

Business Planning Forecasts

16 August 2004

FORECASTS: SEPTEMBER 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
August 2004

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Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +3.6% for the year-ended March 2004.

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period. GDP growth has averaged 3.9% per annum over the past five years, with only one quarter of decline out of the last 20 (June 2000).

GDP growth in the March 2004 quarter was very strong, rising by 2.3%. Higher consumer spending, increased business investment, and a lift in exports all contributed to the rise in economic activity. Growth was widespread across almost all industry groups, with manufacturing up 3.8% in the quarter and construction up 9.1%.

Both short and medium-term forecasts for economic growth have been revised up since our previous report. They now suggest that GDP will increase by a solid 4.4% for the year ended September 2004, and that growth will fall to around 2.6% for each of the years ended June 2005 and 2006.

Forecasts: Real GDP % Growth

	Years Ending		
	Sep 04	Sep 05	Sep 06
Highest	4.6	3.3	3.1
Average	4.4	2.6	2.6
Lowest	4.0	2.1	1.8

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

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

Global economic recovery

Notwithstanding higher oil prices (which have reached new record highs of \$US46 per barrel), strong growth rates are 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 most economists are picking that the domestic economy (which has underpinned growth since 2001) will slow in 2005 and 2006.

Interest rates

On 29 July the Reserve Bank increased its Official Cash Rate (OCR) by 0.25% to 6%, its fourth increase since January. The latest increase was motivated by concerns about inflationary pressures arising from a strong domestic economy and a tight labour market. Prior to the latest increase, opinion among economists was almost universal that the Reserve Bank would raise the OCR and most are expecting a further 0.25% increase in September.

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The Dollar

Between November 2000 and February 2004 the New Zealand Dollar (NZD) appreciated by almost 50% on the Trade Weighted Index (TWI) and by almost 80% against the US Dollar. After reaching a peak of 69.0 against the TWI on 18 February, the NZD fell back sharply to 61.5 on 18 May. Over the past three months the TWI has increased again to reach 66.8 on 13 August. Despite the recent strength in the NZD, most economists expect the NZD to ease back 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 turning downwards.

Short-term visitor numbers increased 10% for the year ended June 2004. 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 22,000 gain for the year ended June 2004. Current monthly data is consistent with an annual net gain of 10,000. There has been both a reduction in arrivals and an increase in departures due to the improving global economy and a slowing New Zealand economy.

Despite the slowdown in migration and higher interest rates the housing market has remained remarkably buoyant. For example, for the year ended June 2004 new dwelling consents were up 13%, house sales were up 8.3%, and house prices were up 15%. However, more recently, there has been some evidence of a cooling in sales and prices.

Commodity prices and farm incomes

International commodity prices boomed in 2003 and well into 2004, with ANZ Bank's Commodity Price Index up 26.3% for the year ended July 2004. However, there is evidence that the upward momentum is now tapering off, particularly for key agricultural commodities.

A higher exchange rate has meant that the increases in the commodity price index have been muted when expressed in NZD terms. Although the NZD index is 16.7% higher than in July 2003, it remains 21% below its peak in April 2001.

These higher commodity prices should feed through to the domestic economy in the form of higher export receipts at a time when the domestic economy might otherwise be slowing.

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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 June 2004 NZIER Quarterly Survey of Business Opinion reported improving business confidence, after a severe slump in March. A net 20% expected general business conditions to deteriorate over the next six months. Meanwhile, it continued to report considerable pressure on resources, with demand particularly high for both 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 recent decisions to increase the OCR.

The National Bank Business Confidence Index also recorded a dramatic downswing in confidence early in 2004, but by July this had improved to a net 13% of respondents expecting general business conditions to deteriorate over the coming 12 months (compared to the net 42% pessimists recorded in March).

Meanwhile, the ANZ-Business New Zealand PMI stood at 57.5 for July 2004, compared to 51.6 in July 2003, indicating a solid pickup in manufacturing activity. Most encouraging has been a continued strength in new orders, while employment has also bounced back after sluggish expansion earlier in the year.

