Business|NZ

Business Planning Forecasts

17 May 2004

FORECASTS: JUNE QUARTER 2004

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, National, and Westpac). 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 2004

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +3.5% for the year-ended December 2003.

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period. GDP growth has averaged 3.7% per annum over the past five year, with only one quarter of decline out of the last 20 (June 2000).

GDP growth rates have been volatile over the past 12 months. Quarterly GDP growth was 0.6% in December 2003 and followed a 1.6% increase in September and a 0.2% increase in June. In many respects the abnormally large September quarter increase was a bounce-back from a particularly weak June, which featured shocks such as the SARS virus, electricity shortages and war in Iraq. The December quarter may well have seen a return to more 'normal' growth rates.

Short-term forecasts for economic growth suggest that GDP will increase by a solid 3.5% for the year ended June 2004, but growth rates will fall to 2.2% and 2.4% for the years ended June 2005 and 2006 respectively.

Forecasts: Real GDP % Growth

	Years Ending		
	June 04	*June 05*	*June 06*
Highest	3.8	2.7	2.7
Average	3.5	2.2	2.4
Lowest	3.3	1.9	1.9

Source: ANZ, ASB, BNZ, National, and Westpac

Key factors to influence GDP over the next two years will include:

Global economic recovery

The international outlook is continuing to improve, with strong growth rates being recorded in Australia, the United States, and most of Asia (driven in large part by China's continuing boom). Even prospects for Japan and Europe are looking up. This improved demand outlook for our exports is encouraging as it is likely that the domestic economy (which has underpinned growth since 2001) will slow in 2004/05.

Interest rates

On 29 April the Reserve Bank increased its Official Cash Rate (OCR) by 0.25% to 5.50%, a move sparked by concern about inflationary pressures arising from the strong housing market and a NZD that had fallen by more than expected (which will impact on import prices). Prior to the latest increase, opinion among economists had been evenly divided on whether the Reserve Bank would raise the OCR, with some suggesting that falling net migration will act as a sufficient enough brake on the domestic economy. Most are now expecting a further 0.25% increase in June.

The Dollar

The NZD appreciated by almost 50% against the Trade Weighted Index (TWI) and by almost 80% against the US Dollar between November 2000 and February 2004. After reaching a peak of 69.0 against the TWI on 18 February, the NZD fell back sharply to 62.3 by 14 May. This has been a relief to exporters but the rapidity of the fall has caused concern for the Reserve Bank. Most economists expect the NZD to ease back further over the next two years.

Tourism and net migration flows

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. While the prospects for tourism appear good, net migration is turning downwards.

Short-term visitor numbers increased 9% in March 2004 over March 2003. Most Asian markets are now recovering losses suffered in early 2003, and visitor numbers from Australia and the UK are growing particularly strongly. An improved global economic outlook should be good news for tourism.

The annual net migration gain peaked at 42,500 for the year ended May 2003 but has since eased to a 28,000 gain for the year ended March 2004. Current monthly data is consistent with an annual net gain of 10-15,000. There has been both a reduction in arrivals and an increase in departures due to the improved global economy and a slowing New Zealand economy.

Despite the slowdown in migration over the past year the housing market has remained buoyant. Compared with March 2003, March 2004 saw new dwelling consents up 11%, house sales up 5.8% and house prices up 20%. However, a significant reduction in net migration should dampen the housing market in 2005.

Commodity prices and farm incomes

International commodity prices have boomed in 2003 and into 2004, with ANZ Bank's Commodity Price Index up 18.2% for the year ended April 2004. Part of this increase has been due to a generalised increased demand from the improving global economy, but there is also the lingering effect of drought in Australia and the US on supply of beef and dairy products.

Although commodity prices in NZD terms remain 26% below their high in April 2001, they are now 4.6% higher than April 2003. If recent increases are sustained this will be good news for export values and the New Zealand economy going forward.

Infrastructure constraints

Energy shortages had a negative impact on GDP growth in mid-2003, not just directly through less electricity being produced, but also indirectly as businesses cut back on production to make savings. More worrying for the future are the longer-term impacts caused by ongoing uncertainty of supply and resulting price increases. Meanwhile, long-term under-funding of roads has caused transport infrastructure to become one of the greatest impediments to business growth, with problems being particularly evident in, but not confined to, Auckland. Although work is being done on addressing infrastructure constraints there are no easy short-term fixes.

Business confidence

Business confidence influences the propensity for businesses to invest in capital and employ staff, so is an important determinant for future economic growth. So far, 2004 has seen pretty dismal levels of business confidence.

