SIX MONTHLY REVIEW

INTRODUCTION AND SUMMARY

Although there have been improvements in some areas of economic performance in New Zealand in the last six months, economic activity generally remains weak. One notable development has been the sizeable reduction in the overseas current account deficit. This has arisen primarily from a significant cutback in imports reflecting the depressed state of domestic demand and production. Certain positive developments that can be considered pre-conditions to an improved growth performance have nevertheless taken place: the rate of inflation has slowed, and recovery in the economies of some of our trading partners is now clearly established.

Real personal disposable incomes in the year to June 1983 (as measured by Reserve Bank statistics) have continued their downward movement, albeit less rapidly than during 1982/83 (March year). The wage and price controls have constrained personal incomes more completely than prices thereby offsetting the reduction in personal income taxation that arose from the October 1982 tax changes. Embodied within this overall trend has been a tax related improvement in the real disposable income position of the higher salary and wage groups, continued strong rates of increase in transfer payments from Government to households (associated with rising unemployment), a fall in farm incomes and a real decline in business and investment income. Reflecting the overall pattern in real incomes, real private consumption spending has contracted further.

Rates of growth of the main monetary aggregates, after slowing sharply in the second half of 1982, eased noticeably early in 1983 mainly in response to an improvement in the overseas current account position and a larger fiscal injection (attributable in part to reduced taxation receipts). Faced with this expansion in liquidity the Government reaffirmed its commitment to a policy of monetary restraint with the introduction of a new savings stock issue (labelled Kiwi Savings Stock) on 21 March 1983. The issue was very successful and was closed on 16 June 1983, having taken in gross subscriptions of over $1,400 million. As a consequence, monetary growth rates slowed in the June quarter 1983 but they picked up again in the September quarter 1983 in response to the underlying trends in the fiscal and external current accounts. M1 and M3 for the year ended September 1983 were estimated to be both up 11.6 per cent on levels a year earlier.

In further monetary policy steps, a second issue of savings stock was introduced on 5 September 1983 and a tendering scheme for government securities commenced on 8 September 1983. Overall the public debt sales programme is oriented towards containing any increase in money supply growth in the private sector as well as providing financial institutions with an attractive stock instrument thereby hopefully encouraging voluntary holding of stock and reducing the second round monetary effects of credit expansion.

Over recent months private sector credit has been increasing at progressively slower annual rates. This trend, that began in late 1982, has continued to the month of September 1983 with an estimated annual increase of only 1.7 per cent in private sector credit over the year. However, there are some current signs that stronger growth in private sector credit may be about to commence, which could contribute to monetary pressures in the economy.

Partly in response to income and monetary developments and also in part due to the lack of widespread confidence in the business sector (until recently), real private investment spending contracted at a faster pace over the year ended the June quarter than was the case for the first quarter of 1983. Despite a projected peaking in private and Government major project investment over the year ending March 1984, the present rate of decline in underlying private investment is such that total real capital formation in the year ended June 1983 is estimated to have grown at a small annual rate of about 3.5 per cent, well down on the much stronger rate of about 19 per cent a year earlier. Some recent leading indicators of residential construction and plant and machinery investment point to some pick-up in investment demand but this has not as yet materialised in investment expenditure.

Associated with the depressed level of economic activity has been a fall in capacity utilization as measured by the New Zealand Institute of Economic Research (NZIER), from a recent peak of 89.6 per cent in the June quarter 1982 to 84.7 per cent in the same quarter of 1983 (this subsequently recovered to 86.2 per cent in the September quarter 1983), and an accompanying increase in the percentage of the labour force registered as unemployed from 3.8 per cent to 5.8 per cent over the year to August 1983.

Depressed domestic demand has also contributed to the improvement in the external current account. The overseas exchange transactions (OET) current account deficit fell from $1,747 million for the September 1982 year to $778 million in the year to September 1983, moving from about 6 per cent of GDP to about 2.5 per cent. While the negative balance in the invisible account has remained relatively stable since January 1983, the trade surplus has improved substantially from a surplus of $206 million in the year ended September 1982 to a surplus of $1,368 million a year later. A strengthening in both prices and volumes of sales for major primary commodity exports, combined with a substantial reduction in import payments, produced this result.

Weak domestic demand (largely arising from the freeze), firm monetary conditions and reduced growth in import prices have combined to produce a significant slowdown in the rate of inflation. The Consumers' Price Index recorded low quarterly increases of 0.8, 1 and 0.8 per cent for the March, June and September quarters of 1983 respectively contributing to an annual increase of 5.4 per cent for the September quarter 1983, considerably lower than the 17 per cent peak a year earlier. By comparison, inflation in the OECD region averaged 4.9 per cent for the year ended August 1983.

CONSUMPTION

The rapid slowdown in sales activity in the retail trade sector over the latter half of 1982 did not continue in the first half of 1983. This was largely attributable to an easing in the rate of decline in real personal disposable incomes, although post-March devaluation induced buying (particularly of new cars) also played a part.

