Business|NZ

Business Planning Forecasts

26 May 2005

FORECASTS: JUNE QUARTER 2005

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 2005

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +4.8% for the year-ended December 2004.

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period. GDP growth has averaged 3.8% per annum over the past five years, with only one quarter of decline out of the last 20 (June 2000).

GDP growth in the December 2004 quarter was more subdued than the previous quarter, rising by 0.4%. This was the lowest quarterly growth level since the June 2003 quarter, and was below market expectations of +0.6%. Both internal and external demand contributed to modest economic activity during the December quarter, with household and Government spending up, but business investment and residential building construction down. The increase in the external account was very small, with growth in exports exceeding growth in imports. The level of manufacturing activity changed little over the last two quarters, as a small increase of 0.2% for the December quarter followed a 0.3% rise in the September quarter. Construction activity fell 2.2%, following a 2.3% fall in the previous quarter. The fall in construction during the December quarter was for both residential and non-residential construction.

Short-term forecasts for economic growth have been significantly revised down; although long-term forecasts have been revised up slightly since our previous report. They now suggest that GDP will increase by 3.4% for the year ended June 2005, but will fall to around 2.2% for each of the year ending June 2006 before picking up again by June 2007.

Forecasts: Real GDP % Growth

	Years Ending		
	Jun 05	*Jun 06*	*Jun 07*
Highest	3.6	2.5	3.1
Average	3.4	2.2	2.7
Lowest	3.1	2.0	2.4

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

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

Global economic recovery

Global growth appears to have tapered off in recent quarters, after reaching a high in mid 2004. Although growth is still above 4% and higher than what was experienced during 2002-2003, further falls may undo much of the recovery experienced during 2003-2004. The ballooning current account deficit in the USA and an overheating economy in China are of foremost concern.

Interest rates

On 28 April the Reserve Bank kept its Official Cash Rate (OCR) at 6.75%, after raising it from 6.5% on the 10th of March. The Reserve Bank has remained extremely hawkish about future increases in the OCR, as concerns remain about further increases in inflation to push the figure beyond the 3% threshold mark. Although recent economic data has come out that shows New Zealand is near a turning point in the economy, further evidence of a down turn will have to be evident for pressure to come off further rises in the OCR. At this stage, no drops in the OCR are expected for the foreseeable future.

The Dollar

The past six months has continued to see the New Zealand dollar appreciate against most of its main trading partners. The NZ$ has continued to hover over the US70c mark, and remains close to the mid 90c mark against the AUS$. Overall, the TWI remains over the 70c mark. Despite the recent strength in the NZD, most economists expect the good fortunes of the NZD are near an end, and expect the dollar to gradually fall over the next two years.

Tourism and net migration flows

Over the past two to three years strong tourism numbers have helped maintain 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 continuing to turn downwards at a sharp rate.

The annual net migration gain peaked at 42,500 for the year ended May 2003 but has fallen to below a 10,000 gain for the year ended March 2005. While the current net gain is still above the long-run average, continued falls in migration arrivals and increases in migration departures will most likely see net gains fall further, and may lead to net losses if the current rate of fall continues.

As the slowdown in migration continues along with increasing interest rates, the housing market should dampen, although recent figures have shown there's still life in the property market at this stage. While the median sell price for a house has gradually increased to hit another new record of $280,000 in March, the number of sales declined further (down 8.5% or 973), mostly at the lower end of the market (i.e. under $400,000). The median sale price has continued to increase because more homes at the top end of the market have been selling for strong prices.

Short-term visitor numbers to New Zealand continue to improve, as numbers increased 10% for the year ended March 2005. Most Asian markets are now recovering from losses suffered in early 2003 (albeit slowly), and visitor numbers from Australia, the UK and the USA are growing particularly strongly.

Commodity prices and farm incomes

International commodity prices boomed in 2003 and have continued to reach even higher levels in 2004 and 2005. ANZ Bank's Commodity Price Index was up 10.7% for the year ended April 2005. These increases have been characterised by rises in prices for dairy, beef and lamb at historically high levels. Although the commodity price index took a dip for the first time since December, the overall trend has been strong.

