NEW ZEALAND ECONOMY — SIX MONTHLY REVIEW

OVERVIEW

In contrast to the relatively weak conditions that prevailed in the domestic economy during the latter part of 1982/83 and the first half of 1983/84, the six months to March 1984 have seen considerable evidence of a recovery in economic activity. This has been mainly concentrated in the consumer durable component of retail trade and in residential construction, although there are indications that the pick-up in activity may be broadening, with increased business confidence emerging.

As a result of a moderate upsurge in the economy in the December and March quarters, economic growth for the year as a whole is expected to be stronger than had previously been thought, although still considerably below that being experienced by many of our trading partners. The Reserve Bank's econometric model estimates real Gross Domestic Product (GDP) growth of 1.6 per cent for the 1983/84 financial year, in contrast to the 0.2 per cent contraction in 1982/83 provisionally estimated by the Department of Statistics. To place these rates of growth in context, figure 1 presents the Reserve Bank model series of growth in real GDP over recent years.

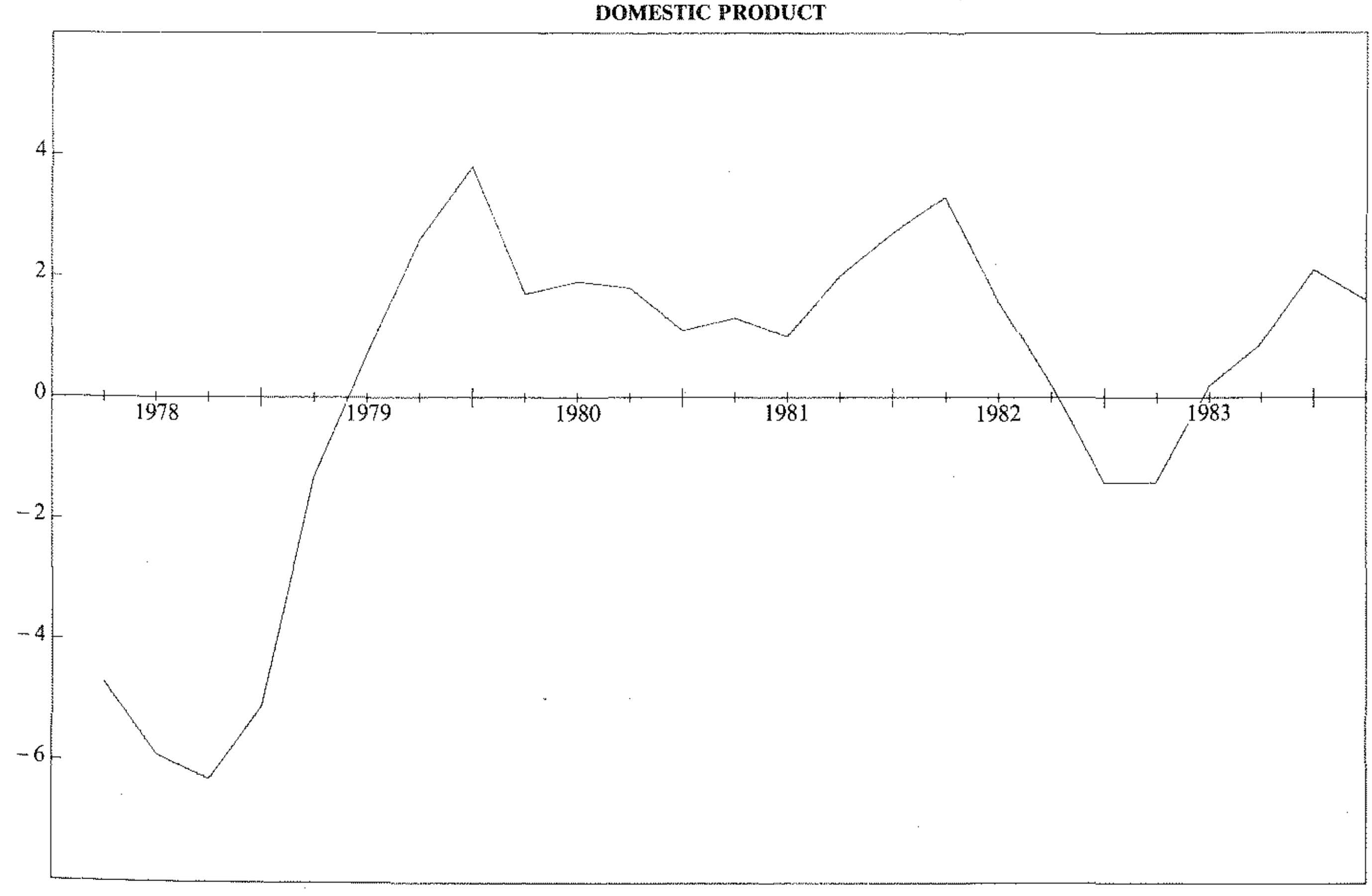
Of the various components comprising GDP, those displaying strongest growth in 1983/84 were public fixed capital formation and exports. For the year as a whole it is estimated that real private consumption expenditure grew relatively slowly while real private fixed capital formation declined marginally, but these overall trends mask contrasting situations in the first and second halves of the year.

The first two quarters saw contractions in both real private consumption and private fixed capital formation, a trend continued on from the previous year, and reflecting falling real disposable income and a relatively tight monetary stance. This was reversed in the second half of 1983/84, with increasing real incomes, lower nominal interest rates and greater availability of credit resulting in a sharp upturn in fixed capital formation (especially residential construction) and to a lesser extent in private consumption expenditure. Whether this proves sufficient to maintain a sustained increase in production remains to be seen. At this stage some doubt remains given the nature of a number of sectoral imbalances facing the economy.

Progress has been made in further reducing inflation in prices and costs, but the fiscal deficit as a proportion of GDP has increased, monetary and credit growth rates over the latter half of the year were excessive, the external current account has deteriorated, and unemployment, as a proportion of the labour force has increased (although first signs of an improvement in this area have recently begun to show up).

One of the most difficult of these imbalances is the government budget deficit, estimated to be about $2,900 million in 1983/84. This represents an historically large 8.7 per cent of GDP. A deficit of this magnitude presents difficulties for monetary policy, the large fiscal injections into the financial system requiring an active

FIGURE 1
ANNUAL PERCENTAGE CHANGE IN REAL GROSS DOMESTIC PRODUCT



public debt policy if excessive growth in monetary and credit aggregates is to be avoided. Because of the perceived need to reduce nominal interest rates, however, the Government has been constrained in funding the budget deficit through sales of government securities to the private sector. Moreover, as a result of this desire to avoid underpinning nominal interest rates at levels perceived as too high (relative to the current inflation rate), the Government has rejected a number of bids put forward in the seven government stock tenders held since September 1983.

Because of the large net fiscal injections into the financial system, monetary growth (M3) has been rapid in the September and December quarters, increasing by 4.9 per cent and 3.5 per cent over the respective quarters (in seasonally adjusted terms). More recently, private sector credit has also been expanding rapidly, mainly due to greater activity in the domestic economy and reduced nominal interest rates.

