ECONOMIC NOTES

33rd Government Stock Tender

Government Stock Tender No. 33 was held on 10 July 1986. A total of $500 million of stock was offered for sale in three maturities: $200 million maturing in November 1989 and September 1991 and $100 million maturing in October 1996. Valid bids received totalled $1,050 million, twice the amount on offer. This was down on the $1,317 million bids received in the 12 June tender (No. 32), which was identical in size and structure.

Weighted average yields on successful bids were 16.8 per cent for the 1989 stock, 16.6 per cent for the 1991 stock, and 16 per cent for the 1996 stock. The average yields were higher than the yields for the same stocks in the previous tender by 1.6 percentage points for the 1989 stock, 1.4 percentage points for the 1991 stock, and 1.2 percentage points for the 1996 stock.

34th Government Stock Tender

Government Stock Tender No. 34 was held on 7 August 1986. The tender size and structure was the same as for the previous two tenders. Valid bids received totalled $1,320 million, two and a half times the amount on offer.

Weighted average yields on successful bids were 17.1 per cent for the 1989 stock, 17 per cent for the 1991 stock and 16.4 per cent for the 1996 stock. The average yields for the 1989, 1991 and 1996 stocks were respectively around 0.4, 0.3 and 0.5 percentage points higher than the yields for the same stocks in the previous tender.

Treasury Bill Tenders and Open Market Operations

Liquidity conditions remained relatively stable over the review period (4 July — 4 August). System cash balances averaged $32 million over this period, slightly below the daily aiming level ($50 million). This reflected low settlement balances on a number of days in mid-July as a result of unexpectedly large liquidity drains from the system. The main factors responsible were early stock tender settlements and higher than expected revenue flows to Government. A large proportion of the total discounting recorded during the review period ($219 million) also occurred in mid-July. All of the securities discounted were close to maturity.

Primary liquidity, defined as settlement balances plus government securities with 30 days or less to maturity, ranged from $459 million to $700 million, with an average of $543 million. The absence of any government stock maturing in August (which would have entered PL in mid-July) contributed to the reduced average PL level compared with preceding months.

During the review period Treasury bill tenders 74 — 77 were held, and Treasury bills with a total value of $570 million were sold. Tender 75 accounted for almost half this total, while Tender 76, which coincided with large end-of-month tax flows to Government, was a nil tender. Some 65 per cent of total bills were sold out of PL (i.e. had maturities of greater than 30 days) with a large proportion having end-August and mid-September maturities. Some March 1987 Treasury bills were sold for the first time, but bidding for these indicated that the market's concern about liquidity flows was predominantly focused on the end-August and mid-September periods.

The Reserve Bank continued to conduct open market operations in order to stabilise the level of daily cash balances at around $50 million. This is achieved by selling government securities when cash balances are forecast to be above the desired level, and buying government securities or conducting sellbacks when forecast cash balances are lower than the aiming level. Over the review period all cash injections were achieved through sell-back operations. Most of the $531 million sell-back operations were conducted in late July to offset strong revenue flows to Government. As well, the Bank withdrew $260 million of cash over the period through open market operations involving the sale of Treasury bills. Of these operations, around $210 million involved short-dated bills which did not affect the level of PL but rather transferred the timing of cash injections to late July and late August in order to coincide with tax flow periods.

Stock Tender 32 settlements were completed on 7 July and totalled $113 million in the review period (only two settlement days). Stock Tender 33 was held on 10 July and the total value of cash settlements for the nominal value of $500 million stock tendered was $474 million. Settlements took place in the period 14 July to 4 August. In contrast to the settlement patterns for previous tenders, the majority of settlements for Tender 32 took place over the first half of the settlement period.