Retail sales (in seasonally adjusted real terms) fell over the September and December quarters of 1982 by 2.9 and 4.5 per cent respectively, whereas over the March quarter 1983 an increase of 3.8 per cent was recorded. The March quarter surge did not continue as retail sales recorded a real seasonally adjusted quarterly increase of only 0.2 per cent in the June quarter 1983, a rate of growth which is more consistent with the trend in real incomes. For the June 1983 year as a whole retail trade turnover increased by 4.2 per cent in nominal terms compared to a 20 per cent increase for the same period a year earlier.

Activity in the automotive, fuels and repairs subgroup had a strong influence on retail turnover in the latter part of 1982 and in the first quarter of 1983. For example, over the December quarter 1982 this sub-group contributed 2.6 percentage points to the quarterly rate of decline recorded for that quarter, while in the March quarter it contributed 1.7 percentage points to the increase. Excluding this sub-group, quarterly rates of increase for the December quarter 1982 and the March and June quarters 1983 were — 1.9, 2.1 and zero per cent respectively (in seasonally adjusted real terms).

More recent retail sales figures, for the years ended July and August 1983, were up only 3.5 and 3.2 per cent respectively on nominal levels a year earlier, confirming that the surge in retail sales in the March quarter was somewhat of an aberration in terms of trend.

Partly in response to the surge in new car sales in the month of March 1983 (10,132 cars registered) but also reflecting underlying demand conditions, new cars registered in the period April to August 1983 averaged a low 5,357; for the same period in 1982 the number was 7,677. The abolition of hire purchase regulations on 8 September 1983 can be expected to have some stimulatory impact on new car sales but preliminary comments by market participants suggest that the effect is not expected to be significant. However, there was a strong pick up in September 1983 with 7,103 new cars registered; but it is too early to say if this represents the start of a firm upward trend.

Hire purchase finance statistics also highlight the depressed state of consumer demand. Total goods bought on hire purchase in the year to June 1983 were valued at $823.9 million, a nominal increase of only 6.1 per cent over the previous year. Growth in hire purchase finance eased in the September and December quarters of 1982, recording annual increases of 18.1 and 15.5 per cent, but then dropped sharply recording an annual increase of only 0.6 per cent in the March 1983 quarter, and an annual decline of 7.1 per cent in the June 1983 quarter.

Further evidence of the contraction in consumption spending is to be found in the NZIER's June 1983 *Quarterly Survey of Business Opinion.*[1] A net 14 per cent of surveyed merchants (retailers and wholesalers) reported a decline in sales over the June quarter of 1983. Of the respondents, 90 per cent cited demand as the principal constraint. However, despite the depressed conditions a net 24 per cent of respondents expect an increase in their sales over the next six months.

In the manufacturing and wholesale sectors further declines in sales were recorded in the June quarter 1983. Manufacturing sales (excluding primary food) were 4.1 per cent lower than in the June quarter last year, similar to the 4.5 per cent annual decline recorded for the March quarter 1983. Similarly, wholesale turnover recorded annual declines in the March and June quarters of 1983 of 0.2 and 1.7 per cent respectively. The NZIER's June 1983 *Business Opinion Survey*[1] recorded that a net 20 per cent of respondents in the manufacturing sector reported declines in output, deliveries and orders in the June quarter 1983. While this was the fourth successive quarter in which an overall decline was reported, the contraction was less extensive than in the March quarter. Their expectations also imply that the worst is over as they now expect no change in the September quarter.

INVESTMENT

Investment spending in all categories, with the exception of major project related private and public capital formation, contracted further in the June quarter 1983 thereby reinforcing the trend that had developed over 1982/83.

Residential investment, as measured by the value of dwellings put in place, was 15.4 per cent down on a year ago in the March quarter 1983. Over the June quarter 1983, the number of dwellings completed (an alternative measure) was 11.3 per cent below the number completed in the June quarter 1982. Nevertheless, this was a slightly better performance than in the March 1983 quarter in which 29.2 per cent fewer dwellings were completed. An advance indicator, the number of dwelling permits issued, suggests that some improvement in residential construction is likely in the months to come. Estimates of the number of dwelling permits issued in August and September 1983 were 24.2 and 54.5 per cent higher than for the same months a year ago, which compares to annual declines of the order of 30 per cent in the latter half of 1982.

Declines in real incomes, shortages of mortgage finance and high nominal interest rates during the early part of 1983 were the main causes of depressed residential spending. Recent developments such as easing rates of decline in real incomes, less tight mortgage finance conditions, lower nominal interest rates, slower escalation in building costs and a migration net inflow of 8,671 in the year to September 1983 all support the view that a turnaround in dwelling permits issued signals a recovery in residential investment. An alternative and more cautious outlook has been adopted by the Building Industry Advisory Council (BIAC) who point to an anticipated tight Government rein on monetary aggregates and impending difficulties in the supply of building materials as being likely to prevent any upward trend gaining strength.

Construction for non-residential purposes has also contracted over 1982/83. The value of non-residential building work put in place in the March quarter 1983 registered a 4.7 per cent annual rate of decline, compared to the 29.7 per cent increase recorded for the March quarter 1982. A slump in the value of non-residential permits issued clearly emerged in January 1983 and continued through to June 1983 but with annual rates of increase of 6.5 and 2.4 per cent in permits issued for the three month periods ended July and August 1983 it appears that the slowdown may have bottomed out.