In recognition of the potential impact on inflation and the external current account deficit of excessive growth in the monetary and credit aggregates, the Government has adopted a number of policy initiatives over the last few months. These aimed to restrict the growth in private sector credit while not significantly compromising the objective of achieving lower nominal interest rates. The measures adopted included successive reductions in the free reserves margin used in setting the reserve asset ratio applicable to trading banks, increased government security ratios for building societies and finance companies and an increase in the effective penal borrowing rate applied to the trading banks in the event of their falling short of the required reserve assets.

The rapid growth in private sector credit evident in the December quarter 1983 and into the March quarter 1984 has had a stimulatory effect on private consumption expenditure, as have increased real disposable incomes, evident in recent months. The Reserve Bank model estimates a 1 per cent growth in real household disposable income over the full 1983/84 year, much of it occurring in the second half of the year, compared with an estimated decline of 3.8 per cent in 1982/83. Most categories of income are estimated to have shown some positive nominal growth in 1983/84. The large wage and salary component has grown only slowly, however, depressing the overall growth in nominal personal incomes, although the effects of the October 1982 tax cut and reduced inflation have resulted in a return to positive growth in real personal disposable income.

In response to the growth in real disposable income and rapid growth in monetary and credit aggregates, real consumption expenditure has shown moderate growth in the six months to March 1984. This has been particularly so with consumer durables such as cars and whiteware. Reflecting these influences, retail trade has picked up since September, recording double-digit annual rates of increase in each month since then.

As a result of increasing retail sales and conscious decisions by the business sector to run down stocks, destocking has continued throughout 1983/84. This has occurred in a wide range of sectors, stock/trade ratios falling over the September and December quarters 1983 in the retail, wholesale, manufacturing and primary sectors. With stock levels now below 'normal' levels in the distribution sectors, and businesses reported to be optimistic about economic activity in the next six months, restocking could be expected to commence. This factor, together with a degree of optimism as to the sustainability of the pick-up in activity (at least in the short-term), should see increased production in the current year.

Other indications of the pick-up in domestic expenditure have become apparent in the investment sectors of the economy over recent months. This has been particularly evident in residential construction, which has displayed rapid growth since the September quarter 1983. Imports of plant and machinery and transport equipment have also risen.

Imports have increased sharply in recent months in contrast to the declines which occurred in the first six months of the 1983/84 year. As a consequence of this, and a lower rate of increase in exports relative to imports, the overseas exchange transactions (OET) current account deficit has deteriorated from a level of \$698 million in the year to August 1983 to be \$992 million in the year to March 1984.

The moderate pick-up in domestic expenditure has seen the level of unemployment ease in recent months, with registered unemployed and assisted employment (excluding vacation workers) both recording significant falls in January and February. These reductions were an encouraging sign but there is some doubt whether this downward trend will continue into 1984/85, as the forecast growth in the economy appears insufficient to absorb fully the relatively large numbers of school leavers now entering the labour force.

Progress has continued to be made in reducing inflation, the annual rate of increase in the Consumer Price Index falling to 3.5 per cent in the March quarter. This reduction has been paralleled in other indices, producers' prices and construction costs also recording substantially reduced rates of increase. While the regulations controlling prices and wages have been instrumental in reducing inflation, the relatively firm monetary stance and weak domestic activity over 1982/83 and first half of 1983/84 also helped reduce cost pressures. With a reversal of these factors in recent months, and a modified regime of price regulation from 29 February 1984, inflation can be expected to increase somewhat from about the June quarter 1984. The extent to which this occurs, however, will depend on the growth in monetary/credit aggregates over 1984/85, the level of demand and the extent to which the general wage adjustment (limited to a maximum of \$8 per week, effective from 1 April 1984) feeds through into prices.

GOVERNMENT SECTOR

In the 1983 Budget, the Minister of Finance estimated a deficit before borrowing of \$3,169 million, or approximately 9.5 per cent of forecast nominal GDP, a 79 per cent increase on the deficit in the previous year. This stemmed from a budgeted 13.1 per cent increase in expenditure, mainly in debt servicing (up 36.9 per cent) and development of industry (up 28.1 per cent). In contrast only a small 2.4 per cent increase in revenue was budgeted for. The low growth in revenue largely reflected the full year effect of the substantial personal tax cuts implemented in October 1982, which were designed to obviate the need for a wage round or general wage adjustment. Because of a commitment to a policy of low inflation, the shortfall in revenue was not compensated for by an increase in indirect taxation, as such a move was seen as compromising the attainment of price stability, at least in the short-term.

In the event the deficit out-turn for 1983/84 was

$2,984 million, or 8.7 per cent of GDP. The lower deficit was primarily due to a higher indirect tax take, reflecting greater domestic activity and stronger growth in imports than originally anticipated, and slightly stronger growth in direct tax revenue than had been originally estimated.

MONETARY SECTOR

The large budget deficit has created problems for controlling the growth in monetary and credit aggregates. It has not been possible in the last nine months to offset completely the cash injections resulting from the deficit as was successfully achieved in the June quarter 1983 with the first Kiwi Savings Stock issue. A second issue of Kiwi Savings Stock offering reduced interest rates had insufficient appeal to attract a large volume of funds. A gross total of $252 million was raised compared with $1,405 million in the first issue. The budget deficit, amounting to $873 million in the September quarter 1983 and $1,235 million in the December quarter, injected reserves into the banking system. This has been compounded by redemptions of Kiwi Savings Stock I and II and Inflation Adjusted Savings Bonds, net redemptions being $499 million and $130 million in the Kiwi I and II issues respectively (up to 26 April 1984), and $147 million in Inflation Adjusted Savings Bonds (over the period 30 June 1983 to 26 April 1984).

The Government adopted, in September 1983, a tendering system to fund the deficit. One aim of this move was to encourage voluntary holdings of government stock as a means of reducing the second round of monetary effects through credit expansion. It also provides the Government with more flexibility and the scope for greater certainty in the domestic financing of its fiscal deficit.

Of the seven tenders held since its introduction on 8 September 1983 , only five had an impact in the 1983/84 fiscal year, the sixth, on 22 March 1984 being too late to have an effect in March. The first five tenders had limited success, with 62.3 per cent (or $1,060 million) of the $1,700 million sought being raised. A large number of rejections occurred because the interest yields in the bids were considered by the Government to be too high.

The reserve assets of the banking system have grown strongly in recent months. From a low of $1,536 million in June 1983, trading bank reserve assets reached $2,519 million in March 1984. The large increase in reserve assets has been translated into rapid growth in monetary aggregates in contrast to the contraction experienced in the June quarter 1983. In the September and December quarters, M1 grew by 8.1 per cent and 5.3 per cent respectively, while M3, the broader definition of money, grew by 4.9 per cent and 3.5 per cent respectively (in seasonally adjusted terms). In annual terms, these growth rates are well in excess of inflation, being 14.8 per cent and 12.4 per cent for M1 and M3 respectively in 1983. The March quarter 1984 has seen some slowdown in the growth rates of the main monetary aggregates compared with the rapid rates of growth in the previous six months but the quarterly figures were not finalised at the time this article was written.