Investment

Despite the gloom about general business conditions, business investment has increased significantly over the past couple of years (e.g., up 12.6% for the year ended March 2004). 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 June 2004 quarter, but remained at a high level (121.7). Over the past couple of years, strong employment growth, lower interest rates, and higher house prices have all made homeowners feel wealthier and more confident. More recent trends of higher interest rates, higher petrol prices, and a possible slowing in the housing market are being reflected in consumer confidence coming off its late 2003 peaks. However, for now retail sales remain robust – up 8.9% for June 2004 compared to June 2003.

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1.2 Inflation

Most recent outcome: +2.4% year-ended June 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. It is also the key reference point for monetary policy.

Inflation rose sharply in June 2004. 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 7.1% for the year ended June 2004. However, government policy changes can also have a major impact on the CPI, with Central and Local Government Charges increasing by 7.7% over the same period. Much of this increase was driven by higher local authority rates (up 10.4%) 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 saw 'tradable' inflation fall into negative territory, compensating for a high level of 'non-tradable' inflation (currently around 5% per annum). The net effect has been a CPI that might on the face of it seem at a comfortable level but was in reality more a reflection of the two-speed economy of 2002-03.

More recently there have been concerns that tradable inflation might now be back on the rise, so risking a breach in the Reserve Bank's 1-3% inflation target. With regard to the recent oil price rises, the Reserve Bank is required to look through such 'shocks' when setting monetary policy, but it will be concerned if it were to lead to more generalised inflationary pressures.

CPI forecasts have once again been revised upwards since the last quarter. A number of forecasters (including the Reserve Bank itself) are now expecting the CPI to exceed 3% in 2005. This explains the Reserve Bank's moves to increase the OCR, although it remains to be seen whether the Bank will overshoot the mark and be forced to reduce rates in 2005.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Sep 04	Sep 05	Sep 06
Highest	2.7	3.2	2.5
Average	2.5	2.8	2.3
Lowest	2.4	2.4	2.0

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

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1.3 Labour Costs

Most recent outcome: +2.3% year-ended June 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.

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 the 2.4% increase for the year ended December 2003 being the highest annual increase since 1997 and the June 2004 quarter's increase of 0.6% being the highest June quarter increase since 1998.

The industry groups that experienced the largest labour cost increases for June 2004 compared to June 2003 were personal and other services (+3.2%), education (+2.9%), construction (+2.9%), and health and community services (+2.8%). The industry groups with the smallest increases were forestry and logging (+0.7%) and printing, publishing and recorded media (+1.4%).

The occupational groups experiencing the largest increases were trades workers (+3.0%), elementary occupations (+2.9%), and professionals (+2.9%). The occupational groups with the smallest increases were agricultural and fisheries workers (+1.5%) and legislators, administrators and managers (+1.7%).

While real wages (as measured by the LCI) fell during 2000-02, they recovered in with the slowing in the rate of increase in the CPI in 2003. Forecasts though suggest that this recovery will only be short-lived, with growth in the LCI falling behind the CPI over the next year or so.

Forecasts: Labour Cost Index % Change

	Years Ending		
	Sep 04	Sep 05	Sep 06
Highest	2.3	2.6	2.3
Average	2.2	2.1	2.1
Lowest	2.1	1.8	1.9

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 4.4% for the year-ended June 2004, up from a 3.3% increase for the year-ended March 2004.

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1.4 Employment

Most recent outcome: +3.1% year-ended June 2004

Employment growth has been strong over the past five years. According to the Household Labour Force Survey, the number employed has grown by around 13% since March 1999 and the unemployment rate has fallen from 7.7% to 4.0% - the lowest rate since March 1987 and the second lowest unemployment rate in the OECD. Continued employment growth should continue to sustain the domestic economy.

2004 has seen strong growth in the labour market, with the June quarter data once again surprising on the upside. There was a much stronger than expected quarterly increase in employment (up 0.9%) and an unexpected fall in unemployment (from 4.3% to 4.0%). 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 June 2004 61,000 more people were employed, taking the number of people employed to over 2 million for the first time. With unemployment falling by 11,000 and the working age population increasing by 52,000, the labour force participation rate increased from 66.3% to 66.7%. 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.

Encouragingly, the substantial fall in unemployment over recent years has been broadly based across the sexes, ethnic groups, and regions.

Comparing June 2004 with June 2003, the industry groups recording the largest increases in employment were construction (+12.2%), business and financial services (+11.2%), and transport, storage and communication (+7.7%). In contrast, agriculture, forestry and fishing (-9.8%) and health and community services (-2.0%) both recorded a fall in employment.