1 For details on the recently released September Quarterly *Survey of Business Opinion* refer to Appendix I.

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Indicators of plant and machinery investment, after weakening considerably over the second half of 1982, exhibit conflicting trends over the first half of 1983. A downturn in surveyed import orders for machinery and electrical equipment which began in January 1983 continued through to March 1983. Since that date orders have picked up and have grown strongly over the period to August 1983 — as indicated by orders for the three months ended August registering an increase of 44.4 per cent compared to the same period a year earlier. While this upturn has, to a lesser extent, also become evident in actual imports, it has not been reflected in wholesale trade turnover of machinery (which for the June quarter 1983 was 7.8 per cent lower than in the June quarter 1982). Although surveyed orders for transport equipment initially held up better, an even stronger contraction in annual terms emerged in November 1982 and was still evident in figures up to August 1983. This decline has also been reflected in actual imports of transport equipment.

A rapid and partly unanticipated build up in inventories in the manufacturing and distribution sectors in the latter half of 1982 resulted in a substantial increase in the ratio of stocks/trade turnover. Destocking has subsequently occurred and the ratios have now returned to more normal levels. For the retail sector the ratio in the June quarter 1983 was 0.45, down from 0.48 in the December quarter 1982, while for the wholesale sector the ratio has fallen from 0.70 to 0.59 over the same period. While destocking has also occurred in the manufacturing sector, a more rapid decline in sales resulted in a smaller net decrease between December 1982 and June 1983, from 0.79 to 0.77. In the June NZIER's *Business Opinion Survey*,[1] it was reported that although merchants were less dissatisfied than previously with their stock levels, they nevertheless expected a further decline in the September quarter. Merchants expected a recovery in their sales volume in the second half of 1983, but manufacturers on balance anticipated no upturn in orders received. The decrease in overall real stock levels during the June quarter of 1983 compares to a substantial increase last year, so that the contribution of inventory accumulation to growth in GDP will now be negative — this is a trend that is likely to persist over 1983/84.

GOVERNMENT SECTOR

The fiscal deficit for the 1983/84 financial year was budgeted at $3,169 million, about 9.5 per cent of GDP, considerably larger than the actual deficit for 1982/83 which was 5.5 per cent of GDP. Estimated expenditure for 1983/84, at $14,336 million, represents an annual increase of 13.1 per cent, while taxation and other receipts are forecast to be $11,167 million, an increase of only 2.4 per cent on last year. The small increase in, Government revenue is a result of the wage controls restraining influence on gross personal incomes coupled with the full year impact of the personal income tax scale reductions in October 1982, as well as the effect on indirect taxation of the current and anticipated depressed state of demand for import and consumer goods. On the expenditure side, capital formation is predicted to remain essentially constant in real terms while transfer payments to households and debt servicing costs are expected to rise in line with rising unemployment and growing public debt levels.

A comprehensive debt sales programme has been introduced over the period under review. A new issue of Kiwi Savings Stock in March was followed up by a second issue in September. A new tendering system for Government securities was also implemented in September. These developments, in part, recognise that the projected size of the deficit might jeopardise the Government's objectives of containing inflation unless it is financed in a relatively non-inflationary manner, i.e. as far as possible by debt sales to the domestic non-bank private sector.

INCOMES

Contributing strongly to the overall contraction in the domestic economy has been the path of real disposable incomes over 1982/83. The Department of Statistics series on real disposable incomes of full time *salary and wage earners* displays a pattern of falling levels in the March, June and September quarters of 1982 followed by a modest improvement in subsequent quarters. Figures released for the June quarter 1983 indicate that real disposable incomes rose by 1.9 per cent since the June quarter 1982. This movement was composed of a small 3.2 per cent increase in average gross income, an increase of 8.3 per cent in the Consumers' Price Index and a substantial reduced tax effect as indicated by the strong 7.4 per cent rise in the ratio of disposable to gross income index. The growth in the last component was attributable to the October 1982 tax changes and is the significant factor underlying the improvement.

The improvement has not been evenly spread across income groups. Up until and including the September quarter 1982 the upper income quintiles ($16,500 and above) had experienced slightly stronger rates of growth in their average gross incomes than had the lower income quintiles, but due to a substantial fiscal drag effect the higher income quintiles had experienced larger annual declines in real disposable incomes. In the more recent December, March and June quarters this has been reversed, and real disposable incomes have registered positive annual growth for the upper income quintiles; for the lower income quintiles growth rates are still negative. This development is solely attributable to a reduced taxation burden on middle and higher income quintiles, evidenced by strong annual increases of 7.3 and 15.2 per cent in the ratio of disposable to gross income index for the two top income quintiles in the June quarter 1983, compared to increases of only 0.5 and 1.8 per cent for the two bottom income quintiles over the same period.

The Reserve Bank's econometric model series, *household* real disposable incomes, captures trends not only in salary and wage incomes but also in farm incomes, self employed incomes and transfers from Government. Although this series displays a similar overall pattern to the Department of Statistics series, the outcome for June 1983 still points to depressed real income levels. For the year ended June 1983 real household disposable incomes were slightly beneath the level for the same period a year ago. So while some small improvement has taken place in the overall salary and wage component, aggregate real personal incomes are not growing and it is developments in this more comprehensive aggregate that drive domestic demand.