In a reversal of recent trends, the New Zealand dollar eased slightly over April, causing the NZD price index to increase. Overall, the month-to-month differences have been minimal, as the NZD trend has hovered around the same level for some months.

Overall, strong commodity prices have resulted in a 'buffer effect' for the high value of the New Zealand dollar over the last two or so years. Demand for agricultural commodities is expected to remain strong for the foreseeable future, and if prices start to fall off their cyclical highs, a drop in the value of the NZD would probably cushion the effect for export returns.

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. Businesses were generally very pessimistic early in the year but there has been an improvement over recent months.

The March 2005 NZIER Quarterly Survey of Business Opinion reported that business confidence declined across all sector, with a net 28% of firms expecting conditions to deteriorate over the next six months. Resources are still stretched thin as capacity utilisation is still near historic highs (92%). Labour continues to be the key constraint, with a net 60% of firms reporting difficulty in finding skilled labour, and a net 49% finding unskilled labour. However, trading activity was reasonably strong, with a net 19% of firms expecting to increase their own activity in the next three months.

The National Bank Business Confidence Index also showed deterioration in confidence, as confidence plummeted to a net 48% of firms expecting conditions to deteriorate over the next year. Although the survey has largely been in negative territory for the last 32 months, the sudden drop is disconcerting. Firms' own activity expectations have also dropped from a net 30 to 15, the 6th largest fall since the survey began. Investment intentions, profit expectations, capacity utilisation and exports are also all similarly down.

Meanwhile, the ANZ-Business New Zealand PMI stood at 47.9 for April 2005, compared to 54.8 for April 2004, and 49.3 for April 2003. Although the March-May period tends to show a fall off in manufacturing activity, the level of fall for April indicates a real decline, which may continue for some months if other areas of the economy also begin to slow. What is becoming clear is that 2004 was a particularly good year for manufacturing, while 2005 is so far not responding to the same levels.

Investment

Business investment in fixed assets has tended to hover at around 20% of GDP over the last few quarters, although this value is still at historic high levels after strong growth during 2003 and 2004. If New Zealand is to achieve stronger productivity growth over the next few decades, the level of business investment must also remain high.

Consumer confidence

The Westpac McDermott Miller Consumer Confidence Index rose to a near record level in December (130.2) after a recovery during the September quarter. The rise in confidence was mainly due to extreme optimism about the economic outlook over the coming year. However, given this release is now over five months old, there is the possibility that sentiments have changed, especially given recent news that the economic downturn is looming on the horizon.

1.2 Inflation

Most recent outcome: +2.8% year-ended March 2005

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. It is also the key reference point for monetary policy.

Inflation continued to increase in March, although not to the same level as many commentators were predicting (mainly due to lower prices for air travel). Overall, the inflation rate stood at 2.8% for the March year, which is near the limit of the 1-3% inflation target by the Reserve Bank. The booming housing market continues to be one of the main inflation drivers of inflation, helped by higher construction prices, higher rents and higher real estate fees.

The strengthening NZD over the past two years has acted as a dampener on overall inflation. This saw 'tradable' inflation fall into negative territory, compensating for a high level of 'non-tradable' inflation, which meant the CPI had appeared to be at a comfortable level given the two-speed economy of 2002-03. However, the trend now shows a clear pattern of reversing, with 'non-tradable' inflation declining and 'tradable' inflation increasing.

CPI forecasts have been revised upwards for the short, medium and long term, although the average shows the figures still below (only just) the all-important 1-3% inflation rate threshold. These expectations also indicate that a fall in inflation levels bringing about an accompanying fall in interest rates may be some time away.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Jun 05	*Jun 06*	*Jun 07*
Highest	3.1	3.3	3.1
Average	2.9	2.9	2.7
Lowest	2.8	2.3	2.2

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

1.3 Labour Costs

Most recent outcome: +2.5% year-ended March 2005

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.

