when expressed in NZD terms prices were down 11% for the year and remained around 32% below their April 2001 peak.

Lower incomes on the farm should have implications for the domestic economy as the negative wealth effect works its way through provincial and eventually metropolitan economies. However, it can take time for these impacts to fully work their way through the economy and high migration inflows have also worked to cushion the impact.

Infrastructure constraints

Energy shortages are likely to have had a negative impact on June quarter GDP, not just directly through less electricity being produced, but also indirectly as businesses cut back on production to make savings. Transport infrastructure is also of concern, with a recent survey of business survey undertaken by Infometrics for the Growth and Innovation Advisory Board found that transport infrastructure to be one of the greatest impediments to business growth. The Government has rightly identified infrastructure as a priority and has launched a stock-take on infrastructure needs and how they can be met. There are few if any immediate short-term fixes to these constraints, however.

Business confidence

The latest NZIER Quarterly Survey of Business Opinion (released in July 2003) recorded a recovery in business confidence, albeit off the record level of pessimism recorded in April. On a seasonally adjusted basis a net 22% of respondents were pessimistic about conditions over the next 6 months (an improvement from a net 41% pessimists in April), but indicators of own activity remained positive (a net 17% of respondents reporting increased activity during the quarter).

The ANZ-Business New Zealand Performance of Manufacturing Index (PMI) initially showed a healthy expansion in manufacturing activity from its inception in August 2002 to the start of 2003. However, the more recent PMI results have recorded a softening in the strength of manufacturing activity from a peak of 65.0 last November to a trough of 49.6 in May (any measure of over 50 indicates expansion). It has since recovered slightly to 53.2 in June.

Consumer confidence

Strong employment growth and reducing unemployment since 1999 has driven consumer confidence, which in turn has helped underpin strong growth in retail sales, with sentiment improving first in rural areas and then spreading first to provincial centres and lastly to metropolitan areas. Lower interest rates and higher house prices are also making homeowners feel wealthier. As a result, consumer confidence levels seem likely to remain at healthy levels well into 2003, with retail sales growth in the June quarter showing surprising strength.

1.2 Inflation

Most recent outcome: +1.5% year-ended June 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 and charges are also an inflation driver, with rates having increased on average by around twice the rate of inflation over the past decade.

Inflation fell sharply from 2.5% for the year ended March to 1.5% for the year ended June. Although the large drop was mainly due to the removal of a high CPI result for June 2002 quarter and a number of one-off price falls (e.g., significantly lower international airfares due to SARS), it is clear that the higher NZD is acting to constrain import prices, with car and petrol prices both falling.

The CPI is forecast to remain low in the September quarter at around 1.6% for the year. In the medium-term, the annual increase in the CPI is expected to average around 2.0%.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Sept 03	March 04	Sept 04
Highest	1.8	1.8	2.8
Average	1.6	1.7	2.1
Lowest	1.5	1.5	1.8

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.3 Labour Costs

Most recent outcome: +2.3% year-ended June 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, but only to a degree as a significant proportion of migrants are actually students.

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

Forecasts: Labour Cost Index % Change

	Years Ending		
	Sept 03	March 04	Sept 04
Highest	2.2	2.3	2.4
Average	2.2	2.2	2.2
Lowest	2.2	2.0	2.0

Source: ANZ, ASB, BNZ, National and WestpacTrust

An alternative measure of labour costs is the Quarterly Employment Survey (QES). The QES tends to be much more volatile than the LCI, mainly because it not only measures changes in pay rates, but it also measures compositional changes in the labour force. The most recent QES release shows that average hourly earnings grew by 3.7% for the year-ended May 2003, up from 2.3% for the year-ended March 2003.

1.4 Employment

Most recent outcome: +2.0% year-ended June 2003

Since 1999, there has been strong employment growth, with 163,000 more people in employment in June 2003 compared to September 1999. Unemployment has fallen from 6.8% of the labour force in September 1999 to 4.7% in June 2003, the lowest rate since December 1987.

The June quarter fall in unemployment from 5.0% to 4.7% was a surprise, with most commentators expecting a rise in unemployment. Despite the latest fall, economists continue to see little further progress in reducing the rate of unemployment over the next two years, with most suggesting unemployment will remain at or over 5% of the labour force.

Business|NZ

In the year to June 2003, 37,000 more people were employed, but over the same period the working age population increased by 63,000, due in large part to a strong net migration gain. This has resulted in the labour force participation rate falling from 66.7% to 66.2%, with most of the fall in participation being among males (female participation rates remaining largely unchanged).

