Manufacturers Business Planning Forecasts

10 November 2000

FORECASTS: DECEMBER QUARTER 2000

Introduction

This bulletin is designed to help plan your business. It brings together forecasts of important indicators to help 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, National and WestpacTrust). 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 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.

The New Zealand Economy

Growth in real GDP, the measure of how much New Zealand's production is likely to increase or decrease, illustrates how demand in volume terms might change in the New Zealand market.

The forecasts prepared for this quarter show an increasing divergence between the highest and lowest forecasts provided because of increasing uncertainty about the direction of economic growth. As discussed last quarter, there are two general views about the direction of the economy:

1. The current downturn in activity is expected to be very short term, with improving export activity offsetting a further decline in domestic manufacturing sales. Further interest rate rises will be required to moderate increasing inflation pressures in 2001.

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2. The alternate view is export growth will be weaker than expected resulting in negative GDP growth in the September and possibly the December quarters. The Reserve Bank may be forced to reduce interest rates to avoid the economy moving into a recession.

The September business opinion survey suggests a further decline in GDP is likely in the September quarter but moderate growth will be achieved in December.

Import growth has continued much more strongly than expected so has been offsetting much of the growth in exports. This has resulted in significant variation in regional growth levels with smaller centres boosted by stronger agricultural returns while Auckland has experienced a downturn because of the impact of imports on domestic manufacturing activity.

There is general agreement that the CPI will be above the Reserve Bank's 0-3% inflation band in the December quarter. There is, however, considerable uncertainty about how quickly inflation will move back within the band and the extent of action by the Reserve Bank next year to move inflation back to the 0-3% band.

Real GDP % Growth

	Years Ending		
	Dec 00	*June 01*	*June 02*
Highest	3.4	2.5	3.6
Average	3.2	1.8	3.3
Lowest	2.7	0.2	2.6

Source: ANZ, ASB, BNZ, National and WestpacTrust

The second key indicator is the rate of inflation, which gives an idea of price increases, plus wage increase demands. There have been in the past two measures: headline inflation that includes all price movements faced by households including interest rate movements; and underlying inflation that excludes interest rate movements.

The new CPI released in October 1999 excluded interest rates, bringing it in line with the underlying inflation rate measure used by the Reserve Bank. There is now, therefore, no distinction between headline and underlying inflation.

Inflation reached 3.0% in the September quarter and is expected to continue to increase, reaching 3.5% by December 2000. Petrol price rises and the recent tobacco tax increases continue to be the main items driving the increase in inflation.

Domestic inflation pressures have been more muted than expected, with businesses finding it hard to pass on the impact of higher import prices.

% Change of Inflation (CPI)

CPI Excluding Credit Services (Underlying Rate)

	Years Ending		
	Dec 00	*June 01*	*June 02*
Highest	3.8	4.3	2.4
Average	3.5	3.3	1.9
Lowest	3.3	2.7	1.3

Source: ANZ, ASB, BNZ, National and WestpacTrust

Statistics NZ produces an index that measures movements in the total cost of employing labour. The present expectation is that this index will move generally in line with the rate of inflation. Short term forecasts for growth in labour costs have increased due to the higher CPI but a weaker labour market will have a dampening effect. Businesses remain under strong cost pressure so productivity growth will be a major focus. This will limit employment growth over the forecast period.

Labour Cost Index % Change

	Years Ending		
	Dec 00	*June 01*	*June 02*
Highest	1.9	2.9	2.7
Average	2.0	2.7	2.7
Lowest	1.3	1.8	1.5

Source: ANZ, ASB, BNZ, National and WestpacTrust

The level of unemployment is expected to fall steadily over the next two years but the level of improvement is slower than earlier expected. High productivity growth and increased labour force participation by workers aged 60 years and over will be two factors impacting on the level of employment growth and composition of the labour force. The survey data is volatile due to the impact of high sample errors so the numbers for each quarter are hard to pick.

Unemployment % (HLFS)

	Years Ending		
	Dec 00	*June 01*	*June 02*
Highest	7.0	7.0	6.1
Average	6.6	6.4	5.9
Lowest	6.5	6.0	5.5

Source: ANZ, ASB, BNZ, National and WestpacTrust

The other major cost driver is interest rates. In general overdraft rates and mortgage rates will move in line with the 90 day bill rate. Interest rates are now forecast to remain unchanged until March next year. The majority of forecasters expect a small increase next year and then a gradual reduction in 2002.