The rapid growth in monetary aggregates has placed financial institutions in a position well able to meet increased demand by the private sector for credit, lending to deposit ratios for the trading banks falling from 81.5 per cent in June 1983 to 75.1 per cent in September 1983 (both seasonally adjusted). This had been aided by the weak growth in private sector credit that had prevailed from late 1982 to September 1983. Since then, however, private sector credit has grown rapidly, rising by a seasonally adjusted 8.8 per cent in the December quarter 1983, up 14.3 per cent on a year earlier, and being 16.2 per cent higher in February 1984 than one year earlier. Trends in the growth of the broad monetary aggregate, M3, and private sector credit, both in real terms can be seen from figure 2, which covers the period 1978 to 1983.

On a disaggregated basis, the two most significant contributions to the rapid growth in private sector credit have been from trading bank lending and finance company advances. In seasonally adjusted terms, trading bank lending grew by 3.8 per cent, −0.3 per cent 3.1 per cent, and 1.3 per cent in December, January, February and March respectively. Finance company advances grew by 3.5 per cent, 3.8 per cent, 2.3 per cent and 2.4 per cent in November, December, January, and February respectively. Some other financial institutions, particularly the Post Office Savings Bank, also recorded strong growth in lending over the same period, well above the credit guideline imposed in April 1983.

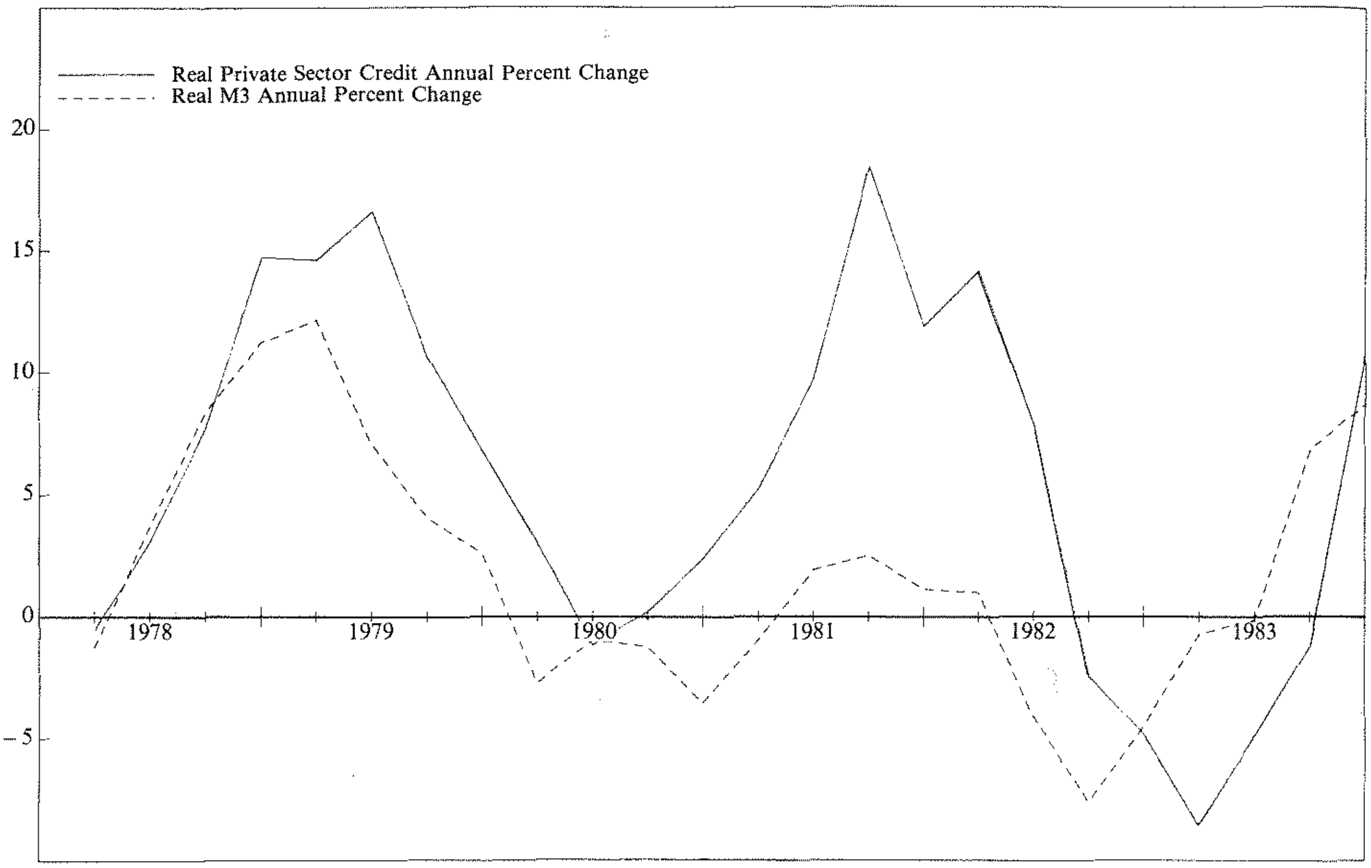
Because of concern about the growth in the monetary and credit aggregates the Government has taken a number of policy initiatives to reduce lending growth to no more than the 1 per cent per month and to penalise those financial institutions whose lending growth exceeds that guideline. On 16 December 1983 the Minister of Finance announced increased government security ratios applicable to finance companies and building societies. The finance company ratios were increased from 20 per cent to 25 per cent effective from 1 March 1984, while those of building societies were increased from 16 per cent to 19 per cent effective from 9 February 1984. Subsequently, on 27 January 1984, in response to continued excessive lending, the finance company government security ratios were increased to 30 per cent effective from 1 April 1984. On 7 May these institutions were made subject to a marginal ratio (to take effect from 1 June 1984) designed to further penalise excessive lending growth.

Similar measures were adopted with respect to the trading banks, the free reserves margin used in setting the reserve asset ratio being reduced from $100 million to $50 million effective from January 1984 to zero, effective from February 1984, and further reduced to −$50 million, effective from March 1984. This caused the trading banks to sustain a shortfall in reserve assets in March, therefore necessitating borrowing from the Reserve Bank. To further discourage lending growth the effective penal borrowing rate was increased by 3 percentage points. Trading bank lending fell back below the guideline in March and April so the free reserves margin was shifted back to plus $50 million for May.

In addition to these moves the Government announced changes to Inflation Adjusted Savings Bonds and the government stock tendering scheme. Inflation bonds were made more attractive by increasing the effective minimum yield and removing limitations on the maximum amount able to be held, while for the tendering scheme, inflation indexed stock was introduced as was the right to accept over-subscriptions up to 20 per cent within a given maturity.

Up until the beginning of the December quarter 1983 nominal interest rates (across the maturity band) had

FIGURE 2
ANNUAL PERCENTAGE CHANGE IN REAL PRIVATE SECTOR CREDIT AND M3



been falling, partly in response to increased liquidity and weak demand for credit, but also in response to overtures by the Government. Indicative of these reductions, the average one year secured debenture rate offered by finance companies in September 1983 was 10.5 per cent, compared with 15.5 per cent in June 1983. Falls of a similar magnitude were also recorded for commercial bills, transferable certificates of deposit (TCDs) and other deposit rates at various financial institutions, with lending rates falling, but on a lagged basis. This situation changed in the December quarter 1983, as the demand for credit increased and, as a result, interest rates on various securities (particularly commercial bills and large deposits) increased through competitive forces. Reflecting this trend, the weighted average TCD rate (6 months and under) rose from 10.2 per cent in mid December to 14.3 per cent in early February 1984.