The composition of employment growth since June 2001 reflects the strength of the domestic economy and weakness of the more export-oriented sectors. There have been strong gains for construction, wholesale and retail trade, education, and health and community services, but employment levels have been static or have fallen in agriculture, forestry, and fishing, manufacturing, transport, storage and communication, and business and financial services.

Nevertheless, strong employment growth, which has been carried into 2003, should continue to sustain the domestic economy through increased consumer spending and residential construction.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	Sept 03	March 04	Sept 04
Highest	5.2	5.3	5.4
Average	5.0	5.1	5.2
Lowest	4.9	4.9	4.8

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 5.13% as at 15 August 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. The Reserve Bank has cut the OCR three times since April, from 5.75% to 5.00%. These cuts followed comments made by Reserve Bank Governor Alan Bollard back in January that he saw scope for interest rate cuts if the NZD maintained its strength and inflationary pressures eased. Both conditions have since been met, with the Trade Weighted Index having increased from 60 to 62 and annual CPI inflation having decreased from 2.7% to 1.5%.

Opinion is divided on whether the Reserve Bank should cut in the OCR further. Those who suggest that it should cut further point to high New Zealand interest rates by international standards, the strong NZD, weak export values, a slowing domestic economy, and reducing inflation. However, those who think the Bank should now take pause point to continued strength in the labour market exacerbating skill shortages, strong residential construction and house price statistics, healthy retail sales, and note that the most recent CPI result was influenced by a number of one-off falls that are unlikely to be repeated.

Business|NZ

While opinion on short-term movement is divided, medium term expectations of the rate of 90-day bills have eased somewhat. Previously, there had been an expectation that rates would rise above 6% in the second half of 2004. However, more recent forecasts indicate that any rise in the OCR should be modest.

Forecasts: Interest Rates (90 day bills)

	Years Ending		
	Sept 03	March 04	Sept 04
Highest	5.1	5.2	5.6
Average	5.0	5.1	5.5
Lowest	5.0	4.9	5.3

Source: ANZ, ASB, BNZ, National and WestpacTrust

1.6 Exchange Rates

Most recent outcome: NZD = USD0.58.76 as at 15 August 2003

NZD = AUD0.8946 as at 15 August 2003

TWI = 63.0 as at 15 August 2003

The first six months of 2003 saw the NZD rise 11.5% against the USD, but fall 6.3% against the AUD and overall it increased 6.0% against the Trade Weighted Index (TWI), which measures the NZD against a basket of currencies. However, since the start of July, the NZD has remained unchanged against the USD, but has risen 2.5% against the AUD and 1% against the TWI.

All economists admit that accurately forecasting changes in currency exchange rates is fraught with difficulty. Currency forecasts need to be treated with caution.

Despite the strength in its gains against the USD, most economists still regard the NZD as being around its historic 'fair value' against that currency and expect it to rise further in 2003 and into 2004 before falling back later in the year. However, the consensus view is that the NZD is still overvalued against the AUD and it is expected to fall in the remainder of 2003 and 2004. The TWI is generally expected to rise slightly in 2003 and early 2004 before easing back later in the year.

	AUD (cents)				USD (cents)		
	Sept 03	Mar 04	Sept 04		Sept 03	Mar 04	Sept 04
Highest	89.0	87.2	86.7	Highest	60.0	64.0	62.0
Average	87.9	86.1	84.9	Average	58.9	61.6	60.2
Lowest	87.0	85.0	83.5	Lowest	58.0	60.3	58.1

	TWI		
	Sept 03	Mar 04	Sept 04
Highest	63.1	64.7	63.4
Average	62.3	63.5	62.3
Lowest	61.2	62.1	61.3

Source: ANZ, ASB, BNZ, National and WestpacTrust

Business|NZ

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: +2.9% for the year-ended March 2003.

Forecasts:

- December 2003: +2.8%
- December 2004: +3.5%

Source: The Economist

Short-term forecasts for Australian GDP growth have been reduced from those made in the previous quarter, down from 3.0% to 2.8% for the year ended December 2003. Employment has shown weakness over recent months and exports continue to be hit hard by the impact of the drought, currency appreciation, and slow world growth. The drought continues to have a lingering effect on rural and regional incomes, while business investment and household spending are both slower than 2002. Some economists suggest 2003 will be Australia's slowest year for economic growth since 1992 (when real GDP grew by 2.4%).