Stronger demand for labour has caused skills shortages in a number of industries and regions, so pushing up average labour costs. Growth in the LCI has increased steadily over recent times, with recent year ended rises well above previous levels last seen in 1997. The March quarter saw an increase of 0.5% for all salary and wage rates from December, and an increase of 2.5% for the year ended March.

The industry groups that experienced the largest labour cost increases for March 2005 compared to March 2004 was again construction (+3.8%), education (+3.1%) and retail trade (+2.8%). The industry groups with the smallest increases were accommodation, cafes & restaurants and communication services (both at +1.3%).

The occupational groups experiencing the largest increases were trades workers (+3.2%), followed by professionals and 'other' occupations (both at +3.1%). The occupational groups with the smallest increases were again legislators, administrators and managers (+1.7%) and clerks (+2.1%).

Wage inflation pressures are likely to remain relatively high during the remainder of 2005. Labour market shortages still persist and although the unemployment rate has eased slightly, further wage pressure seems to be evident.

Forecasts: Labour Cost Index % Change

	Years Ending		
	Jun 05	*Jun 06*	*Jun 07*
Highest	2.8	3.0	2.5
Average	2.7	2.5	2.1
Lowest	2.5	2.2	1.7

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 reflects compositional changes in the labour force. The most recent QES release shows that average hourly earnings grew by 3.6% for the year-ended March 2005, up from a 2.1% increase for the year-ended December 2004, and also up from the 3.3% recorded for the year ended March 2004.

1.4 Employment

Most recent outcome: +3.4% year-ended March 2005

Employment growth has been strong over the past five years. According to the Household Labour Force Survey, the number employed has grown by around 16.6% over a five-year period from March 2000 and the unemployment rate has fallen from 6.3% to 3.9%. During the December quarter, the unemployment rate reached a record low of 3.6%, which was the lowest unemployment recorded during the history of the survey, and the lowest unemployment rate in the OECD. The increase to 3.9% for the March quarter has moved New Zealand into second position.

2004 saw strong growth in the labour market, although 2005 has started with a levelling off after some dramatic gains. Continued increases of such a magnitude cannot be sustained indefinitely, unless immigration policies are such that they bring more workers into the labour market. Presently, this does not appear to be the case and the labour market clearly remains very tight, consistent with the results of the NZIER Quarterly Survey of Business Opinion and the ANZ Job Advertisements series.

In the year to March 2005, 68,000 more people were employed, taking the number of people employed to a new high of 2.055 million. With unemployment rising by 6,000 and the working age population increasing by 6,000, the labour force participation rate stayed relatively the same at 67.6%, compared with 67.7% for the December 2004 quarter. The gains in employment and the subsequent falls in the number unemployed have been broadly based across sex, ethnic groups, and regions.

Comparing March 2005 with March 2004, the industry groups recording the largest increases in employment were ‘other’ services (+9.5%), health & community services (+8.0%), and business & financial services (+2.9%). In contrast, agriculture, forestry and fishing experienced a drop in employment (-4.8%).

With HLFS unemployment surprising on the upside for the March quarter, it is possible that over the next year the unemployment rate will edge over 4%, although this would still be a historically low rate.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	Jun 05	*Jun 06*	*Jun 07*
Highest	3.6	4.4	4.5
Average	3.5	4.0	4.2
Lowest	3.4	3.5	4.3

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

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 7.06% as at 25 May 2005

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 once, with it now standing at 6.75%. The Bank is still concerned that strong inflationary pressures exist, although recent economic data that has pointed towards a potential slowdown as well as a continued strong NZ dollar may relive some inflation pressure.

The recent depreciation of the exchange rate will obviously bring about concerns that tradable inflation will continue to increase. If sustained, a weaker NZD will generate imported inflation at a time when domestic inflation is already at uncomfortable levels. The Bank will be watching for further signs of the domestic economy slowing and easing inflationary pressures, otherwise it will be forced to make further increases in the OCR.

Most economists have increased their forecasts of 90-day interest rates for 2005 and 2006. This implies a moderate further tightening by the Reserve Bank, although a downward turn in the New Zealand economy during the second half of 2005 may cause the Reserve Bank to quickly rethink its stance. Interest rates are expected to be lower in 2007 though.