Interest Rates (90 day bills)

	Years Ending		
	Dec 00	*June 01*	*June 02*
Highest	7.0	7.2	6.8
Average	6.8	6.9	6.2
Lowest	6.7	6.1	5.1

Source: ANZ, ASB, BNZ, National and WestpacTrust

Exchange Rates

A number of forecasts of exchange rates are available. Individual cross-rates (e.g. the NZ$/A$) can change quite sharply, but the trade weighted index (TWI) is more stable because of the way the Reserve Bank operates. There is considerable uncertainty over the expected movement against the Australian Dollar and US Dollar. The general view is that the currency will appreciate against the US$. This appreciation is now expected to be stronger because of the lower starting point. The average forecast is for the currency to appreciate marginally against the Australian dollar, but forecasters remain divided on whether the cross rate will weaken further or appreciate.

A$

	Dec 00	*Jun 01*	*Jun 02*
Highest	77.0	81.7	81.6
Average	75.4	77.0	77.0
Lowest	73.0	73.0	72.0

US$

	Dec 00	*Jun 01*	*Jun 02*
Highest	43.5	49.0	55.5
Average	42.5	46.7	51.5
Lowest	40.0	44.0	49.0

TWI

	Dec 00	*Jun 01*	*Jun 02*
Highest	49.5	54.5	58.3
Average	48.8	52.1	54.5
Lowest	47.0	49.7	50.9

Source: ANZ, ASB, BNZ, National and WestpacTrust

In practice, buying forward the A$ and US$ can reduce the risk in cross rate movements. Sell rates quoted by the BNZ (all other banks are the same but the rates change from day to day) on 13 November 2000 were:

A$		**US$**	
13 May 01	*13 Nov 01*	*13 May 01*	*13 Nov 01*
.7607	*.7590*	*.3950*	*.3948*

Source: Bank of New Zealand

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. These rates for instance are now lower than those quoted six months ago, when forward rates for the Australian $ were nearly 83 cents and the forward rate for the US$ was 50 cents.

The Australian Economy

The performance of the Australian economy impacts in two ways. It provides a measure of how well exporting is likely to go, and it gives an idea of what kind of competition there is coming from Australian sourced products.

GDP Growth

	Calendar Years	
	2000	*2001*
Highest	4.9	4.0
Average	4.4	3.5
Lowest	4.0	3.1

Source: The Economist

Short term growth forecasts have increased slightly because of strong growth recorded in the first half of this year. Manufacturing activity declined, but there was strong growth in output from new petroleum activity and from the tourism sector. Business confidence has recently fallen sharply because of uncertainty about growth prospects after the Olympics, and declining domestic consumption as a result of higher interest rates.

The introduction of GST on 1 July has also created some volatility with stronger growth recorded in June and uncertainty about what impact the Olympics will have on growth in September and December.

Headline Inflation

	Calendar Years	
Quarter	*2000*	*2001*
Average	4.7	3.6

Source: The Economist

Inflation forecasts have increased, taking into account the impact of the introduction of GST, stronger wage growth, higher commodity prices and the fall in the currency. Actual inflation in the September quarter, the first quarter including the impact of GST, was 3.1%, lifting the annual rate to 6.1%, well above expectations.

Interest rates (90 day bills)

	Calendar Years	
2000	*2001*	*2002*
6.4	7.0	5.4

Source: NZIER Quarterly Predictions

Short-term interest rates have risen as a result of monetary policy tightening by the Reserve Bank. Further interest rate rises are now expected in 2001 as a result of higher inflation recorded in the September quarter. The outlook for 2002 is unchanged.

Rest of the World

Short term international prospects have improved further, with strong growth in most of Asia and more concrete signs of growth in Japan. Growth in the US is expected to slow over the next two years but still achieve a respectable 2.7% growth rate in 2002.

Growth levels in 2001 and 2002 will, however, be influenced by trends in oil prices over the next 12 months. If oil prices remain high, there is a potential for growth rates to be lower.

World GDP Growth (Trading Partners)

Calendar Years

2000	*2001*	*2002*	*2003*
4.6	3.6	3.5	3.8

Source: NZIER Quarterly Predictions