The March 2004 NZIER Quarterly Survey of Business Opinion reported gloom descending on the business community, with confidence slumping across all sectors and regions. A net 29% expect general business conditions to deteriorate over the next six months. NZIER is also forecasting slower growth going forward – but not a hard landing. Meanwhile, it continued to report considerable pressure on resources, with demand particularly high for skilled and unskilled labour. These pressures were reflected in a lift in inflation indicators and would have been a factor behind the Reserve Bank's decision to increase the OCR.

The National Bank Business Confidence Index has also recorded a downswing in confidence in 2004, with its April survey indicating a net 36% of respondents expecting general business conditions to deteriorate over the coming 12 months.

Meanwhile, the ANZ-Business New Zealand PMI stood at 58.9 for March 2004, compared to 52.7 in March 2003 – this indicates a pickup in manufacturing activity. Most encouraging was a strong increase in new orders. It should be noted when comparing the PMI to the NZIER and National Bank surveys above that the PMI is a measure of own activity rather than confidence in general business conditions (own activity indicators tend to be more positive than views of the general economy).

Investment

Despite the gloom about general business conditions, business investment has increased significantly over the past couple of years (e.g., up 11.6% for the year ended December 2003). This increase has been assisted by a stronger NZD, which reduces prices for imported plant, machinery and equipment in NZD terms. Increased levels of business investment should help lift capacity and productivity.

Consumer confidence

The Westpac McDermott Miller Consumer Confidence Index fell slightly in the March 2004 quarter, but remained at a high level (124.0). Strong employment growth, lower interest rates and higher house prices have made homeowners feel wealthier, underpinning strong growth in retail sales (up 10.7% in February 2004 compared to February 2003). Consumer confidence levels are likely to remain at healthy levels well into 2004, which should continue to maintain robust growth in retail sales.

1.2 Inflation

Most recent outcome: +1.5% year-ended March 2004

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.

The booming housing market has been cited as one of the main inflation drivers over the past two years, with the Housing group of the CPI increasing by 7.0% for the year ended December 2003. However, government policy changes can also have a major impact on the CPI, with Central and Local Government Charges increasing by 7.3% over the same period. Much of this increase was driven by higher local authority rates (up 10%) and higher excise taxes for petrol, alcohol, and tobacco.

The strengthening NZD over the past two years has acted as a dampener on overall inflation. This has seen 'tradeable' inflation fall into negative territory, compensating for a high level of 'non-tradeable' inflation (currently around 5% per annum). The net effect is a CPI of 1.5%, which may seem comfortable but is more a reflection of the two-speed economy.

The currency's recent drop is likely to remove the degree of comfort for the Reserve Bank had about tradeable inflation counterbalancing non-tradeable inflation. High non-tradeable inflation largely reflects the housing sector and central and local government charges. These influences explain Reserve Bank Governor's public comments seeking to talk down the boom in house prices[1] and his public castigation last year of local authorities for their large rates increases.

The CPI is forecast to remain inside the Reserve Bank's 1-3% target in the short-term, although forecasts have been revised upwards since the last quarter. The Reserve Bank Governor must take a medium-term approach to the conduct of monetary policy and in the medium-term the annual increase in the CPI is expected to increase closer to the target ceiling.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	June 04	*June 05*	*June 06*
Highest	2.5	2.7	2.7
Average	2.3	2.4	2.3
Lowest	2.1	1.9	2.1

Source: ANZ, ASB, BNZ, National, and Westpac

[1] Although house prices are not included in the CPI, the housing boom has flow on impacts for rents and prices for house construction. The Reserve Bank is also taking interest in the housing boom for the simple reason that asset price bubbles tend to burst – even house prices have experienced lengthy periods where prices have fallen in real if not nominal terms following booms.

1.3 Labour Costs

Most recent outcome: +2.2% year-ended March 2004

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. As such, the LCI is preferred by the Reserve Bank as a measure of labour costs.

Growth in the LCI has increased steadily over recent times, with the 2.4% increase for the year ended December 2003 being the highest annual increase in six years. Stronger demand for labour has caused skills shortages in a number of industries and regions, so pushing up average labour costs. Stronger net migration has tended to mitigate some of the pressure, but only to a degree as a significant proportion of migrants have been students and therefore not in the labour force.

While real wages (as measured by the LCI) fell during 2000-02, they have recovered with the slowing in the rate of increase in the CPI over the past year. Forecasts though suggest that this recovery will only be short-lived, with growth in the LCI converging with the CPI by 2005.