Treasury Bill Tenders & Open Market Operations

Treasury Bill Tenders:

Tender	Amount Offered $m	Term	Amount Sold $m	Weighted Average % Rate
74	50	14 days	50	15.625
	50	21 days	50	15.688
	50	49 days	50	15.695
	50	70 days	50	15.737
75	40	7 days	25	15.56
	40	14 days	55	15.601
	140	42 days	140	15.752
	50	231 days	50	15.725
76	Nil Tender			
77	20	21 days	20	15.970
	50	56 days	70	16.047
	30	224 days	10	16.590

Open Market Operations:

	Amount Offered $m	Term	Amount Sold $m	Amount Purchased $m	Amount Injected $m
4 July	30				
Sell-back		11 days	—	—	20
7 July	45				
Sell-Back		7 days	—	—	25
8 July	20				
Sell-Back		7 days	—	—	20
14 July	80				
Treasury Bills		15 days	7	—	—
Treasury Bills		17 days	—	—	—
15 July	130				
Treasury Bills		10 days	17	—	—
Treasury Bills		14 days	—	—	—
Treasury Bills		16 days	21	—	—
16 July	80				
Treasury Bills		9 days	35	—	—
Treasury Bills		13 days	32	—	—
Treasury Bills		15 days	13	—	—
17 July	70				
Sell-Backs		6 days	—	—	70
18 July	80				
Sell-Back		5 days	—	—	—
Sell-Back		17 days	—	—	85
22 July	25				
Sell-Back		13 days	—	—	25
23 July	70				
Sell-Back		13 days	—	—	63
24 July	45				
Sell-Back		11 days	—	—	28
25 July	175				
Sell-Back		12 days	—	—	57
Sell-Back		18 days	—	—	118
28 July	25				
Treasury Bills		59 days	25	—	—
1 August	110				
Treasury Bills		27 days	83	—	—
Treasury Bills		60 days	27	—	—
4 August	20				
Sell-Back		9 days	—	—	20

Reserve Bank Appointment Announced

The Reserve Bank announced on 24 July 1986, the appointment of Mr Peter Nicholl as an Assistant Governor.

Mr Nicholl has been largely involved in the economic activities of the Bank. He was initially involved primarily on monetary policy issues. He became Assistant Chief Economist in 1978, Deputy Chief Economist the following year, Chief Economist in 1982 and Economic Adviser in 1984. He returned in July 1986 from a year's secondment, through the IMF, as Director of Research to the Central Bank of Seychelles.

This appointment is the latest in a number which have restructured the Bank's organisation to cope with changes in its responsibilities. Among these has been the upgrading of the personnel function and the appointment of Mr A.C. Fenwick as the Chief Manager of a new Personnel Department which incorporates the previous Staff and Staff Payments Offices and has wider responsibilities for staff planning and advancement.

Public Debt Programme

"The decisions announced in the Budget to make provision for repayment of Think Big and other debts would have little effect on the domestic debt programme," the Governor of the Reserve Bank, Mr Spencer Russell said on 31 July 1986.

"Most of the $7.2 billion allowed for in the supplementary estimates will be financed by new foreign borrowings as the Government effectively takes over large project debts." Mr Russell noted that the total, national external debt would be unaltered by these actions. From this perspective, the changes were essentially of a bookkeeping nature. He added that the offshore refinancing would be well spread out in order to avoid any congestion in the Government's external borrowing programme.

In the case of the producer board debts, the overall effect could be to reduce somewhat the domestic borrowing programme. Mr Russell said that the recent agreement with the Dairy Board regarding sale of its $750 million subordinated loan for $150 million would reduce the current tender programme by $150 million. The consequent $600 million compensation by the Government to the Reserve Bank would have no liquidity effect and would therefore require no extra borrowing.

Mr Russell said that the Government was currently discussing with the Meat Board the repayment to the Reserve Bank of the bulk of the Meat Income Stabilisation Account debt. The outcome of these discussions would, at most, only involve a small injection or withdrawal of liquidity.

With respect to the main Budget estimates, Mr Russell pointed out that the Budget night deficit estimate of $2,452 million was very close to the $2,500 million estimate used as the basis of his most recent (27 June) statement on the debt programme. There would therefore be little effect on the borrowing requirement from that quarter.