Further attempts were made in February to persuade institutions to reduce rates with the result that interest rates eased across most maturities, with larger falls being recorded for large deposits, commercial bills and TCDs. (The TCD weighted average interest rate (6 months and under) fell to 10 per cent in late February 1984) and has remained at that level.

In November, reductions in mortgage loan interest rates were considered insufficient and regulations were invoked to achieve satisfactory reductions. Interest rates on new or reviewed mortgages were accordingly reduced to maximum rates of 11 per cent on first mortgages and 14 per cent on second and subsequent mortgages. As a result, interest rates on new mortgages have fallen sharply, although rates on existing mortgages have been slower to respond. In some cases, owing to the mandatory 11 per cent and 14 per cent maxima, financial institutions have been reluctant to reduce rates on existing mortgages, postponing reductions that might have occurred in the absence of the regulations.

INCOMES

In contrast to the fall in real personal disposable income in 1982/83, estimated by the Reserve Bank to have been 3.8 per cent, real incomes have displayed modest growth in 1983/84 as a whole but much stronger growth in the last six months. Overall, the Reserve Bank estimates a 1 per cent growth in real personal disposable income for the 1983/84 fiscal year. The New Zealand Institute of Economic Research (NZIER) estimates a similar low rate of growth, at 0.8 per cent.

Most of the growth in personal incomes has been concentrated in the non-salary/wage components, such as farm incomes and business and investment incomes. Farm incomes are estimated to grow 17.8 per cent over the year to March 1984, mainly reflecting increases in the value of gross output not matched by increases in expenditure, and also export volume growth. Business and investment incomes are estimated to have grown more slowly, averaging approximately 8 per cent over 1983/84, much of this occurring in the second half of the year. These growth rates in nominal terms imply moderate growth in real incomes, which, coupled with the full year effect of the 1982 personal tax reductions, should have resulted in some growth in real disposable income over 1983/84.

In contrast to the steady growth in most non-salary/wage components, gross salaries and wages have displayed very little growth during 1983/84, the Reserve Bank estimating growth of 1.8 per cent, mainly as a result of wage drift. This is confirmed by the

Department of Statistics' wage rate indices (covering rates within the jurisdiction of all authorities), which show no movement in award and prevailing wage rates since December 1982. The Department of Labour's average surveyed weekly earnings series (excluding overtime) reflects similar trends, having displayed virtually no growth in the six months to November 1983, and increasing only 2.2 per cent on year earlier levels.

After adjusting for the effects of inflation, gross salary and wage incomes have continued to fall, though at slower rates than earlier in the year due to lower quarterly rates of inflation. Therefore, whereas in the June quarter 1983 the effective prevailing wage rate index (adjusted for inflation) recorded an annual decline of 7.4 per cent, the December quarter was 3.6 per cent below the same quarter a year earlier. When taking into account taxation, as does the Department of Statistics real disposable income index, real after-tax salaries and wages fell by 1.1 per cent in the year to December 1983, compared with a positive annual rate of increase for each of the previous four quarters. These increases were primarily attributable to the substantial October 1982 personal income tax cuts.

Although, on average, salary and wage earners have sustained only minor reductions in real disposable income over the last year, this fails to identify the differential effects of the 1982 tax cuts on different income groups, with lower income earners experiencing significant reductions in real incomes since June 1982. To a large extent, however, the regressive nature of the 1982 tax cut was a deliberate effort to redress the disproportionate effects on upper middle income earners of fiscal drag in earlier years.

As the economy emerges from the wage/price freeze, and while economic activity continues to grow, real disposable income should display some limited growth. This is particularly so with respect to business and investment related income, which should derive more immediate benefit from increased domestic demand and higher export volumes and prices.

The introduction of price surveillance and relaxation of rent controls coupled with the expiry of the Limitation of Directors' Fees Regulations 1982 and the Companies (Limitations of Distributions) Regulations 1982 from 29 February 1984, will also contribute to some movement in business and investment incomes. Controls on wages and salaries, however, have been extended to 1 August 1984 with indications that these may be extended further into 1985, at which stage new wage fixing mechanisms should be put in place. As a transitional measure, the Government instituted a general wage adjustment up to a maximum of $8 per week, effective from 1 April 1984. Should this be the only wage adjustment over 1984/85 it could be expected that real disposable income for wage and salary earners will decline over the year despite the likelihood that increased domestic activity may boost overtime earnings, and lead to an increase in employment. Largely reflecting this, for the 1984/85 year as a whole, the Reserve Bank's econometric model forecasts growth of 1.2 per cent in real personal disposable income, similar to 1983/84.

CONSUMPTION

Reflecting liquidity trends and a halt to the decline in real disposable income, consumption expenditure grew moderately in the last six months of 1983/84, in sharp contrast to the previous twelve months. Retail trade has been relatively buoyant since September 1983, recording an average annual growth rate of 14 per cent over the September to February period, compared with annual growth averaging only 3.5 per cent in the six months to August 1983. In real seasonally adjusted terms, the September and December quarters 1983 grew strongly (at 2.3 per cent and 2.9 per cent respectively).

Much of this overall recovery in retail sales can be attributed to the automotive sector, reflecting the strong growth in new car sales evident since August 1983. Until August the twelve month running total of new car registrations had been declining steadily for 14 months to stand at 72,404. By March 1984 this annual total had recovered 77,965, a 7.7 per cent increase from the low-point. As well as the general factors that have stimulated an increase in consumption, new car sales were possibly assisted by the relaxation in September 1983 of hire purchase restrictions applicable to motor vehicle purchase agreements, and the reductions in nominal interest rates.

Other consumer durables, such as home appliances and furniture have also displayed strong growth in sales recently, again reflecting the effect of reduced nominal interest rates and greater availability of credit. Expectations of future price increases after the expiration of the prices freeze may have been a catalyst, along with the perception that when restocking commences higher prices will be passed on to the consumer. In response to the pick-up in retail trade, wholesale turnover also recovered, growing by a relatively strong annual rate of 10.5 per cent in the December quarter 1983 as compared to an annual rise of 2.1 per cent in the September quarter and annual declines recorded in each of the three previous quarters.

The recovery in consumption is also evident in the NZIERs December 1983 Quarterly Survey of Business Opinion, which indicates that a net 49 per cent of merchants (retailers and wholesalers) recorded an increase in orders in the December quarter, compared with only 3 per cent in the previous quarter. Similarly, a net 63 per cent experienced an increase in sales in the December quarter, as compared with a net 11 per cent in the September quarter. While not as optimistic about sales in the next six months as they were in the September survey, a significant majority of merchants felt confident of an increase in the volume of sales over the first six months of 1984.

PRODUCTION

Increases in consumption in the last few months have largely been met through reductions in stock levels rather than increased production. Destocking commenced in late 1982 in response to an earlier build-up in stocks and has continued throughout 1983 with the real value of retail, wholesale, manufacturing and primary stocks recording declines over most of the year. In the December quarter 1983 retail stocks were only 0.8 per cent above year earlier levels, while over the same period, wholesale stocks recorded a decline of 9.3 per cent. As a result, and in the face of increasing turnover, stock/trade ratios have fallen in both the retail and wholesale sectors. In seasonally adjusted terms, the retail stock/trade ratio has fallen 11.5 per cent over the year to December 1983, with the December quarter ratio of 0.424 being well below the 1979–1982 average of 0.487.