Other official wage statistics confirm the overall decline in real incomes. In the year ended June 1983 the

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average level of the award wage rate index (after adjustment for inflation but not tax) was 8 per cent lower than the average for the June 1982 year, compared with an increase of 1.6 per cent between the same periods a year earlier. The prevailing wage rate index has historically tended to increase slightly faster than the award index and this relationship has continued with slightly slower rates of decline in real terms than for the award wage rate index — the average level of the prevailing wage rate index (adjusted for inflation) was 7.9 per cent lower in the year ended June 1983 than in the previous year. In addition, the Labour Department's August 1983 Quarterly Employment Survey estimated that the average weekly wage (including overtime) in mid-August was $290, a nominal increase of only 2.6 per cent since August 1982. On the basis of the inflation rate for the year ended September 1983, this clearly represents an erosion of purchasing power over the year.

Corporate profits and farm incomes have also weakened. Non-farm operating surplus is estimated by the NZIER in its September 1983 Quarterly Predictions to have risen by only 6.5 per cent in nominal terms in the 1982/83 year and in their *Quarterly Survey of Business Opinion* for the June quarter 1983[1] a net 46 per cent of respondents reported a deterioration in profitability over that quarter. Respondents were slightly less pessimistic about profitability in the September quarter. An improvement is expected by the Institute as the year progresses as indicated by a forecast 14.5 per cent increase in non-farm operating surplus for 1983/84. In real terms this would represent a return to the level prevailing in 1981/82.

Agricultural operating surplus in nominal terms is estimated by the Institute to have increased by only 8 per cent in 1982/83. Underlying an acceleration in farm expenditure over and above the rate of growth in gross farm production was an SMP contribution of $410 million. Agricultural operating surplus is forecast to rise by a nominal 10.5 per cent in the 1983/84 year, a substantial revision from the 1 per cent nominal increase forecast in the March 1983 issue of the NZIER's *Quarterly Predictions*. This stronger growth is expected to result primarily from higher export prices to farmers, due to the combined effects of the March 1983 devaluation and stronger demand for beef and wool and also from expenditure on farm inputs rising at a slower rate than gross farm production over the year.

PRODUCTION

As measured by an index derived from the Department of Statistics' quarterly manufacturing survey, the volume of manufacturing production (excluding primary foods) in the June quarter 1983 was 9.1 per cent beneath that recorded in the same quarter a year earlier. This was the third quarter in a row that a strong annual rate of decline has been recorded. Sales of manufacturing goods (excluding primary goods) in the June quarter 1983 were down 4.1 per cent compared to sales in the same quarter a year earlier; for the March quarter 1983 the comparable rate of decline was 4.5 per cent. As sales activity slowed throughout the latter half of 1982 and early 1983, there was also a downward adjustment in the rates of increase in inventory levels as indicated by the small annual increase of 0.3 per cent in inventories over the year ended the June quarter 1983. This deceleration was nevertheless not fast enough to prevent an increase in the ratio of stocks of finished goods to sales throughout 1982/83. By the March quarter 1983 the ratio had risen to an historically high 41.5 per cent. In the June quarter 1983 it dropped to 36.4 per cent, probably still above what would be considered a normal ratio. Faced with this set of developments there has been no stimulus to manufacturers to increase production.

As the growth in production in surveyed industries slowed, so too has the growth in the number of hours worked. Beginning in the September quarter of 1982 the number of hours worked has not only fallen in annual percentage change terms but has done so at an accelerating rate. In the June quarter 1983 hours worked were 8 per cent beneath that recorded in the June quarter 1982. Capacity utilisation in the manufacturing sector, as measured by the NZIER in their *Business Opinion Survey*,[1] remained low in the June quarter of 1983. For the third successive quarter 70 per cent of respondents reported spare capacity of 11 per cent and over.

THE LABOUR MARKET

While the growth in output recorded in 1981/82 did not lead to a reduction in unemployment, the decline in economic activity more recently has affected jobs across the board. Based on the Department of Labour's employment survey in August 1983, total employment at just under 1.099 million was 1.3 per cent down on numbers employed in August of last year. Over the same period registered unemployment plus those on special work increased from 81,898 to 115,192. The latter figure represents 8.5 per cent of the estimated total labour force at the end of August 1983, compared to 6.1 per cent a year earlier.

By the end of September 1983 there were 76,963 persons registered as unemployed of whom 43 per cent had been registered for more than 13 weeks (up from 32 per cent a year earlier) and 71 per cent were receiving unemployment benefits (up from 66 per cent a year earlier). In addition to those registered in September 1983 there were 38,468 people employed under either public (22,748) or private sector (15,720) job creation schemes. Overall the total of registered unemployment plus assisted employment reached 115,431 in September 1983.

In seasonally adjusted terms total registered unemployment plus assisted employment has recorded a monthly increase of 1.3 per cent in September 1983 up from the small monthly increases of the previous three months. This supports the view that with conditions of under-utilised capacity any pick-up in domestic demand and hence supply is likely to be met by increased hours worked and an increase in labour productivity rather than a substantial increase in employment, at least in the initial stages of recovery.