"The overall effect of the Budget decisions and the payment of $150 million to the Reserve Bank by the Dairy Board would be to allow some reductions in the domestic borrowing programme. This would be taken into account when finalising the December quarter tender programme.'' Mr Russell said that the September quarter programme would not be altered from the previously announced $1,500 million.

Reserve Bank Econometric Model Forecasts

The Reserve Bank released on 8 August 1986 a new set of economic forecasts which update those released in November of last year, and incorporate the effects of the May Statement on Government Expenditure Reform and the 1986 Budget. The forecast period has been extended to cover the full 1987/88 year for the first time. It should be noted that the forecasts are prepared using the Bank's econometric model, which incorporates behavioural linkages established over a period when the policy environment was different in some important respects. Accordingly, the results must be interpreted with considerable caution.

Economic Activity

Economic activity as measured by the Reserve Bank's real Gross Domestic Product (GDP) series, is expected to fall by about 1.6 per cent in 1986/87 and then increase by 0.7 per cent in 1987/88. On a seasonally adjusted basis, the trough in economic activity is forecast to occur around the start of the 1987 calendar year with a gradual recovery emerging through the 1987/88 fiscal year.

All the components of domestic demand contribute to the downturn through 1986/87. Relevant factors include: falling real household disposable incomes over 1985/86 which have a lagged effect on real consumption expenditures; a decline in government capital formation as investment in the major energy projects tails off; and the effects of reduced profitability and firm financial policies on the demand for both consumer and investment goods.

Incomes and Consumption

Real private consumption expenditure is estimated to have increased by around 0.5 per cent in 1985/86 but is forecast to fall on average by 0.5 per cent in both 1986/87 and 1987/88. The fall predicted for 1986/87 is mainly due to an estimated 3.4 per cent contraction in real household disposable incomes in 1985/86; with the wage round taking effect late in the year, the full-year impact on wage and salary incomes was more than offset by the negative effects of inflation, fiscal drag, and, in particular, a steep decline in farm incomes. The bringing forward of expenditure in anticipation of GST should cause the forecast moderate decline in consumption to be concentrated in the second half of the 1986/87 fiscal year.

The full year effect of the 1985/86 wage round will imply strong nominal wage growth on average over 1986/87. Combined with the 1 October tax cuts and strong growth in transfers from Government, this is forecast to more than offset the effects of inflation and lower farm incomes on real disposable incomes, with the result that consumption expenditure should bottom out in early 1987. A gradual recovery in real consumption is expected to develop through 1987/88.

Investment

The outlook for investment is much the same as portrayed in our November forecasts. Gross fixed capital formation is forecast to fall in real terms by 10.7 per cent in 1986/87 and by a further 0.9 per cent in 1987/88.

Private investment is expected to decline in response to tight financial policies, reduced profits and lower output, although there are signs that commercial building activity will hold up through most of 1986. Housing investment has been falling since the March quarter in response to the high real interest rates and falling real disposable incomes through most of 1985/86. This decline should accelerate following the introduction of the GST. A modest recovery in other business and residential investment is expected by the end of the forecast period.

Balance of Payments

Import volumes are projected to fall by 3.5 per cent in 1986/87 before increasing by 3.2 per cent in 1987/88. These movements are roughly in line with the forecast movement in domestic demand, though they also reflect a shift from the construction to the production phase of the major energy projects, and import liberalisation measures.

Export volumes are anticipated to grow by 7.4 per cent in 1986/87 and by 3.6 per cent in 1987/88. The strong growth in 1986/87 is largely due to the effects of industrial action in the March quarter 1986 on the timing of meat shipments. The terms of trade are expected to remain fairly steady over the next two years.

The combined effect of declining import volumes, moderate export volume growth and a stable terms of trade, gives a fall in the balance of payments current account deficit to around $1,350 million, or some 2½ per cent of GDP, in both 1986/87 and 1987/88.