As a result of the downturn in demand that took effect from mid – 1982, and because much of the recent recovery in demand has been met through stock depletions, the volume of production in the manufacturing sector recorded annual declines in the four quarters from December 1982 to September 1983. This was reversed in the December quarter 1983, with the Quarterly Manufacturing Survey recording a 7.3 per cent annual increase in the volume of production, largely reflecting the 11.7 per cent increase in manufacturing sales over the same period. With stock levels now well below average, it could be expected that continued sales growth in the March and June quarters 1984 will be met by moderate growth in the volume of production.

Despite the turnaround in production, the number of hours worked in the manufacturing sector continued to fall in the December quarter 1983, being 2.8 per cent below the number worked in the same quarter of the previous year. This decline was less than those recorded in the four preceding quarters.

Destocking has also been evident in the agricultural sector in 1983/84, following the involuntary accumulation of primary product stocks over 1980 and 1981, a consequence of market access difficulties and unfavourable price developments. Over much of 1983/84, however, primary stocks have been reduced in response to stronger growth in export volumes and some improvement in export prices, particularly for beef and wool. Indicative of these developments, New Zealand Wool Board stocks fell from a peak of 424,000 bales in February 1982, to 161,000 bales in February 1984.

The value of agricultural production has picked up in the 1983/84 year, particularly in the wool and horticultural sub-sectors. Overall, total gross output from the agricultural sector is estimated by the NZIER to have grown by 9.5 per cent over 1983/84, comprising 1 per cent volume growth and an 8.5 per cent increase in prices, the latter reflecting stronger beef, wool and lamb prices. The outlook for 1984/85 is similar, with the NZIER forecasting 9.5 per cent growth in gross output, with volume growth contributing slightly more than in 1983/84.

INVESTMENT

For the 1983/84 year as a whole, gross fixed capital formation is estimated by the Reserve Bank's econometric model to have grown 4.1 per cent in real terms. Within this, real private fixed capital formation is estimated to have grown by 1.5 per cent, while real public fixed capital formation is estimated to have increased by 8.5 per cent, the latter mainly as a result of continued investment in major project construction. In the last six months of 1983/84, however, certain components of private fixed capital formation have displayed strong growth, countering the depressed conditions that prevailed in the first half of the year.

Of these, residential construction, accounting for approximately 28 per cent of private fixed capital formation, has displayed the most rapid growth. The value of residential building work put in place in the September quarter 1983 was 12.8 per cent higher than in the same quarter one year earlier. Since September, there have been indications that demand for residential building has continued to show significant growth. Over the six months to February 1984, the average number of building permits issued for houses and flats was 1,813 a month, an increase of 22.8 per cent on the monthly average for the previous six months. As a leading indicator, this would suggest that residential building work put in place should continue to increase through into 1984/85.

The large increase in residential construction can in general be attributed to an increased demand for housing, coupled with a greater availability of credit. An underlying factor has been the migration turnaround in 1983. Net permanent and long term migration for the calendar year 1983 resulted in an inflow of 8,285 in comparison to an outflow of 1,542 in the previous year. This reversal, coupled with another demographic trend, an increase in the number of persons entering the household formation age groups (the 'baby boom' generation of the 1950s and early 1960s) has placed pressure on the existing housing stock and therefore increased the demand for new housing. Reinforcing this has been the sharp decline in the rate of increase in housing construction costs relative to the increase in existing house prices, and the large number of home ownership savings account maturities. These factors, coupled with some growth in real income, reduced nominal interest rates, expectations of cost increases after the freeze, and rapid growth in private sector credit have led to increased demand for new housing. Whether this demand will continue to be manifest as strongly in 1984/85 will depend to a large extent on the ability of prospective home owners to acquire finance.

Other building activity has been less consistent and, although estimated to record some real growth in 1983/84 as a whole, has not been as strong as residential construction. Non-residential building work put in place in the September quarter 1983 fell 0.4 per cent on the same quarter a year earlier, compared with an annual rise of 8.2 per cent in the June quarter 1983. The leading indicators for this activity, the value of building permits issued (for 'other' buildings), recorded strong growth in mid – 1983, but slowed somewhat towards the end of 1983 suggesting that non-residential construction will grow at a slower pace in the 1984/85 year than has been the case in the second half of 1983/84.

Paralleling the growth in building construction has been a recovery in plant and machinery investment, the December quarter 1983 recording 9.7 per cent annual growth in wholesale machinery trade. This compares with zero growth in the September quarter, and contractions in the three previous quarters. The value of imports of machinery, electrical and transport equipment has recorded strong growth in the last six months of 1983/84, with transport equipment showing a distinct recovery from the depressed conditions in early to mid – 1983. For the three months ended February 1984, surveyed import orders for machinery and electrical equipment grew 72.2 per cent on the same period a year earlier, while for transport equipment a strong 160 per cent annual rise was recorded, the latter possibly reflecting to some extent the effects of transport deregulation. Plant and machinery investment can be expected to continue growing over the next six months in line with the relatively strong growth in surveyed import orders recorded over the latter part of 1983.

Countering the expected continuation in 1984/85 of recovery in private fixed capital formation, public sector investment is forecast to fall, mainly as a result of decreasing investment expenditure related to the major projects as a number of these are nearing the end of the construction phase. As a result, public fixed capital formation is forecast by the Reserve Bank model to decline 4 per cent in real terms in 1984/85, although the forecast growth in private fixed capital formation more than compensates for this.

LABOUR MARKET

The downturn in the domestic economy that began in mid – 1982 and lasted through to mid – 1983, resulted in a substantial rise in the numbers registered as unemployed, with a smaller rise for those on assisted employment schemes. In November 1982, registered unemployment represented 4.2 per cent of the estimated labour force, while by August 1983 it represented 5.8 per cent of the estimated labour force. The proportion who had been registered for thirteen weeks or more also recorded a large increase, rising from 33.5 per cent of registered unemployed in November 1982, to 40.9 per cent in August 1983.

Since the middle of 1983, however, the rate of increase in unemployment has slowed appreciably in response to the recovery in domestic demand, and seasonally adjusted declines have been recorded in January, February and March 1984. In March, the combined total of registered unemployment and assisted employment (excluding vacation workers) stood at 106,725, well down on the 112,866 in February, and 7.5 per cent below the number in September 1983. These recent declines in unemployment, and an increase in the estimated labour force, have seen registered unemployment as a percentage of the labour force fall in November 1983 to 5.3 per cent. These trends, put into a longer term context, are clearly evident in figure 3 which covers the years 1980 to 1983 inclusive.

The improvement in the labour market can be attributed to the pick-up in the domestic economy, particularly in relatively labour intensive sectors such as residential construction. This is confirmed by the NZIER December Quarterly Survey of Business Opinion, which indicates that for the economy as a whole a net 2 per cent of respondents reported an increase in the numbers employed by their business, compared with a net 15 per cent reporting a decrease in the September quarter 1983. Also reported in the December survey was an increase in the median utilised capacity variable, which at 88.6 per cent is the highest it has been since the June 1982 quarter, largely reflecting increased activity in the building sector. While further increases in production should lead to growth in employment it is unlikely that this will be sufficient to both absorb the growing workforce and lead to a significant reduction in unemployment.