The forecasts below were received prior to the latest HLFS release. With HLFS unemployment again surprising on the downside, it is likely that short-medium term forecasts for unemployment will again be revised downwards.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	Sep 04	Sep 05	Sep 06
Highest	4.5	5.3	5.3
Average	4.3	4.6	4.8
Lowest	4.0	4.1	4.0

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

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 6.42% as at 13 August 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 on four occasions (each time by 0.25%), with it now standing at 6%. The Bank has been concerned for some time that the strong domestic economy is generating inflationary pressures, but until recently it took comfort from a higher NZD pushing down import prices. It was therefore prepared to accommodate non-tradable inflation more than it would have had the NZD been at a lower level.

The rate of appreciation of the exchange rate has eased and there are now concerns that tradable inflation is back on the rise. 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 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 the remainder of 2004 and 2005. This implies a moderate further tightening by the Reserve Bank. Interest rates are expected to be lower in 2006 though.

Forecasts: Interest Rates (90 day bills)

	As at End of		
	Sep 04	Sep 05	Sep 06
Highest	6.5	6.7	6.0
Average	6.5	6.3	5.9
Lowest	6.5	5.7	5.7

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

1.6 Exchange Rates

Most recent outcome: NZD = USD0.6576 as at 13 August 2004

NZD = AUD0.9207 as at 13 August 2004

TWI = 66.8 as at 13 August 2004

After falling sharply from mid-February to mid-May, the NZD has risen against almost all major currencies over the past three months. Since reaching a trough on 18 May, the NZD has appreciated by 10.8% against the USD, 5.7% against the AUD, 7.5% against the UK Pound, 7.2% against the Japanese Yen and 8.7% against the Euro. Overall, the Trade Weighted Index (TWI) has risen by 8.6% over the past three months.

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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 has increased in value.

Consistent with a rising exchange rate, export values fell consistently during 2002 and 2003, with import values also being relatively flat. However, so far this year both exports and imports have been growing strongly despite the higher exchange rate. This is partly due to higher commodity prices, but the global economy has also recovered after 2-3 flat years, so increasing demand for New Zealand products. New Zealand's strong domestic economy has also fuelled a strong increase in import values this year.

All economists agree that accurately forecasting changes in exchange rates is fraught with difficulty – currency forecasts must always be treated with caution. The fall in the exchange rate in February-March caused forecasters to revise down their short-term forecasts. The more recent appreciation in the NZD has since resulted in short-term forecasts being revised upwards compared to three months ago. However, the medium-longer term forecast for a falling exchange rate remains.

AUD (cents)			
	<i>Sep 04</i>	<i>Sep 05</i>	<i>Sep 06</i>
Highest	92.6	86.2	85.3
Average	91.1	84.3	83.1
Lowest	89.5	82.8	80.0

USD (cents)			
	<i>Sep 04</i>	<i>Sep 05</i>	<i>Sep 06</i>
Highest	64.4	62.4	58.0
Average	63.7	57.1	54.0
Lowest	63.5	53.0	52.0

TWI			
	<i>Sep 04</i>	<i>Sep 05</i>	<i>Sep 06</i>
Highest	65.5	62.3	59.2
Average	65.1	58.3	56.9
Lowest	64.7	54.1	55.7

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: +3.7% for the year-ended March 2004.

Forecasts:

- December 2004: +3.5%
- December 2005: +3.3%

Source: The Economist

Australian GDP has grown solidly since a brief slack period in mid-2003 and it is expected to continue to grow by over 3% over the next two years. Both exports and imports have risen strongly so far this year, consistent with the New Zealand situation. Business confidence has also risen and consumer confidence is at a 10-year high. However, the main difference with New Zealand is that Australia's housing market has slowed and appears not to be such a significant driver of inflation.

Some key recent economic statistics:

- Real retail sales up 7.9% for June 2004 compared to June 2003.
- Motor vehicle sales up 3.9% for May 2004 compared to May 2003.
- Manufacturers sales up 2.8% for March 2004 compared to March 2003.
- Dwelling unit approvals down 0.4% for June 2004 compared to June 2003.
- Employment up 2.4% for June 2004 compared to June 2003.
- Unemployment rate of 5.6% as at July 2004.
- Company profits before tax up 17.2% for March 2004 compared to March 2003.