Prices

The annual change in the Consumers Price Index to March 1987 is forecast to be 15.2 per cent. The underlying rate of inflation at that time will be around 9 per cent with the GST making a one-off contribution of about 6 percentage points. Further reductions in inflation are predicted over the following year with the annual rate expected to slow to 6½ per cent by March 1988.

Employment

Employment numbers are expected to remain close to their current levels over the coming two years with perhaps a modest recovery in 1987/88 as activity picks up.

Government Accounts

The Budget Table 2 deficit in 1986/87 is predicted to be around $2,450 million or 4.9 per cent of GDP. This forecast is consistent with the Budget night announcement and incorporates the effects of the October 1986 tax changes and the Government's recent expenditure review. The 1986/87 deficit is up on the previous year because of the downturn in economic activity, the high public sector pay round and the timing effect of the tax package (income tax cuts applying from 1 October 1986 will immediately reduce revenues while there will be a lag between the collection of GST by traders and payment of the revenue to Government).

The budget deficit is forecast to fall to around $2,200 million in 1987/88 or around 4 per cent of GDP. The 1987/88 forecast incorporates the full impact of the expenditure review, the first full year's GST revenue and the increased debt servicing costs associated with the major projects.

SUMMARY OF FORECASTS
(annual percentage changes of annual totals or averages)

March Years	*1985*	*1986*	*Forecasts* *1987*	*Forecasts* *1988*
REAL EXPENDITURES ON GDP				
Consumption	4.2	0.4	−0.2	−0.4
Gross Fixed Capital Formation	−2.2	11.0	−10.7	−0.9
Final Domestic Expenditure	2.6	2.9	−2.8	−0.5
Stockbuilding[1]	3.0	−2.2	−2.5	0.9
Gross National Expenditure[2]	6.6	0.5	−5.2	0.5
Exports of Goods and Services	7.6	1.0	7.4	3.6
Imports of Goods and Services	12.7	−0.3	−3.5	3.2
Expenditure on GDP[3]	4.8P	1.0P	−1.6	0.7
PERSONAL INCOME				
Personal Income	12.3	15.5	14.1	7.7
Less Income Tax	7.2	28.4	10.3	2.1
Personal Disposable Income	14.0	11.5	15.4	9.6
Consumer Price Index (average)	8.7	15.2	12.6	9.8
Real Personal Disposable Income	5.2	−3.4	2.7	−0.4
GOVERNMENT BUDGET TRANSACTIONS				
Expenditure	7.5	15.3	15.9	10.4
Receipts	12.2	20.7	13.0	13.2
Balance Before Borrowing ($m.)	−2784	−1871	−2451	−2210
EXTERNAL SECTOR TRANSACTIONS				
Current Credits[4]	23.6	3.7	11.0	14.1
Current Debits[4]	34.1	3.5	−1.8	13.3
Current Account Balance ($m.)[5]	−2818	−2869	−1350	−1350
EXTERNAL TRADE PRICES				
Export Price Index	17.2	0.9	2.3	9.6
Import Price Index	19.0	3.7	1.7	9.8
Terms of Trade — % change	−1.5	−2.7	0.5	−0.1
PRICES				
Consumer Price Index[6]	13.4	12.9	15.2	6.6
EMPLOYMENT (full-time)[6]	3.5	0.7	−0.3	0.4

P Provisional
1 Percentage point contribution to growth in GDP
2 Includes a statistical discrepancy
3 Unofficial series. Differs from the Statistics Department's index of real GDP which measures increments in production
4 SNA basis
5 Balance of Payments basis
6 March quarter to March quarter

Notes
(1) These predictions are not adopted as official Reserve Bank forcasts by the Bank's Governors and Board. They are used extensively within the Bank however, to complement other available information.
(2) The above forecasts are based on a no policy change assumption — no allowance is made for possible government policy reactions to the developments portrayed.
(3) The forecasts contain a degree of judgmental input arising first from the necessary process of adopting one of several alternative structures for the econometric model of the New Zealand economy, and second from forecasters' assumptions with respect to projects of exogenous variables and technical adjustments.