EXTERNAL SECTOR

Unlike the first half of 1983/84, which saw a substantial improvement in the current account deficit (OET basis), from $1,845 million in the calendar year 1982 to a low of $698 million in the year to August 1983, the second half has seen a significant deterioration. In the year to March 1984 the current account deficit reached $992 million, having deteriorated fairly steadily since August 1983. On a balance of payments basis, the current account has exhibited a similar pattern, with a deficit of $1,428 million being recorded in the year to September, deteriorating to $1,821 million in the year to December. Figure 4 shows recent trends in the current account/GDP ratio as presented in the Reserve Bank's econometric model, clearly demonstrating the

FIGURE 3
UNEMPLOYMENT AS A PERCENTAGE OF LABOUR FORCE

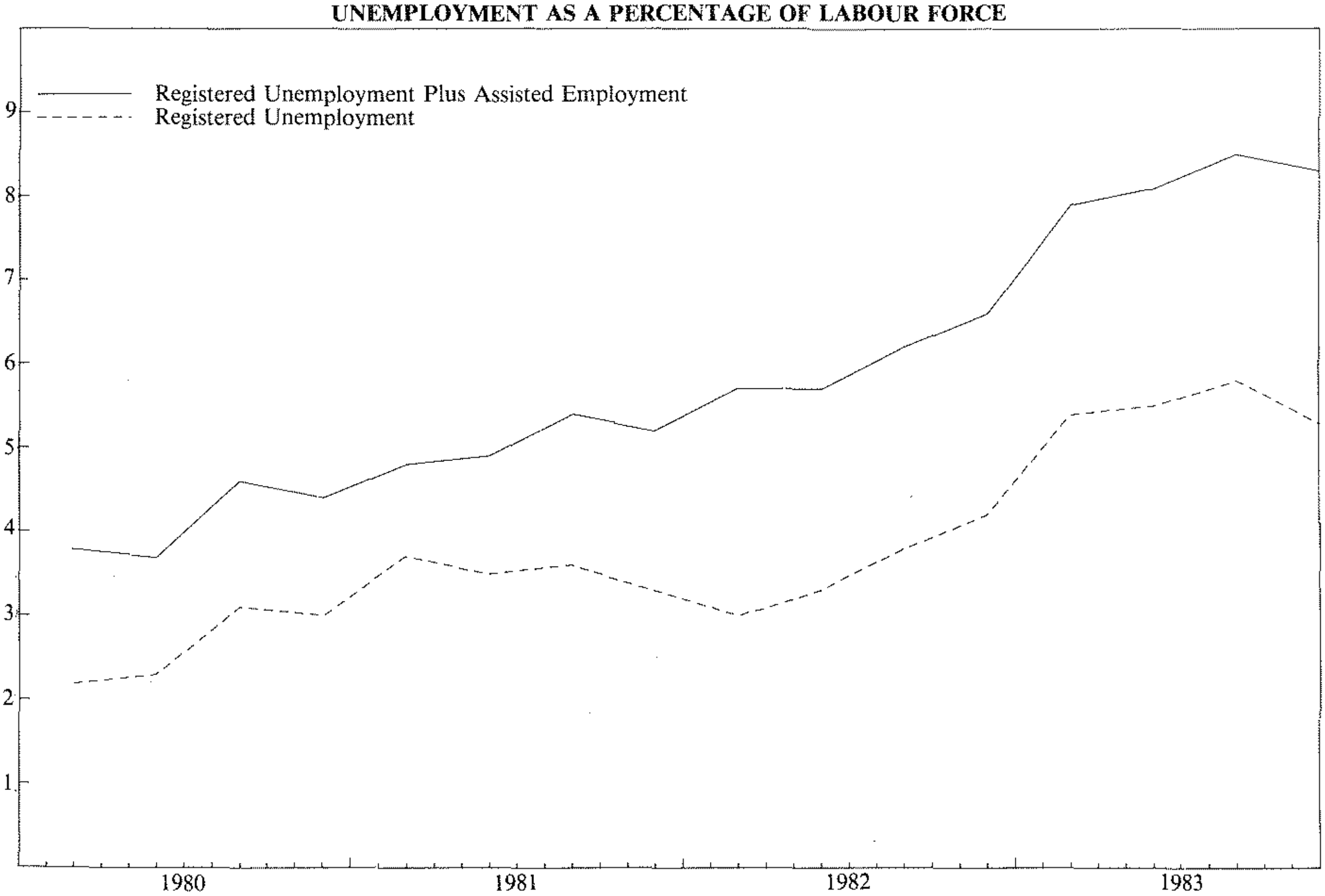
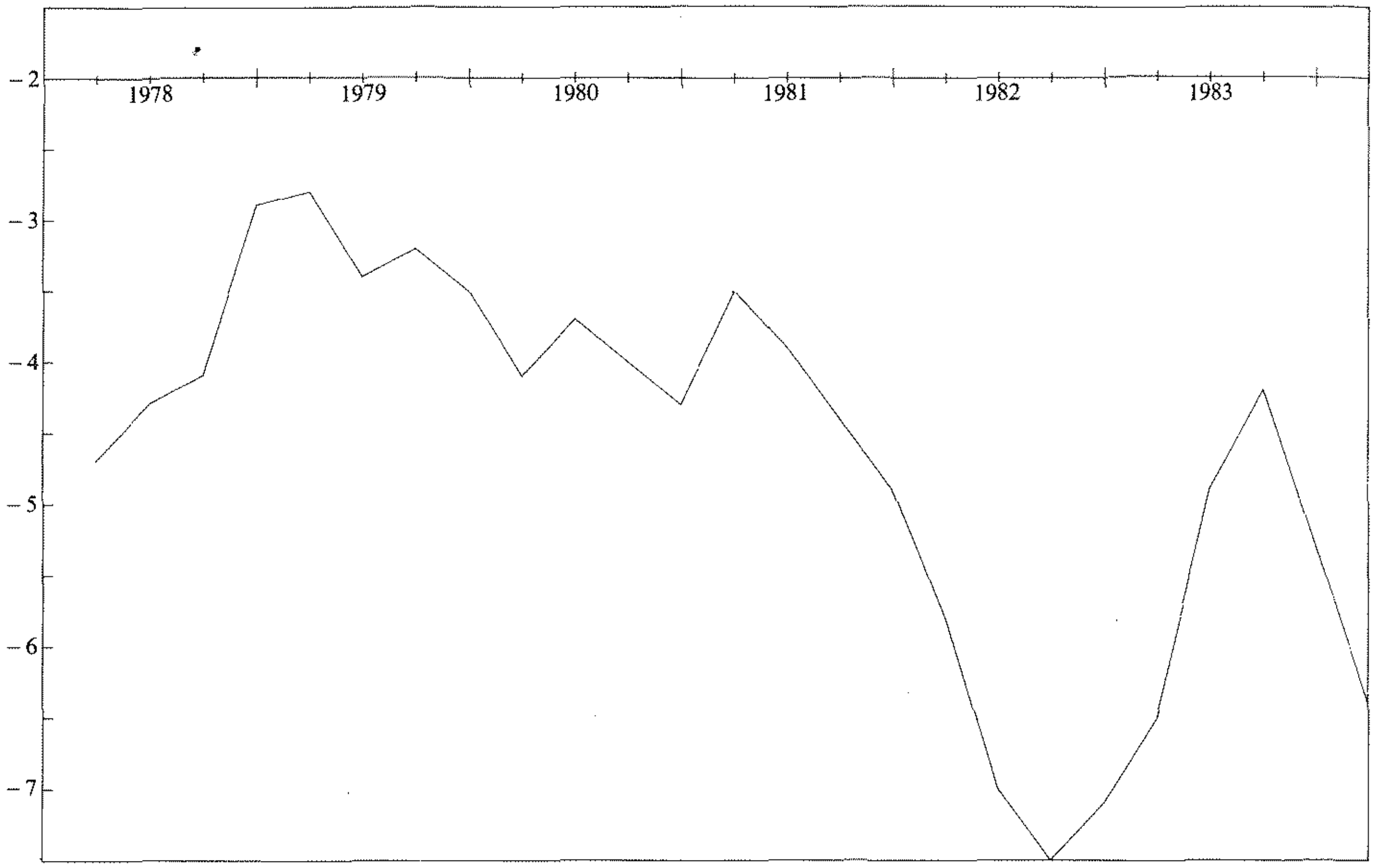