The latest Australian PMI results show manufacturing activity remaining positive, but the overall index remains close to 50 (no change), with it rising slightly in July to 50.5 compared to 50.2 in June.

While growth forecasts for 2003 have been pared back, earlier forecasts suggesting a rebound in growth to 3.5% for 2004 remain unchanged.

2.2 Headline Inflation

Most recent outcome: +2.7% for the year-ended June 2003

Forecast:

- December 2003: 2.7%
- December 2004: 2.3%

Source: The Economist

After breaching the higher limit of the Reserve Bank of Australia's 2-3% target in March 2003, inflation has since eased as the economy has slowed and the appreciation in the AUD (particularly against the USD) has taken effect.

Australia's wage cost index increased by 3.6% for the year ended March 2003, but unemployment remains stubbornly over 6%, compared to New Zealand's rate of 4.7%.

2.3 Interest rates (90-day bills)

Most recent outcome: 4.84% as at 15 August 2003

Forecasts:

- September 2003: 4.75%
- March 2004: 4.85%

Source: HSBC

The Reserve Bank of Australia (RBA) has kept its OCR unchanged at 4.75% for over a year. Like its New Zealand counterpart, the RBA has been concerned the international economy, but it has had less room to move on inflation and the RBA is also worried about the impacts of rapid house price inflation. Few commentators in Australia expect any monetary easing in the near future, particularly after a relatively hawkish Monetary Policy Statement was released on 11 August.

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, although there are tentative signs of improvement in the United States.

United States

The United States has reduced its Federal Funds Rate to 1% since our last forecast. Recent economic data has been relatively positive and economic growth is expected to recover to over 3% in 2004. Consumer and homebuilder optimism has remained strong, and business confidence has been improving over recent months, with the ISM manufacturing index (the United States' PMI) now in positive territory. Despite this improvement, output growth is still tentative and deflation remains a significant concern in the United States. With the Federal Funds Rate close to 1%, there is less and less room for further monetary stimulation.

Japan

The Japanese economy has continued to stagnate and deflation is continuing. As noted in our previous forecasts 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.

Asia

South East Asia and China (which has been one of the few engines for growth over the past few years) were hit hard by the impact of SARS, although GDP growth in China is still likely to be around 7% and there are signs of recovery in other

Business|NZ

economies. However, the wealthiest economies in the region, Taiwan, Singapore and Hong Kong, still continue to show a worrying combination of weak growth and falling prices.

Europe

GDP growth in the Euro area is less than 1% and is likely to improve only slightly in 2004. Even Ireland's growth has slowed and the largest European economy, Germany, is particularly weak. Germany, like Japan, desperately needs economic reform, but the political will is lacking. Ironically, the European Central Bank's relatively tight monetary policy is working against Germany, the very country that insisted on initiatives like the fiscal stability pact. Non-Euro countries with the freedom to set their own monetary policy, such as the United Kingdom and Sweden, have fared somewhat better.

World Outlook

Although global growth was fairly stagnant in 2002 and looks likely to remain so in 2003, most economists are still predicting that 2004 should be a better year, and with the United States at last showing signs of recovery these forecasts may prove true (unlike previous years' forecasts that kept saying next year would be better – and were wrong). An improved global outlook would obviously be good news for New Zealand, but unexpected events (e.g., the power blackouts in eastern United States and Canada) show how fragile economies can be.

Forecasts: World GDP Growth (Selected Trading Partners)

<i>Country</i>	<i>2003</i>	<i>2004</i>
Australia	2.8%	3.5%
Canada	2.2%	2.9%
Japan	0.9%	0.9%
United Kingdom	1.8%	2.4%
United States	2.3%	3.4%
Euro Area	0.6%	1.7%

Source: Economist

Meanwhile, forecasts for inflation in developed countries remain relatively subdued for 2003 and global inflation is expected to ease slightly in 2004, but remain at moderate levels, as economies begin to recover (there is likely to be a fair bit of unused capacity which will allow for non-inflationary growth in many countries).

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

<i>Country</i>	<i>2003</i>	<i>2004</i>
Australia	2.7%	2.3%
Canada	2.8%	1.9%
Japan	-0.4%	-0.4%
United Kingdom	2.7%	2.4%
United States	2.1%	1.3%
Euro Area	1.8%	1.3%

Source: Economist