Forecasts: Labour Cost Index % Change

	Years Ending		
	June 04	*June 05*	*June 06*
Highest	2.8	2.6	3.0
Average	2.4	2.3	2.2
Lowest	2.2	2.0	1.6

Source: ANZ, ASB, BNZ, National, and Westpac

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 3.3% for the year-ended March 2004, down from a 3.7% increase for the year-ended March 2003.

Both the QES and the LCI have recorded significantly larger increases in labour costs for the public sector as opposed to the private sector. As measured by the QES public sector hourly earnings are 33% higher than those in the private sector, with the gap having widened over the past two years.

1.4 Employment

Most recent outcome: +3.2% year-ended March 2004

Employment growth has been strong over recent years. According to the Household Labour Force Survey, the number employed has grown by 215,000 (12.3%) since September 1999 and the unemployment rate has fallen from 6.6% to 4.3% - the lowest rate since March 1987 and the fourth lowest unemployment rate in the OECD. Continued employment growth should continue to sustain the domestic economy.

Although the December 2003 quarter saw a slow down in the labour market, the March 2004 quarter saw a return to strong growth. There was a much stronger than expected quarterly increase in employment (up 0.9%) and a larger than expected fall in unemployment (from 4.6% to 4.3%). The labour market clearly remains tight, consistent with the results of the NZIER Quarterly Survey of Business Opinion and the ANZ Job Advertisements series.

In the year to March 2004 49,000 more people were employed. With the working age population increasing by 58,000 (due in large part to net migration gains), the labour force participation rate increased from 66.5% to 66.6%. Although such a rate is another indication of a tighter labour market, there is still scope to increase labour force participation of both men and women, particularly those aged over 60.

Encouraging, the substantial fall in unemployment over recent years has been broadly based across the sexes, ethnic groups, and regions. However, the composition of employment growth since June 2001 very much reflects the strength of the domestic economy and weakness of export-oriented sectors over the following two years.

Since June 2001 there have been strong gains for construction (up 42%), wholesale and retail trade (up 11%), education (up 8%), and health and community services (up 22%). However, employment has been static or has fallen in agriculture, forestry, and fishing, manufacturing, and transport, storage and communication.

The manufacturing sector is still the largest employer. Manufacturing shed 14,000 jobs from June 2001 to September 2003, but has increased its employment by 12,000 over the past two quarters. It is probably too early to tell whether this jump is a statistical fluctuation or the beginning of a more sustained export-led recovery.

It should be noted that the forecasts below were received prior to the latest HLFS release. It is likely that with unemployment falling to 4.3% short-medium term forecasts for unemployment will be revised downwards.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	June 04	*June 05*	*June 06*
Highest	5.0	5.3	5.4
Average	4.7	4.9	5.1
Lowest	4.5	4.4	4.6

Source: ANZ, ASB, BNZ, National, and Westpac

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 5.87% as at 14 May 2004

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 (although they may be in variance if the markets price in future increases or decreases in the OCR).

So far this year, the Reserve Bank has increased the OCR twice (each time by 0.25%), with it now standing at 5.5%. The Bank has been concerned for some time that the strong domestic economy is generating inflationary pressures, but until recently it has drawn some comfort from a higher NZD pushing down import prices. It has therefore been prepared to accommodate non-tradeable inflation more than it would have had the NZD been at a lower level.

The recent fall in the NZD will change this thinking – its current value is well under what the Reserve Bank had earlier forecast. If sustained, the weaker NZD will generate imported inflation at a time when domestic inflation is already at uncomfortable levels. The Bank will be watching for signs of the domestic economy slowing and easing inflationary pressures, otherwise it will be forced to make further increases in the OCR.

Recent research undertaken by the Reserve Bank indicates that a 'neutral real interest rate' may be between 3.5% and 4.5%. If that is the case, the current 90 day bill rate is probably only around neutral despite recent increases.

Most forecasters are suggesting that by June 2004 90-day bill rates will remain at around 5.9% in the short-medium term. This implies a moderate further tightening by the Reserve Bank.

Forecasts: Interest Rates (90 day bills)

	As at End of		
	June 04	*June 05*	*June 06*
Highest	6.0	6.2	6.0
Average	5.9	5.8	5.8
Lowest	5.8	5.4	5.5

Source: ANZ, ASB, BNZ, National, and Westpac

1.6 Exchange Rates

Most recent outcome: NZD = USD0.5995 as at 14 May 2004
NZD = AUD0.8712 as at 14 May 2004
TWI = 62.3as at 14 May 2004

The NZD has fallen sharply against almost all major currencies since our March quarter forecast. Since 20 February, the NZD has depreciated by 14.7% against the USD, 8.0% against the UK Pound, 8.6% against the Japanese Yen and 8.0% against the Euro. The exception is Australia, against whose dollar the NZD has depreciated by only a relatively small amount – 1.7%. Overall, the Trade Weighted Index (TWI) has fallen by 9.4% over the past three months.