FIGURE 4
CURRENT ACCOUNT BALANCE (BOP) AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT



improvement over much of 1983, and its more recent deterioration.

The deterioration in the trade surplus reflects both a slowdown in the growth in exports, and a strong recovery in the demand for imports, reversing the weak demand that had prevailed earlier in 1983. Whereas exports (OET basis) had been showing annual growth averaging 17.6 per cent during the six months to August 1983, this slowed to an average of only 9.2 per cent in the six months ended March 1984. Imports displayed an even greater reversal in growth, having been declining at an annual rate averaging 10.9 per cent per month in the six months to August 1983, while growing at an average of 14.6 per cent per annum in the six months to March 1984, reflecting the recent pick-up in the domestic economy.

The apparent strength of the international recovery in North America, Japan and Australia notwithstanding, difficulties with access, large overseas stockpiles and relatively poor export prices have hindered the growth in many of the main export goods categories. This has been particularly so with dairy exports (whose growth has been limited by very large stockpiles in the European Community and the USA) and with sheep meat exports, (which have faced continued difficulties in terms of market access). Exports of forest products have grown slowly throughout much of 1983/84, although the extent of the international recovery triggered a substantial recovery towards the end of the year, which is likely to continue into 1984/85.

Much more rapid growth has been recorded in the exports of services, with invisibles receipts growing 19.8 per cent to $2,220 million in the year to March 1984. The major increase came from transport receipts, which increased by 33 per cent over the March year.

Invisibles payments also increased during the year, although not as rapidly as receipts, increasing 12.2 per cent to $4,472 million in the year to March 1984. As was the case in the previous year, the category of invisibles payments that grew most rapidly was debt servicing, reflecting increased overseas borrowing by the private sector and to a lesser extent by the public sector. Despite the recent more rapid growth of invisibles receipts than of payments, the invisibles deficit has deteriorated marginally, since August 1983, reaching $2,252 million in the year to March 1984.

Whereas in 1982/83 considerable official overseas borrowing was undertaken, amounting to $1,211 million, 1983/84 has seen a substantial reduction in official net capital inflows, to $442 million in the year to March 1984 assisted by the relatively strong, although declining, private net capital inflows, which, for the year to March 1984 amounted to $432 million. Although the private capital account recorded strong inflows in the first six months of 1983, averaging $136.5 million per month, these have tapered off recently, averaging $18.3 million per month in the nine months to February 1984. This reflects changed conditions in recent months, with lower nominal interest rates, greater availability of credit, and tax changes introduced in the 1983 Budget which resulted in the effective cost of overseas borrowing being increased. These changes, coupled with reduced major-project related borrowing, are likely to produce smaller private net capital inflow in 1984/85. The higher current account deficit in prospect, and reduced private capital inflow, will probably necessitate increased official borrowing.

The outlook for the international economy over the coming year looks reasonably positive, particularly in the USA and Australia. The Organisation for Economic Co-operation and Development (OECD) has forecast a relatively strong recovery in a number of its major member countries. The recovery should confer some benefits on New Zealand, particularly with respect to exports of manufactures and forestry products. However, continued problems with access to the European and North American markets, instability in Middle East markets, and the persistence of large overseas stockpiles of dairy products will limit the growth in traditional primary product exports. Overall, the Reserve Bank model forecasts volume growth in exports of 1.9 per cent in 1984/85, 6.4 per cent volume growth in imports, and a current account deficit of $1,703 million (OET basis).

PRICES

The last six months have seen further reductions in the rate of inflation, reinforcing the declines recorded over much of the period since the introduction, in June 1982, of various regulations controlling prices, interest rates, the exchange rate and various forms of remuneration. The Consumer Price Index recorded small increases of 0.9 per cent and 0.7 per cent in the December quarter 1983 and March quarter 1984 respectively, rising 3.6 per cent and 3.5 per cent in the years to December 1983 and March 1984 respectively, the latter being the smallest annual increase since the 2.4 per cent increase in the year to December 1966. The progress made in reducing inflation can be seen from figure 5 which details percentage movements since 1978, in the Consumer Price Index.