MONETARY CONDITIONS

A marked slowing in the growth rates in the main monetary aggregates was experienced in the June

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quarter 1983. In seasonally adjusted terms M1 increased over the December quarter 1982 and the March quarter 1983 at respective quarterly rates of 2.7 and 4.4 per cent whereas over the June quarter a decline of 3.9 per cent was recorded. A similar pattern occurred with the broader monetary aggregate M3 where the quarterly rates of change for the December quarter 1982 and the March and June quarters 1983 were 4.1 per cent, 4.6 per cent and −1.4 per cent respectively. Latest statistics available, however, indicate a return to rates of monetary growth closer to those experienced earlier in the year. Estimates for the September quarter 1983 indicate that both M1 and M3 increased at an annual rate of 11.6 per cent. By comparison annual rates of change for the March and June quarters 1983 for M3 were 11.8 and 8.2 per cent respectively.

The underlying factors responsible for the pick-up in monetary growth in the last quarter of 1982 have continued to exert a positive influence over 1983 to date. The large fiscal deficit remains the major source of funds flowing into the financial system. In addition, the period under review has seen a substantial improvement in the current account position and strong growth in the net private capital inflow (although this latter growth has eased off during the September quarter). The resulting expansion in the reserve base in the March quarter 1983 led the Government to take certain measures in March to restrain reserve growth to a level more consistent with its policy of achieving a permanent reduction in the inflation rate. Most important of these was the introduction of a new debt instrument, Kiwi Savings Stock, aimed primarily at the retail market. The terms of Kiwi Savings Stock were very attractive, as the instrument was both highly liquid, redeemable on seven days' notice, and offered an interest rate of 15 per cent per annum, reduced to 13 per cent for stock redeemed within twelve months. The response from the market was very favourable and when subscriptions closed on 16 June 1983, over $1,400 million had been issued. A steady stream of redemptions has subsequently reduced this to a net figure of $950 million as at 30 September 1983. Additional measures taken at the same time were a new advertising campaign for Inflation Adjusted Savings Bonds, an increase in the yields offered on Treasury bills and Government securities and an increase in the Government security ratio applying to finance companies.

The withdrawal of funds from the banking system through the Kiwi Savings Stock issue was the major contributing factor in the fall in average reserve assets from $2,546 million in March 1983 to a June level of $1,536 million. With the removal of Kiwi Savings Stock from the market reserve assets have resumed their earlier upward trend, with the average level climbing to $2,025 million in August before levelling off in September. Similarly, deposit growth has also resumed. Trading bank deposits are estimated to have risen by a seasonally adjusted 5.4 per cent in the September quarter, compared with a 6.3 per cent fall in the June quarter. Other financial institutions have exhibited similar, although less marked, deposit swings.

Throughout this period, demand for credit in the economy has generally remained weak. This is reflected in the annual growth rate of private sector credit which has fallen steadily from 14.1 per cent in September 1982 to 1.7 per cent for the year ended September 1983.

As an additional measure to restrain monetary growth the Government has indicated to the major financial institutions that increases in their private sector lending should not exceed 1 per cent a month after seasonal factors are taken into account. However, the lending growth of most institutional groups has generally been well below this level since the guideline was introduced in April, with the largest institutional group, trading banks, showing negative monthly lending growth rates in July and August. The monthly growth rate was positive again in September, and was much stronger in October.

The combination of growth in liquidity, low demand for loans (until recently) and the rapid fall in the rate of inflation has led to downward pressures on interest rate levels throughout much of the year to date. The introduction of Kiwi Savings Stock in March led to a temporary departure from this trend as the reserve base tightened considerably. Once the first issue of savings stocks was withdrawn however, the pressures for downward movement in rates returned. This process was accelerated in late July when the Government announced that it expected to see interest rates fall across-the-board to a level more in line with the current low rate of inflation. Yields on Treasury bills were immediately reduced by around 4 percentage points, and two of the major Government owned lending institutions, the Post Office Savings Bank and the Housing Corporation, announced cuts in their lending rates. Subsequently most financial institutions have reduced their new deposit rates by between 3 to 5 percentage points. By way of example, the weighted average of rates on trading banks' transferable certificates of deposit (six months and under) stood at 14.2 per cent in mid-July, prior to the Government's announcement, but by the end of September had fallen to 8.4 per cent. Reductions announced in new lending rates were initially somewhat lower at between 2 to 3 per cent. However, most institutions indicated that further cuts in lending rates will be made as the impact of the new lower deposit rates is felt on their average cost of funds.

In September the Government moved to a new method of selling ordinary Government stock, by tender rather than on a tap basis as had previously been the case. The main aim of this move is to encourage voluntary holding of stock as a means of reducing the second round of monetary effects through credit expansion. An additional aim of this change was to provide the Government with more flexibility and greater certainty in the domestic financing of its fiscal deficit. It is envisaged that tenders will be held at frequent intervals (say, every five or six weeks) with the amount in each case to be determined on the basis of monetary policy, financing needs and prevailing liquidity conditions. The yield at which the stock is sold will be determined by the market. The first tender was held on 13 September 1983, with $100 million of stock sold at weighted average rates of 8.7 and 9 per cent for stock maturing in 1985 and 1987 respectively. On 13 October a second tender was held selling $195 million Government stock across a maturity band (1986 to 1989) at weighted average yields ranging from 9.5 to 10.6 per cent.

