

ECONOMIC FORECAST

OCTOBER 1990 EXECUTIVE SUMMARY

Introduction

These forecasts update those published in May 1990 and includes information available up to 3 October. The forecasts cover the period to March 1992 and are the first forecasts produced using the Reserve Bank's new econometric model of the New Zealand economy, Model XII.

Forecast Summary

- *Activity outlook remains weak.*

Recent statistics confirmed that no overall growth in the economy took place over 1989/90. A strong stocks accumulation along with domestic demand growth of almost 3 per cent was offset by a rapid pick-up in imports and a fall in export volumes. In 1990/91, domestic demand is expected to contract as declines in private consumption and stocks more than offset modest growth in investment. However, strong export volume growth, with only a small increase in import volumes, is expected to give 0.4 per cent GDP growth over 1990/91. With continued good export growth, GDP recovers by 2 per cent over 1991/92.

- *Future consumption growth constrained by falling incomes.*

While private consumption is expected to improve somewhat in the second half of 1990/91, a contraction of 0.5 per cent is expected over the full year. A small improvement in private consumption growth is expected in 1991/92 as activity improves and interest rates decline.

- *Little growth in total investment.*

Residential investment has weakened over 1990 with falling incomes and rising interest rates discouraging investment. The overall level of business investment will be underpinned by increasing investment in plant, machinery and equipment, as the Maui B project gains momentum. However, commercial building activity continues to exert a negative influence. Public sector investment is expected to drop sharply in 1991/92 as large investment expenditures by state owned corporations are curtailed. As a result, the overall (public and private) level of investment is predicted to rise by 1.4 per cent in 1990/91 before falling by 2.7 per cent in 1991/92.

- *With no changes in policy, the fiscal balance deteriorates sharply.*

With a lower activity profile than earlier expected, the Budget night estimate of a fiscal surplus for 1990/91 of \$89m is unlikely to be attained. Instead, a deficit of around \$150 million is forecast. With no change from announced policies, the projected financial position deteriorates to a deficit of around \$2.5 billion or 3.1 per cent of GDP in 1991/92.

- *Current account deficit forecast to reach \$5 billion*

Lower real export prices, coupled with higher international inflation and more expensive oil imports result in a significant downturn in New Zealand's terms of trade in both the 1990/91 and 1991/92 years. Thus, despite strong export volume growth and only modest import volume growth, a deficit of just over \$5 billion, or around 7 per cent of GDP, is forecast in 1990/91. No significant improvement is expected the following year, with the current account deficit forecast to remain around \$5 billion, or approximately 6.6 per cent of GDP, in the year to March 1992.

- *Oil shock boosts inflation.*

The oil price shock has worsened the inflation outlook. Assuming an oil price of around US\$30 per barrel is sustained, domestic inflation is expected to be boosted by a total of around 3 per cent over the next 12 - 18 months. Thus, while the underlying ex-oil inflation rate is expected to remain around 4.5 per cent per annum in March 1991, and to fall to 2.6 per cent by March 1992, oil-inclusive inflation is forecast to reach 6.8 per cent and 3.4 per cent respectively in each of these years.

- *Official HLFS unemployment holds up.*

The June quarter HLFS recorded a rise in the official unemployment rate, as a result of the labour force growing rapidly in the face of flat employment levels. Consistent with the less positive outlook for the economy overall, we now expect the official HLFS unemployment rate to rise to 7.8 per cent over 1990/91, before easing back slightly to 7.6 per cent by March 1992.

11 October 1990

SUMMARY OF ECONOMIC FORECASTS
(Annual percentage changes of annual totals of averages)

	ACTUAL		FORECASTS	
	1988/89	1989/90	1990/91	1991/92
March years				
Real Expenditure on GDP				
Final consumption				
- private	1.9	0.3	-0.5	0.3
- public authority	1.6	-1.7	2.0	0.0
- Total	1.9	-0.2	0.1	0.2
Gross fixed capital formation				
- private: residential	5.2	11.8	1.0	1.4
business	-8.0	7.7	0.9	1.6
- public authority	3.2	22.7	2.4	-11.1
- Total	-2.6	13.0	1.4	-2.7
Final Domestic Expenditure	0.8	2.9	0.4	-0.5
Stockbuilding ¹	-0.5	4.1	-1.2	0.4
Gross National Expenditure	0.3	6.9	-0.7	-0.2
Export of goods and services	1.3	-3.5	5.7	6.0
Imports of goods and services	-0.7	15.4	1.7	-0.3
EXPENDITURE ON GDP	1.0	0.0	0.4	2.0
Government Accounts				
Financial balance (\$M) ²	-954	-948	-150	-2450
as a % of GDP ²	-1.5	-1.4	-0.2	-3.1
Cyclically adjusted % of GDP ²	-1.0	-0.9	0.9	-2.7
External Account				
BOP current account balance (\$M)	-835	-4123	-5100	-5060
as a % of GDP	-1.3	-6.1	-7.1	-6.6
SNA Terms of trade	10.1	2.2	-9.8	-5.3
Incomes				
Real household disposable incomes	4.1	0.8	-1.4	-0.3
Prices				
Consumer price inflation ³	4.0	7.0	6.8	3.4
Consumer price inflation excl. oil & GST ³	4.0	5.0	4.5	2.6
Labour Market				
HLFS employment ³	-4.1	0.4	1.1	1.8
Official HLFS unemployment (000's) ³	116.3	115.7	125.2	123.9
Official HLFS unemployment rate (%) ³	7.4	7.3	7.8	7.6
<p>1. Percentage point contribution to growth rate in GDP. 2. June years for 1989/90 onwards. 3. March quarter to March quarter % changes or rate/level as at March quarter.</p>				