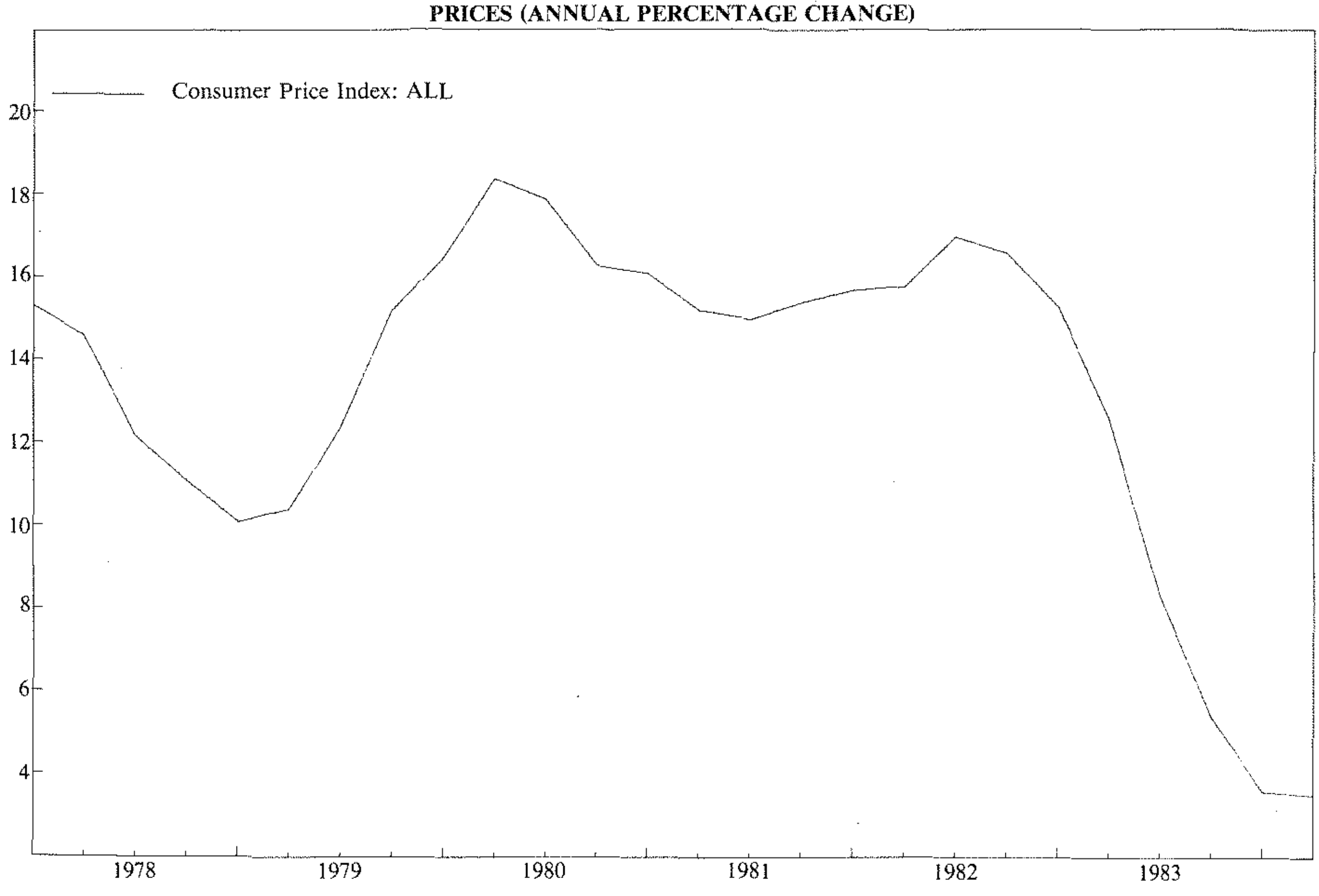
The reduction in inflation has been apparent in all the sub-groups comprising the Consumer Price Index, the Food component increasing 4 per cent in the year to March 1984, while the other main sub-group, housing, rose 6 per cent and 5.3 per cent respectively. Because of the lagged basis with which the housing cost components are incorporated into the Consumer Price Index, it is not a useful indicator of current movements in housing costs. Other, more current indices, however, such as the Institute of Valuers Modal House Cost Index tend to confirm the continued fall in house construction costs, the index rising only 4.5 per cent in the 1983 calendar year compared with 14.6 per cent in 1982.

The cost of existing housing has also been increasing less rapidly, with the Urban Property Price Index (Houses) recording an increase of 8.8 per cent in the calendar year 1983, compared with 22.9 per cent in the previous year. Although, for the 1983 year as a whole, the rate of increase in existing house prices is lower, the second six months recorded larger increases (5.9 per cent) than the first six months (2.7 per cent), in part reflecting the sensitivity of property prices to growth in monetary and credit aggregates.

Other cost indices confirm the continued decline in inflation, with the Producers Price Index rising by 3.1 per cent for inputs and 3.8 per cent for outputs in the 1983 calendar year, compared with 12.2 per cent and 11.4 per cent respectively in 1982. Similarly, the BIAC Building Cost Index, a broader measure of construction costs, increased by only 0.9 per cent in 1983, compared with 10.1 per cent in the previous year.

The considerable reductions in the rate of increase in costs and prices over the past year has probably resulted in some improvement in New Zealand's overseas

FIGURE 5
PRICES (ANNUAL PERCENTAGE CHANGE)



competitiveness, the CPI inflation rate (at 3.6 per cent for the calendar year 1983) being below the estimated OECD average of 5.5 per cent, and well below that prevailing in Australia.

The rate of inflation is likely to rise somewhat through 1984/85. The Reserve Bank model forecasts an increase to around 7 per cent (March quarter 1985 on the same quarter of the previous year) and the NZIER a little higher at 7.9 per cent over the same period. The extent to which the rate of inflation increases will depend on the growth in monetary and credit aggregates and the amount of price movement permitted as the full rigour of the price freeze is relaxed. The introduction of price surveillance and removal of controls on directors' fees and company distributions, effective from 1 March 1984, coupled with the relaxation of rent controls effective from 1 April 1984 will facilitate some adjustment in costs and prices that was largely precluded by the freeze regulations. There are indications, however, that the Government will closely monitor such adjustments, and may intervene should it perceive such increases to be excessive. This was evident in discussions on wage setting procedures which saw the extension of wage/salary controls to 1 August 1984 and a Government imposed general wage adjustment with a maximum of $8 per week effective from 1 April 1984.

Potentially more destabilising is the strong upward trend in monetary and credit aggregate growth in late 1983 and early 1984. If this was to continue the stimulatory potential could well spill over into higher rates of inflation. However, measures taken by the Government in recent months to discourage excessive credit growth would seem to indicate continued determination to prevent such an upsurge and there are some indications in the latest available statistics on money and credit that growth rates may be slowing down.

CONCLUSION

In many respects, the 1983/84 year was been a year of contrasts, with the first half continuing the relatively depressed conditions characteristic of 1982/83, while the last six months saw an upturn in economic activity. Although narrowly based at first, being largely concentrated in the residential construction and consumer durables sectors, more recently the pick-up in demand has widened, with some evidence of increasing production. The decline in real personal disposable income that had been a prime factor underlying the contraction in domestic demand in 1982/83 and first half of 1983/84, reversed in the second half of the year, having a stimulatory impact on domestic demand. This was reinforced by a turnaround in monetary and credit conditions, the firm monetary stance and slow growth in private sector credit of the first six months of 1983/84 being reversed in the second half. Reflecting these changed conditions, unemployment grew slowly in the second half of 1983/84, and actually fell in the last few months, in sharp contrast to the rapid growth in unemployment experienced earlier in the year. Also reflecting these changed conditions, the external current account deficit, which had been improving up to August, deteriorated significantly in the last six months of the year, as did net private capital inflows, the latter mainly in response to reduced domestic interest rates and greater availability of domestic credit.

Despite the recovery in economic activity over recent months, 1983/84 as a whole is estimated by the Reserve Bank to produce only a moderate 1.6 per cent growth in real GDP (because of the weakness experienced in the first half of the year). Prospects for 1984/85 are similar with growth in real GDP forecast by the Bank as likely to be in the region of 2 per cent — probably not enough to prevent some further increases in unemployment. This largely reflects the absence of strong growth potential in any major sector of the economy with slight to moderate recovery being spread over most sectors. Although the strength in the international recovery could be expected to generate an increase in New Zealand's exports, particularly manufactures and forest products, difficulties with access and large overseas stockpiles will continue to hinder growth in primary product exports.

For the longer term, although the major projects can be expected to make a useful contribution, the resumption of sustainable economic growth and the maintenance of an acceptable balance of payments position will be dependent on consolidating the gains from the much reduced rate of inflation recorded during the later stages of the wage/price freeze. In turn, success on this front will be dependent on achieving agreement on appropriate wage determination procedures, moderating the fiscal deficit, and restraining the growth of the monetary aggregates to rises considerably lower than those which prevailed in the second half of 1983/84.