As a further measure aimed at keeping monetary conditions firm, a second issue of Kiwi Savings Stock was opened on 5 September 1983, thereby maintaining a Government presence in the retail market. The yield was pitched more in line with other current market rates, at 10 per cent, reducible to 8.5 per cent if redeemed within a year. Although not expected to have the same dramatic impact on the market as the first issue, Kiwi Stock II has still proved to be an attractive investment with applications totalling $116 million by 18 October 1983. It is hoped that the continued presence of a competitive retail instrument coupled with the additional flexibility provided by the tender system will help the Government to maintain reasonably firm monetary conditions over forthcoming months.

PRICES

Over the last six months the main thrust of Government economic policy has continued to be to reduce the rate of inflation. On 23 May 1983 the freeze on prices, interest rates, wages, rents, dividends and other forms of remuneration was extended to 29 February 1984. Furthermore, the 1983 Budget stated that it was the Government's intention to maintain an anti— inflationary monetary policy, despite the large fiscal deficit, thus implying an active role for public debt policy. These measures, underpinned by depressed economic activity, and reduced price pressures in our major trading partners' economies, have led to a substantial fall in the annual rate of inflation.

Small quarterly increases in the Consumers' Price Index (CPI) of 1 and 0.8 per cent were recorded in the June and September quarters of 1983 respectively, resulting in an inflation rate for the year ended September 1983 of only 5.4 per cent. This is the smallest annual increase since the 4.8 per cent recorded in the year to March 1970.

The food and housing subgroups were the largest contributors to the 0.8 per cent increase in the CPI over the September quarter 1983, contributing 36.3 and 26.3 per cent respectively. The housing sub-group has dominated increases in the CPI over the last two years, with its contribution (to the quarterly rate) increasing from around 20 per cent in early 1981 to a peak of 51.1 per cent in the March quarter 1983. Quarterly rates of increase in this sub-group have eased considerably from the strong rates of last year. Over the September quarter 1983 an increase of 1 per cent was recorded compared to a strong quarterly increase of 6 per cent for the December quarter 1982.

Confirming this slowdown is the Institute of Valuers Modal House Cost Index which has recorded a steadily falling annual rate of increase since June 1982, and for the month of July 1983 was only 6 per cent higher than a year earlier, the lowest annual increase since December 1970. In the month of August there was a slight pick-up in the rate of price increase but the annual rate of change was still a low 6.7 per cent. Similarly the BIAC Building Cost Index (which measures cost escalation in all buildings) increased by only 0.4 per cent between the March and June quarters 1983, thereby contributing to a small annual increase of 3.3 per cent. With the more rapid slowdown in these associated series, coupled with what appears to be a long recording lag of house price movements in the housing sub-group of the CPI, a further easing in this group's contribution to inflation can be expected over the next few quarters.

Although the annual increase in the Food Price Index for the month of September 1983 was still a very low 3.4 per cent, recent monthly change information indicates that no further easing in the annual rate is likely. In the months of August and September food prices rose at a monthly rate of 1 and 0.9 per cent respectively, which compares to an average monthly increase over the previous six months of 0.3 per cent. The upward movement over these recent months was attributable almost entirely to price movements in the sub-groups meat and fresh fruits and vegetables, much of which, being sold by auction, is not subject to the freeze.

The deceleration taking place in all of the sub-groups of the CPI with the exception of the food group indicates that a further lowering in the annual rate of inflation is likely over the next one or two quarters. Current developments in the monetary sector, domestic demand and in the labour market as well as a further lowering in inflation in our major trading partners' economies should assist this slowdown. Import prices are provisionally estimated to have risen by 4.2 per cent between the March and June quarters 1983 but by only 9.4 per cent between the June quarters 1982 and 1983, which represents the smallest annual increase, after the 9 per cent increase in the year ended December 1982, since June 1979.

THE EXTERNAL SECTOR

The deterioration that was occurring in the OET current account balance up to December 1982 has been reversed during 1983. Rapid improvement led to a deficit of $778 million in the year to September 1983, compared with $1,748 million a year earlier (overseas exchange transactions basis). This reduction largely reflected the substantial improvement in the trade surplus which has been occurring since mid – 1982. From a surplus of $206 million in the year to September 1982 the account moved to a surplus of $1,368 million in the year to September 1983. Over this period, as a result of a strengthening in both prices and volumes of sales for major primary commodities (in part due to reduction of New Zealand's stockpiles) export receipts increased by 12.8 per cent. At the same time, the lack of demand domestically was reflected in reduced payments for imports (with an annual decline in the year to September 1983 of 4.7 per cent). Meanwhile the invisible deficit since January has remained relatively stable, and for the year ended September 1983 stood at $2,146 million.

The growth in export receipts recorded over the year to September 1983 was concentrated in the second half of that year as the annual rates of growth increased to almost 13 per cent compared with an average 5 per cent rate of growth which prevailed over the first half of the year. The improved export receipt performance occurred in the traditional export commodities of meat, wool and dairy products and there was continued growth in manufactured exports.

