Manufacturers Business Planning Forecasts

24 July 2000

FORECASTS: SEPTEMBER 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 NZ’s production is likely to increase or decrease, illustrates how demand in volume terms might change in the New Zealand market.

The forecasts provided for this quarter were prepared before the latest NZIER Business Opinion data was available. The June quarter data showed a sharp downturn in business confidence and expectations for much weaker business activity, particularly on the domestic market. As a consequence of this domestic downturn, more manufacturers expect their total output to fall in the September quarter than those who expect output to rise.

Two general views are emerging from forecasters about the direction of economic growth over the next 12 months.

1. There is a view that the downturn in activity will be very short term, with improving export activity beginning to offset the downturn in domestic activity. Further interest rate rises are expected, with interest rates peaking at 7% before the end of the year.

2. There is an alternate view that export growth will not be sufficient to offset the fall in domestic activity, leading to the possibility of a shallow recession in the September or December quarters. There may be some economic growth because of buoyancy in the agricultural sector, but a decline in manufacturing sector activity.

At this point, the Federation believes the second option is more plausible for the following reasons:

- much of the growth in exports is due to improved prices of commodity exports (exchange rate and international prices) but non commodity export growth has been much weaker;

- weakening growth in Australia and weakness in their currency have limited the prospects of New Zealand manufacturers achieving strong export growth to Australia;

- continuing strong growth in imports is offsetting much of the growth in exports;

- business concerns about Government policy directions have had a detrimental impact on investment intention, reducing future growth prospects; and

- petrol price increases, tax increases and interest rate rises are all dampening domestic activity and will continue to have a negative impact over the next six months.

This second scenario would suggest that the interest rate cycle should have already peaked and that a cut in interest rates could be justified. At the same time, we are still at the bottom of the exchange rate cycle so flat or declining interest rates will limit the pressure for an appreciation in the currency. The longer term prospects for exporters are therefore positive, with forecasters continuing to reduce their expectations for the level of appreciation likely in the currency. Interest rates are also likely to remain much lower in real terms than we have seen over the last 15 years.

The business environment in the short term, however, is likely to remain very uncertain. It is still too early to assess the full impact of the oil shock on international economic activity and the future path for oil prices is unclear. In addition, a myriad of changes in Government policy will impact on your business (some negatively, while others may be positive). In light of this, it will be important for businesses to focus on their longer term strategy while continuing to monitor short term economic impacts.

Real GDP % Growth

	Years Ending		
	Sept 00	*Mar 01*	*Mar 02*
Highest	5.5	4.1	3.5
Average	5.2	3.5	3.2
Lowest	4.9	2.9	2.8

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 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 2.0% in the June quarter and is expected to continue to increase, reaching 2.5% in March 2001. Petrol price rises and the recent tobacco tax increases are 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		
	Sept 00	*Mar 01*	*Mar 02*
Highest	2.6	3.0	2.1
Average	2.4	2.5	1.8
Lowest	2.3	2.1	1.6

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.

Labour Cost Index % Change

	Years Ending		
	Sept 00	*Mar 01*	*Mar 02*
Highest	1.8	2.4	2.7
Average	1.5	2.1	2.2
Lowest	0.5	1.8	1.8

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.

Unemployment % (HLFS)

	Years Ending		
	Sept 00	*Mar 01*	*Mar 02*
Highest	6.5	6.3	6.0
Average	6.3	6.1	5.6
Lowest	6.1	5.9	4.9

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 peak by the end of this year, or early next year, and then to begin to decline through 2001.

Interest Rates (90 day bills)

	Years Ending		
	Sept 00	*Mar 01*	*Mar 02*
Highest	7.4	7.3	7.1
Average	7.0	7.1	6.5
Lowest	6.8	6.8	5.9

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 short-term movement against the Australian Dollar, reflecting significant volatility over the last six months. The general view is that the currency will appreciate against the US$ but less strongly than previously forecast. The average forecast is for the currency to appreciate gradually against the Australian dollar, but forecasters remain divided on whether the cross rate will weaken further or appreciate.

A$

	Sept 00	*Mar 01*	*Mar 02*
Highest	81.0	84.0	85.2
Average	79.7	80.8	83.0
Lowest	77.5	77.2	81.4

US$

	Sept 00	*Mar 01*	*Mar 02*
Highest	50.0	54.0	61.0
Average	49.0	53.2	57.3
Lowest	48.5	52.5	53.4

TWI

	Sept 00	*Mar 01*	*Mar 02*
Highest	55.2	59.5	62.8
Average	53.7	56.7	59.3
Lowest	52.4	54.5	56.2

Source: ANZ, ASB, BNZ, National and WestpacTrust

In practice, buying forward the A$ and US$ will reduce the risk in cross rate movements. Sell rates quoted by the ANZ (all other banks are the same but the rates change from day to day) on 20 July 2000 were:

A$		US$	
20 January 01	*20 July 01*	*20 January 01*	*20 July 01*
0.7865	0.7838	0.4555	0.4554

Source: ANZ Banking Group (New Zealand) Limited

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 three months ago, when forward rates for the Australian $ were nearly 83 cents and the forward rate for the US$ was 50 cents. Lower interest rates in New Zealand reduced some of the benefits of buying forward cover, so future interest rate changes will have an impact on whether it is useful to have forward cover.

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	4.8	4.1
Average	4.2	3.7
Lowest	3.8	3.4

Source: The Economist

Growth forecasts have increased slightly because of strong growth recorded in the first quarter 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 most goods increasing in price under GST, while prices for some goods fell. The introduction of GST appears to have taken place more smoothly than anticipated.

Headline Inflation

Calendar Years		
Quarter	*2000*	*2001*
Average	4.3	3.5

Source: The Economist

Inflation forecasts have increased, taking into account the impact of the introduction of GST and the fall in the currency. There are signs that wage growth is beginning to increase, leading to higher inflation expectations for next year.

Interest rates (90 day bills)

Calendar Years		
2000	*2001*	*2002*
6.2	6.2	5.4

Source: NZIER Quarterly Predictions

Short-term interest rates have risen as a result of monetary policy tightening by the Reserve Bank. It is generally considered there will be no further interest rate rises but it will be some time before interest rates fall.

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*
4.1	3.6	3.5	3.58

Source: NZIER Quarterly Predictions