Forecasts: Interest Rates (90 day bills)

	As at End of		
	Jun 05	*Jun 06*	*Jun 07*
Highest	7.2	6.7	6.1
Average	7.0	6.6	5.9
Lowest	6.8	6.1	5.7

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

1.6 Exchange Rates

Most recent outcome: NZD = US$0.7108 as at 24 May 2005
NZD = AU$0.9367 as at 24 May 2005
TWI = 70.6 as at 24 May 2005

After gains against all of the major currencies throughout 2004, the NZD has stagnated somewhat during the first five months of 2005. Although the NZD has appreciated by 1.1% against the USD, 2% against the Australian dollar, and 3.4% against the TWI this hides the fact that the NZD has pushed higher than that, but has dropped back on two occasions. Still, the NZD remains at historic highs, and the next few months will indicate whether the levelling trend continues, or whether the NZD starts to indicate a stronger movement downwards.

All economists agree that accurately forecasting changes in exchange rates is fraught with difficulty – currency forecasts must always be treated with caution. Forecasters have revised up their short and medium term expectations, but have revised down forecasts out to 2007. If the NZD shows a stronger downward trend over the coming months, medium-long term expectations will likely follow suit.

AUD (cents)			
	Jun 05	*Jun 06*	*Jun 07*
Highest	93.1	87.1	86.6
Average	92.5	86.0	84.1
Lowest	92.0	84.0	82.4

USD (cents)			
	Jun 05	*Jun 06*	*Jun 07*
Highest	76.0	62.0	56.0
Average	72.2	59.0	53.9
Lowest	70.0	55.9	51.0

TWI			
	Jun 05	*Jun 06*	*Jun 07*
Highest	71.6	62.3	59.0
Average	70.0	60.2	57.2
Lowest	68.7	58.0	54.8

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

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: +1.5% for the year-ended June 2004.

Forecasts (averages):
- Mid 2005: +2.5%
- Mid 2006: +3.2%

Source: The Economist

Australia's annual GDP dropped to 1.5% for the December 2004 year, which was the lowest annual GDP result since mid 2001 as consumer spending and home building cooled. However, forecasts point to a 2.5% growth rate over 2005. Looking out to 2007, GDP growth is expected to pick up to 3.4%, mainly due to a lift in exports, which are believed to double from 4.6% in 2005 to 8.1% in 2006.

Some key recent economic statistics:

- Real retail sales up 3.4% for March 2005 compared to March 2004.
- Motor vehicle sales up 6.7% for April 2005 compared to April 2004.
- Manufacturers sales down 0.9% for December 2004 compared to December 2003.
- Dwelling unit approvals down 13.5% for March 2005 compared to March 2004.
- Employment up 3.4%% for April 2005 compared to April 2004.
- Unemployment rate of 5.1% as at April 2005 – the same as March 2005.
- Company profits before tax up 20.6% for December 2004 compared to December 2003.

The latest Australian PMI results show the pace of manufacturing activity has remained in positive territory, although continues to hover around the 50-55 mark. Overall, manufacturing activity in Australia has been stronger than New Zealand's during the first few months of 2005 but it is important to bear in mind that the Australian PMI is seasonally adjusted, whereas the New Zealand PMI is not at the same stage of development.

2.2 Headline Inflation

Most recent outcome: +2.4% for the year-ended March 2005

Forecasts:
- Mid 2005: 2.6%
- Mid 2006: 2.7%

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 generally experienced a slowdown. Because of tighter monetary conditions and slowing growth in 2005, inflation is expected to stay below 3%.

Australia's wage cost index increased by 3.0% for the year ended December 2004, while Australia's unemployment rate remains at 5.1% - considerably higher than New Zealand's current rate of 3.9%.

2.3 Interest rates (90-day bills)

Most recent outcome: 5.67% as at 18 May 2005

Late in 2003 the Reserve Bank of Australia (RBA) increased its OCR twice (from 4.75% to 5.25%) but left it untouched during the whole of 2004. In March, the RBA decided to increase the OCR by 25 basis points, due to reduced capacity, stronger inflationary pressures, stronger domestic and global demand, and increased prospects of spending growth.