For the year ended September 1983 meat receipts increased at an annual rate of 20 per cent. This was due largely to much higher returns from beef exports which reflects an export volume increase of the order of 20 per cent combined with a favourable exchange rate effect. (Most beef is exported to the United States and over the year to September 1983 the New Zealand dollar has depreciated 8.4 per cent against the U.S. dollar.) Market conditions for both lamb and mutton exports were depressed throughout the year and there is little sign of any immediate improvement. Wool receipts were up 14 per cent and dairy receipts, boosted considerably by exports of casein and milk powder, increased by 12 per cent. While this latter increase represents a marked improvement from the performance in the year to March 1983, the international supply/demand situation is such that the industry is currently experiencing and is likely to continue to experience difficult trading conditions.

An 11 per cent increase in export receipts for manufactured goods was largely attributable to higher metal receipts (associated with the expanded output from the Tiwai aluminium smelter), strong growth in processed foodstuff receipts, and abnormally high transport equipment receipts (associated with the one-off sale of DC10 aircraft). The 'other' animal product and primary product categories displayed growth rates of 14 per cent and 16 per cent respectively, while the only major category to display a decline over the August year was forestry products. The decline, 4 per cent, would have been even greater had not the sharply reduced export volume and static nominal prices been partly offset by an appreciating U.S. dollar.

The weakness in domestic demand and associated depressed production levels coupled with a period of above normal stocks/sales ratios has led to a rapid contraction in the demand for imported goods. Monthly figures for August 1983 represented the sixth consecutive month in which import payments were substantially down on corresponding monthly levels a year earlier. Over the year to August 1983 import payments declined by 6.2 per cent, which compares to a strong increase of 19.6 per cent for the year ended August 1982. The adjustment has clearly been in import volumes because although the rate of increase in import prices has eased they are still provisionally estimated to have grown by 9.4 per cent over the year ended June 1983. Monthly import payments figures for September 1983 showed a strong increase of 14.2 per cent over that recorded in the same month in 1982, indicating that the rapid contraction in import demand may have run its course.

The deficit on invisibles widened slightly from $1,953 million in the year to September 1982 to $2,146 million in the year to September 1983 despite invisible receipts rising faster than invisible payments over this period. Invisible receipts rose 22.5 per cent to $2,075 million in the September 1983 year, while invisible payments rose by 15.7 per cent to $4,221 million over the same period. Over the year invisible receipts have accelerated mainly due to an increase in the New Zealand expenses of overseas firms (reflecting the involvement of foreign companies in the major projects and other overseas loan raising) and an increase in transport receipts which together have offset slower rates of increase in both travel earnings (the impact of the international recession and the real appreciation of the New Zealand dollar) and in interest and investment income. Invisible payments on the other hand were constrained by the fall in both emigrant transfers (in part due to the migration turnaround) and overseas expenses of New Zealand firms over the year.

In the year ended September 1983 a net capital inflow of $1,281 million was recorded, $664 million lower than in the previous year. The distinguishing feature was the reversal of the usual pattern of capital flows — the net official capital inflow was only $163 million compared with $1,486 million for the previous year, but the net private capital inflow was $1,130 million, an increase of about $600 million. The substantial private capital inflow, together with the reduced current account deficit, provided room for reduced net Government borrowing (some large Government debt repayments were made in the last half of the year) and for an increase in overseas reserves to $1,320 million from $759 million a year earlier. The substantial increase in private overseas borrowing was primarily the result of the financing demands of the major projects and the Meat Board, firm monetary conditions in New Zealand over the year as a whole, falling interest rates overseas, and expectations that the New Zealand exchange rate would not move much on average in the short-term. It should be noted that in the months of August and September 1983 there were private capital outflows of $63 million and $44 million respectively — the first monthly outflows recorded since October 1981 — suggesting that the rapid expansion in this aggregate over the last year may have run its course.

In the short-term, improvement in New Zealand's external position seems largely dependent upon a recovery in the international economy. The OECD recently forecast that positive GDP growth in the majority of OECD countries will average 2 per cent during 1983, an insufficient increase to provide any strong stimulus to the New Zealand economy.

While the timing and size of the upturn is expected to vary across countries the recovery is presently being led by the United States. Indicators of the United States economy over the first three quarters of 1983 exhibited a much stronger recovery than was generally forecast. Future developments in the monetary/fiscal policy mix in the U.S. are at this stage a little uncertain, and developments here are likely to be crucial in determining the sustainability of the present expansion. In the other main OECD countries recovery is expected to be somewhat slower than in the U.S. Activity has picked up in Japan but it remains weak by past Japanese standards and Europe remains an area of particular uncertainty with only modest growth in the range of 1 to 2 per cent expected over the next year. The Australian economy is expected to remain sluggish over the remainder of 1983/84 but to turn around sharply later in 1984 as the slowdown in the rate of decline of non-farm stocks and the expected recovery in farm output and exports is translated into a rapid recovery.

Bearing in mind the uncertainty which still surrounds the sustainability of the international recovery underway, some export volume growth is expected over the 1983/84 financial year. Reserve Bank estimates point to volume growth in New Zealand exports of the order of 4 per cent over this period. A slow improvement in the terms of trade is also expected while import volumes are predicted to decline by about 6 per cent over the year to March 1984, largely in response to weak internal demand.