Comparative interest rates are just one of a number of factors that can influence exchange rates. Others include current account deficits and relative growth rates. With New Zealand's growth rates having been higher than most OECD countries over the past few years it is perhaps not surprising that the NZD increased in value. A generally stronger USD, an improving global economy, a slowing New Zealand economy, and a growing New Zealand current account deficit are likely to be factors in the more recent retracing of the currency, despite increasing interest rates.

All economists agree that accurately forecasting changes in exchange rates is fraught with difficulty – currency forecasts must be treated with caution. Most economists had been expecting the USD to continue weakening against all currencies due to its large and growing current account deficit, but the opposite has been the case over the past three months (a reflection of stronger economic data). Short-term forecasts expect the NZD to rise against the USD to June 2004, before falling over the following two years.

Although the NZD has so far held onto most of its gains over the past two years against the AUD, it is forecast to fall against that currency over the next two years. Australia is New Zealand's largest trading partner and by far New Zealand's largest market for manufactured products, making many manufacturers particularly sensitive to the NZD-AUD cross-rate.

Overall, the TWI is expected to fall over the next two years, so increasing export prices when expressed in NZD terms. Higher rates of trading partner growth in 2004 should also help increase demand and therefore export volumes.

AUD (cents)			
	June 04	*June 05*	*June 06*
Highest	87.0	86.0	86.8
Average	86.7	84.4	83.4
Lowest	86.5	81.9	80.3

USD (cents)			
	June 04	*June 05*	*June 06*
Highest	67.0	63.0	58.0
Average	65.1	59.6	55.0
Lowest	64.0	56.0	53.0

TWI			
	June 04	*June 05*	*June 06*
Highest	65.9	63.0	60.2
Average	65.2	60.2	57.8
Lowest	64.4	57.2	56.2

Source: ANZ, ASB, BNZ, National, and Westpac

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 United States. Forward cover rates can be obtained from banks.

Part 2: The Australian Economy

Monitoring the performance of the Australian economy is critical in that firstly, 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 secondly, it provides an indication of the likely strength of competition from Australian sourced products on the domestic market.

2.1 Economic Growth (GDP)

Most recent outcome: +3.5% for the year-ended December 2003.

Forecasts:
- December 2004: +3.9%
- December 2005: +3.1%

Source: The Economist

As was the case for New Zealand, Australian GDP has bounced back from a low June quarter outcome, annual growth recovering from 2.0% in June to 3.5% in December. Despite concerns about the impact of a high AUD on export competitiveness, forecasts continue to suggest that GDP growth for the December 2004 year will recover to 3.9% before easing in 2005.

The latest Australian PMI results shows manufacturing activity remaining solid with a reading of 55.6 for March 2004, up from 51.0 in February. Again, as with the case in New Zealand, a solid domestic economy is underpinning activity, with retail sales volumes up 8.2% and new motor vehicle sales up 6.1% for the year ended March 2004. Investment has also been strong, with new capital expenditure up 11% for the December 2003 year.

However, unlike in New Zealand the heat appears to be going out of the Australian housing market, with dwelling unit approvals and commencements flat for the year ended March.

2.2 Headline Inflation

Most recent outcome: +2.0% for the year-ended March 2004

Forecasts:
- December 2004: 2.2%
- December 2005: 2.5%

Source: The Economist

After breaching the higher limit of the Reserve Bank of Australia's 2-3% target in March 2003, inflation has steadily eased as the economy has slowed and the appreciation in the AUD (particularly against the USD) has taken effect – although, as with New Zealand, this latter phenomenon is now in reverse.

Australia's wage cost index increased by 3.7% for the year ended December 2004, but at a rate of 5.7%, Australian unemployment remains considerably higher than New Zealand's current rate of 4.3%.

2.3 Interest rates (90-day bills)

Most recent outcome: 5.51% as at 14 May 2004

Forecasts:
- June 2004: 5.50%
- December 2004: 5.50%

Source: HSBC

Late last year the Reserve Bank of Australia (RBA) increased its OCR twice (from 4.75% to 5.25%) but over the past six months it has been left unchanged.

Some economists suggest that further increases in the Australian OCR are unlikely in the short-medium term, saying that a cooling in the Australian housing market takes away much of the pressure to do so. The proximity of a Federal election may also influence opinion among some on the board of the RBA.