The general belief by most economists is that the RBA will probably keep the OCR unchanged for the foreseeable future as the Australian economy begins to cool.

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, although economic conditions started to pick up for 2003-2004. However, it appears that other countries are again starting to experience lower growth, which could exacerbate New Zealand's own falling economic growth.

United States

Evidence is continuing to mount that output in the USA is slowing. GDP grew at an annual rate of 3.1% for the March 2005 quarter, down from 3.8% in the December 2004 quarter. However, GDP figures out to 2007 are still expected to be well above 3%, and the strong growth in business investment should help keep the economy moving along. The ISM manufacturing index (the US version of the PMI) has steadily fallen after values above 60 between Nov 2003 and July 2004, while the US unemployment rate for April (5.2%) continued the trend of hovering round the 5.2-5.5% mark since July 2004.

The Federal Reserve recently increased its Federal Funds Rate from 2.75% to 3%, following three other 25 basis point hikes since the last business-planning forecast. Further hikes in the near future cannot be discounted, as the Federal Reserve still considers that growth and inflation risks remain 'balanced'.

The large and growing fiscal and trade deficits mean that the fundamentals are against a sustained rise in the USD (some economist have pointed to the wildcard aspect of the USD), although the currency has improved somewhat recently on the back of adequate economic data. America's lack of fiscal restraint poses a continued threat, as the government's continued borrowing is driving a current account deficit that is expected to reach US$900 billion by 2006.

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, although further evidence is required before there is talk of a sustained change in Japan's fortunes.

Japan's recovery was not helped by the economy hitting a slow patch in 2004, which has caused projected growth to be cut from 2.1% to 1.5%. Consumer demand in Japan has generally been weak (although figures for March show a slight rebound), and with Japan's central bank having an interest rate of zero, monetary-policy options are few and far between.

Asia

Asian economies were hit hard by the impact of SARS in 2003, but most have since bounced back and are now growing strongly, largely due to very strong increases in industrial production. Current annual growth rates include 9.5% for China, 7.1% for

Hong Kong, 6.4% for Indonesia and 6.2% for India. This should have flow on effects for New Zealand exporters.

China's continued red-hot economy is seen as a strong catalyst for the change in fortunes for the Asian region. With China's industrial production rising 16% for the year ending April, talks of an attempt to slow the pace of growth down do not seem to be borne out in the data. Growth rates are expected to hover close to double digit figures for some time yet.

Europe

GDP growth in the Euro area only grew by 1.4% for the year ending March 2005, with more signs of gloom evident. The manufacturing sector experienced a fall in activity, while unemployment edged upwards to 8.9%. On a positive note retail sales picked up and inflation remains unchanged at 2.1%.

The UK is also experiencing signs of a slow down, as growth rates slipped below 3% to 2.8% for the year ended March 2005. Manufacturing also slipped downwards, although the unemployment rate edged downwards to 4.7% for the March quarter. Italy has sunk into a recession, with recent negative GDP quarterly growth, causing annual growth to quickly slide to 1.8%. The Netherlands also recorded negative growth for the first quarter of 2005.

World Outlook

Most economists are predicting that 2005 will not be as good as the increase in growth evident over 2003-2004. 2005 will see slower rates of growth, but will still be stronger than during the 2000-03 period. Continued good fortunes in the 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.

Forecasts: World GDP Growth (Selected Trading Partners)

Country	*2005*	*2006*
Australia	2.6%	3.2%
Canada	2.7%	3.0%
Japan	1.1%	2.1%
United Kingdom	3.2%	1.9%
United States	3.7%	3.2%
Euro Area	1.5%	1.9%

Source: Economist

Inflation forecasts in most countries have again increased since our last forecast. As a result, monetary policy will likely be tightened.

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

Country	*2005*	*2006*
Australia	2.6%	2.7%
Canada	1.9%	2.1%
Japan	0%	0.3%
United Kingdom	1.8%	1.8%
United States	2.6%	2.5%
Euro Area	1.8%	1.6%

Source: Economist