CONCLUSION

Real economic activity in the New Zealand economy declined in 1982/83 and is expected to remain flat in 1983/84. The lack of a broadly based international recovery through most of this period meant that the domestically generated expansion of 1981/82 was not sustainable.

The downturn has resulted from a combination of a marked tightening in monetary conditions in the middle of 1983 and the impact of wage controls on personal incomes. While the rate of increase in prices fell, the lack of demand both on the domestic and external fronts had adverse effects on consumption, investment (excluding the major project component) and employment opportunities. In the first half of 1983 real economic activity has remained depressed and even though some improvement has occurred in external demand this has been met by destocking rather than through increased production. The rapid and partly unanticipated contraction in domestic demand during 1982/83 led to an involuntary build up in manufacturing and distribution stocks. Over recent months manufacturers and merchants have run down stocks and stocks/sales ratios are now returning to more normal levels, indicating that should domestic demand improve this may provide some stimulus to production. Although the anticipated growth in real cash balances would support some expansion in domestic demand there is unlikely to be any sustained improvement unless confidence becomes more widespread in the economy.

If a production increase does occur, and it is still uncertain at this stage that it will to any degree, it is likely to involve a reduction in excess capacity and an increase in labour productivity rather than a substantial reduction in unemployment.

In the external accounts import payments have fallen substantially over the year to August 1983 while export receipts have registered stronger rates of increase than has been the case for some time. A substantial private capital net inflow combined with a more expansionary fiscal policy to produce an easing in monetary conditions in the March quarter. This was reversed in the June quarter through an active public debt sales programme. A policy of monetary restraint can be expected to remain in place over the months to come but with a slowdown in the rate of inflation some growth in real cash balances is likely. It has already been seen in the September quarter when money supply growth rates accelerated. The impetus that this will give to domestic spending may be moderated by a firming in real interest rates and the impact of this on interest sensitive expenditures.

Inflation has slowed significantly over the year to the September quarter 1983 and a further lowering in the annual CPI rate is likely over the next one or two quarters.

Internationally, prospects are better than earlier envisaged, with clear evidence that the recovery in the U.S. economy is stronger than anticipated and that some recovery is taking place in Western Europe and Japan, albeit slowly. Nevertheless, some doubts still remain as to the durability of the recovery. Improvement in New Zealand's terms of trade and export volume growth should continue over the remainder of 1983/84, but due to the lags involved the external sector cannot be expected to provide strong stimulus to New Zealand's domestic economy over the near future.

In summary, the prospects for significant economic growth over 1983/84 are not favourable. The Reserve Bank's econometric model for example, predicts zero growth in real GDP for the 1983/84 year. The likely consequences for employment are obvious. While some slight recovery in the domestic economy in 1984 may arise from a real cash balance effect, the prospects for sustainable economic growth, at this stage, would appear to be largely dependent on the strength and durability of the international recovery currently underway.

APPENDIX I

NZIER September 1983 Quarterly Survey of Business Opinion

At the time of going to press the September issue of the NZIER's *Business Opinion Survey* became available. According to this latest report the decline in output and sales experienced over the past twelve months ceased in the September quarter and the business sector is now very confident that a recovery in output and sales will occur over the next three months. Furthermore, a net 51 per cent of respondents are optimistic about the general business situation over the next six months. Expectations of an improvement have never been so high in the past eight years of this survey.

Two factors underlying this confidence are, first, respondents see a recovery in their export activity and second, stocks have been run down for the last six months and are at much more satisfactory levels. In contrast to this confidence, however, are reports of declining profitability and expectations of further such declines in the near future.

A net 11 and 4 per cent of retailers and wholesalers reported increases in sales and orders respectively over the September quarter 1983, a significant improvement on the net declines of 14 and 33 per cent respectively in the June quarter. A net 52 per cent expect stronger sales over the next six months.

Conditions in the manufacturing sector were not as clear with Vehicles, Other Producers' Materials and Appliances/Electrical Goods/Electronics subsectors showing the most significant recovery in activity, while the Clothing/Footwear and Food/Drink/Tobacco subsectors recorded no change. This was, however, an improvement over the June quarter in which 20 per cent of respondents in the manufacturing sector reported declines in output, deliveries and orders. Further improvement in output and sales is expected by a net 33 and 38 per cent of respondents respectively.

Stock levels fell over the September quarter as expected and 71 per cent of merchants are now satisfied with their stock levels, while only 16 per cent of respondents in the manufacturing sector (down from 30 per cent in the June quarter) reported their stock levels as 'too high'. Looking ahead to the December quarter, retail and wholesale stocks are expected to rise a little while manufacturers' stocks should continue to fall further.

Profitability continues to decline sharply with a net 36 per cent of respondents reporting a decline over the September quarter. They are not, however, as pessimistic as they have been for the past year as only a net 6 per cent expect a decline in profitability in the December quarter.

Capacity utilization in the manufacturing sector was 86.2 per cent for the September quarter, a recovery from the low of 84.7 per cent in the June quarter. However, this sharp rise has only occurred in the building sector as utilised capacity in the manufacturing sector has remained at the same very low level now for over a year. In the 1978 upswing, utilized capacity in both the Manufacturing and Building sector rose concurrently, suggesting that the current upturn may not yet be as established and widespread as that experienced in 1978.