However, on the other hand, the Federal Budget on 11 May was unambiguously stimulatory, with increased family benefits and tax cuts, and it seems likely to fuel inflation. Many expect that the RBA will be forced to increase its OCR later in 2005 or early 2006 in response to the fiscal stimulus and further pressures driven by a lower currency and higher oil prices. Financial markets are pricing a further increase in Australian interest rates.

Part 3: Rest of the World

The economic picture in the rest of the world is very important for New Zealand. Generally speaking, the international climate was not particularly favourable over the period 2000-03, but it now appears that a sustained recovery is underway – although oil prices that are at their highest in 21 years are becoming a cause for concern.

United States

The impact of expansionary monetary and fiscal policy over recent years is being felt with GDP growth forecast to be a robust 4.7% for 2004 and 3.6% for 2005. There has been much positive data over recent months on GDP, industrial production, and retail sales coupled with strong levels of consumer and homebuilder confidence. Business confidence has also been improving over recent months, with the ISM manufacturing index (the US version of the PMI) remaining over 60, indicating strong levels of expansion.

Although the Federal Reserve has maintained its Federal Funds Rate at 1%, the recently strong data has resulted in a change in the Fed's language, indicating that it is getting closer to tightening monetary policy. This has caused 90-day rates to rise.

Although the good economic news and prospects of interest rate increases have pushed the USD up over the past three months, the combination of large and growing fiscal and trade deficits mean that the fundamentals are against a sustained rise in the USD. For example, the US trade deficit rose by 17% during 2003 and it seems likely to get worse, particularly with oil prices hitting US$40 per barrel.

Japan

For over a decade the Japanese economy has been stagnating and suffering from prolonged deflation. However, there have more recently been signs of a rebound, with strong data on industrial production and GDP and a reduction in unemployment. Many are suggesting that this improvement in fortunes is being driven by demand generated by the Chinese economy.

Forecasters have upgraded their GDP forecasts for Japan, with growth expected to be around 3.3% for 2004 and 2.0% for 2005 – significantly better than recent years' outcomes and earlier forecasts. The situation is still patchy, however, and economic reform is still desperately needed (but is still being resisted).

Asia

Asian economies were hit hard by the impact of SARS last year, but most have since bounced back and are now growing strongly. Despite SARS, China's GDP growth is still forecast to have been 9.7% for 2003, while India's GDP grew by 10.4%, Thailand's by 7.8%, Singapore's by 7.3% and Malaysia's by 6.4%. China is clearly becoming a significant engine of growth in the region, if not the world.

After suffering from deflation last year, most Asian economies are now 'reflating', with annual CPI increases of between 1% and 4% being recorded.

Europe

GDP growth in the Euro area registered at just 0.6% for 2003 but is likely to improve slightly to 1.6% for 2004 and 2% for 2005. France and Germany are beginning to show signs of recovery, but none of the Euro area countries are growing particularly strongly (Spain appears to have been the best performer at 2.8% annual growth). This slow growth is likely to be a reflection of low population growth, generally less flexible economies and rigid monetary policy from the European Central Bank. Non-Euro countries with the freedom to set their own monetary policy, such as the United Kingdom and Sweden, have fared somewhat better (although Switzerland has not).

The UK grew by 3% in 2003 and is forecast to grow by 3.2% in 2004 and 2.7% in 2005 – better than any other country in Western Europe. New EU members such as Poland, Czech Republic, Hungary, and the Baltic states are all growing considerably faster, at annual rates of 3-7% (albeit off much lower bases), than the 'old' EU countries.

World Outlook

Most economists are predicting that 2004 should be a better year than any since 2000. An improved global outlook would obviously be good news for New Zealand, but unexpected events (e.g., SARS, war, terrorist attacks etc) show how fragile economies can be. For example, recent oil prices rises in response to instability in the Middle East could cause difficulties.

Forecasts: World GDP Growth (Selected Trading Partners)

Country	*2004*	*2005*
Australia	3.9%	3.1%
Canada	2.7%	3.3%
Japan	3.3%	2.0%
United Kingdom	3.2%	2.7%
United States	4.7%	3.6%
Euro Area	1.6%	2.0%

Source: Economist

Global inflation is expected to ease slightly in 2004 and remain at moderate levels, despite the economic recovery (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	*2004*	*2005*
Australia	2.2%	2.5%
Canada	1.6%	2.0%
Japan	-0.2%	0.0%
United Kingdom	1.5%	1.8%
United States	1.9%	1.8%
Euro Area	1.7%	1.6%

Source: Economist