The latest Australian PMI results show the pace of manufacturing activity has increased slightly, with a reading of 53.5 for July 2004 (up from 50.6 in June). The Australian PMI has been below the New Zealand PMI for the past three months.

2.2 Headline Inflation

Most recent outcome: +2.5% for the year-ended June 2004

Forecasts:

- December 2004: 2.5%
- December 2005: 2.5%

Source: The Economist

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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 slowed and the appreciation in the AUD (particularly against the USD) has taken effect. The slowing in the Australian housing market has also helped cool inflationary pressures.

Australia's wage cost index increased by 3.6% for the year ended March 2004, but at a rate of 5.6%, Australian unemployment remains considerably higher than New Zealand's current rate of 4.0%.

2.3 Interest rates (90-day bills)

Most recent outcome: 5.44% as at 13 August 2004

Forecasts:

- December 2004: 5.70%
- March 2005: 5.95%

Source: HSBC

Late last year the Reserve Bank of Australia (RBA) increased its OCR twice (from 4.75% to 5.25%) but this year 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 to delay any increase.

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.

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 record high oil prices that 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 4.5% for 2004 and 3.5% for 2005. Although economic data in late 2003 and early 2004 was very strong, more recent data have been weaker – for example, June quarter economic growth was weaker and July employment growth was much lower than expected, largely due to the impact of higher energy prices. However, business confidence has continued its strength of

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recent months, with the ISM manufacturing index (the US version of the PMI) remaining over 60, indicating strong levels of expansion.

The Federal Reserve has increased its Federal Funds Rate from 1% to 1.5% since our last forecast. Further increases are likely although its latest comments have been more measured due to the weaker recent data. The Federal Reserve considers that growth and inflation risks remain 'balanced'.

The less impressive recent economic news has been a factor behind the weaker USD over recent 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 exceeding US\$46 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, a reduction in unemployment, and signs that deflation may soon become mild inflation. 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 4.5% for 2004 and 2.3% for 2005 – significantly better than recent years' outcomes and earlier forecasts. However, the situation is still patchy (for example, retail sales continue to fall) and economic reform 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, largely due to very strong increases in industrial production. Current annual growth rates include 9.6% for China, 6.8% for Hong Kong, 8.2% for India, 7.6% for Malaysia, and 11.7% for Singapore. This should be good news for New Zealand exporters.

After suffering from a bout of deflation last year, most Asian economies are now 'reflating', with annual CPI increases of between 1% and 5% being recorded. China's CPI rose 5.0% for the year ended June, a rate that may cause concern considering China's growing economic and trade importance.

Europe

GDP growth in the Euro area has increased to reach 1.3% for the year ended March 2004. It is likely to improve further to 1.8% for 2004 and 2% for 2005. France and Germany exhibiting stronger growth than in recent years, 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

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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 3.7% for the year ended June 2004 and is forecast to grow by 3.3% 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 3-9% (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. 2005 will see slower rates of growth, but will still be stronger than during the 2000-03 period. 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.

Recent instability in the Middle East, political unrest in Venezuela, storms in the Gulf of Mexico and ongoing dramas in Russia over major oil producer Yukos are all causing concern about oil supply at a time when demand for oil is high. As a result, oil prices have hit a record high of \$US46 per barrel, which is likely to dampen growth prospects.

Forecasts: World GDP Growth (Selected Trading Partners)

<i>Country</i>	<i>2004</i>	<i>2005</i>
Australia	3.5%	3.3%
Canada	2.9%	3.4%
Japan	4.5%	2.3%
United Kingdom	3.3%	2.7%
United States	4.5%	3.5%
Euro Area	1.8%	2.0%

Source: Economist

Oil price rises are also likely to feed into higher inflation around the world. Inflation forecasts in most countries have been increased since our May forecast, particularly for 2004. As a result, monetary policy is generally being tightened. However, inflation is expected to moderate in 2005.

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

<i>Country</i>	<i>2004</i>	<i>2005</i>
Australia	2.5%	2.5%
Canada	2.0%	2.1%
Japan	-0.1%	0.3%
United Kingdom	1.5%	1.8%
United States	2.6%	2.3%
Euro Area	2.0%	1.7%

Source: Economist