ECONOMIC FORECAST OVERVIEW AND SUMMARY TABLE

These forecasts update those released in May 1992 and, in the case of the inflation forecasts, those released in the Bank's June Monetary Policy Statement. The key aggregates discussed in this release are detailed in the summary table opposite. The forecasts were finalised on 14 September 1992.

Indications are that the economic recovery in New Zealand has now been underway for more than a year. The recovery appears to be becoming increasingly well-grounded and broadly-based. Official data show three successive quarters of growth since the economy bottomed in the June quarter of last year, at an annualised rate of around 4 per cent on the more reliable production-based measure of Gross Domestic Product (GDP). Although the impact of the recent electricity "crisis" and of the poor weather over the winter may yet throw up a negative quarter during 1992, even allowing for those factors we have become more confident of the positive economic outlook. In particular, employment seems to be rising sooner and more strongly than most had expected. Such solid growth rates are expected to persist through 1993/94. At the same time as we have become more positive about the real economic outlook, no significant threats to the favourable inflation outlook have emerged.

The economic indicators which have come available since our May forecasts were prepared have, on balance, been at least as positive as we had envisaged. As always, some have been more positive (notably employment) and some a little more negative (for example, the strong reported GDP growth in the March quarter was still a little less than we had expected). Unsurprisingly, after the very sharp rise in surveyed business and consumer confidence in the March quarter there were signs of some correction over the June quarter. Since then, however, most survey measures appear to have consolidated at high levels. The temporary dip in confidence appears to have been reflected in a modest fall in retail sales in the June quarter - a possibility we drew attention to in May. More consistently positive have been the performances of manufactured exports and employment. Overall, recent developments have tended to reinforce the very positive series of indicators which became available during the January to April period. Those indicators had - deliberately - been only partly taken on board in preparing our formal forecasts in May.

Accordingly, and despite the weak world economy, we are now forecasting that GDP will rise by 2.9 per cent between the March quarter of 1992 and the March quarter of 1993, compared with our previous point-to-point forecast of 2.5 per cent. However, whereas in May we were picking that GDP for the full year to March 1993 would be 4.2 per cent higher than GDP in the year to March 1992, we now expect this annual average growth rate to be only 3.0 per cent. The difference is solely due to the final outcome for 1991/92. Growth in the March quarter was a little less than we had expected, while previously reported outcomes for the June to December quarters were revised up, significantly altering the base from which the annual average forecasts were being made. It is precisely because of this sort of problem that we suggested in May that readers should focus primarily on the point-to-point growth rates. Even though on this occasion the two forecasts are little different, the suggestion still stands (particularly as further revisions to historical data are likely when the June GDP numbers are released in November).

Over recent months, most overseas forecasts of growth in the key international economies have been revised further down. But because we had been very sceptical about the degree of optimism that seemed to underpin international forecasts earlier in the year, this change has had relatively little impact on the Bank's forecasts. Of our major trading partners, Australia is showing some signs of solid growth. By contrast, the Japanese and German economies still appear to be slowing, and in the United States any growth seems anaemic and inconsistent at best. The non-Japanese Asian economies are growing much more rapidly than the OECD countries, but Asian growth rates themselves are forecast to slow over the next couple of years. Our forecasts for the New Zealand economy do not rely on any very rapid recovery in the world economy from here, although they do assume that "disaster scenarios" (such as Japan and Germany falling into deep recessions and dragging our other key trading partners back down with them) are avoided.

Despite the indifferent performance of the world economy, New Zealand's manufactured exports continue to do better than expected. Manufactured export growth appears to have been very strong in the June quarter, and discussions with businesses and survey data both continue to suggest that firms will go on expanding their export sales at a fairly rapid pace. More rapid export growth is one of the reasons for the higher GDP growth forecasts.

Previous forecasts, particularly last year, had also pointed to an export-driven recovery, but there had been considerable uncertainty about how quickly export growth would feed through into the domestic economy. In many forecasts, very sluggish employment growth had been expected and there had been widespread doubts about how rapidly investment would recover. In others, there had been concerns that, even if a significant recovery in investment did occur, it would simply involve a rapid increase in imports and a blow-out in the current account of the balance of payments. In the event, however, the recovery now seems likely to be more evenly balanced between export demand and domestic demand than had earlier appeared probable, and the current account seems set to remain near-balance.

In fact, an improvement on the employment front has been one of the most significant and surprising aspects of this recovery to date. We had not expected employment to bottom out until around the middle of 1992, partly because of an expected initial impact of the Employment Contracts Act on the productivity of existing employees. However, both the Household Labour Force Survey (HLFS) and the Quarterly Employment Survey (QES) now appear to confirm that, even after adjusting for the impact of government-subsidised job schemes, employment bottomed at the end of last year. Again, most indicators suggest that the rise in job numbers will continue, at a faster pace than we, and most other commentators, had previously expected. Part of the reason for the stronger employment growth may be that employers carried fewer under-utilised workers through the latest recession than they might have at times in the past. In addition, of course, the Employment Contracts Act has tended to make it easier and cheaper to take on new employees. The peak in unemployment will be lower than we had previously thought likely, but the rate of job growth does not appear to be likely to absorb fully all those drawn back into the official labour force by the improvement in employment prospects. Hence, despite the recent fall in the rate of unemployment, we do not believe that a sustained downward trend in unemployment will begin before 1994.

With stronger employment, and average earnings likely to be a little higher than we had previously predicted, at a time when inflation remains well in check, real disposable household incomes will be growing quite rapidly. In an environment of rising confidence, and with house prices levelling out, this income is likely to support stronger growth in private consumption than we had previously expected. The extent to which higher incomes will translate into higher savings remains debatable, but the sort of sharp recovery in household savings currently being seen in the United Kingdom is unlikely to be repeated here. By comparison with the UK, in New Zealand consumer confidence is considerably higher, employment has begun rising again, and consumer and mortgage debts are considerably lower (certainly relative to the value of houses). That said, we expect a gradual increase in the rate of household savings, and households, in aggregate, appear unlikely to be willing to take on significant additional debt.

Investment prospects also look good. Most indicators suggest strong growth in plant and machinery investment is about to get underway and that, as expected, the collapse in non-residential construction activity has come to an end. Overall investment growth will not be strong in 1992/93, but as 1993/94 gets underway industrial investment growth rates appear likely to be rising rapidly. This is what would be expected as output picks up at a time when businesses are generally increasingly confident about the medium-term sustainability of the improvement.

Notwithstanding the domestic recovery, we expect that the balance of payments current account will remain in near-balance over the next couple of years. The forecast recovery in investment will draw in imports of capital equipment, and an upturn in the earnings of foreign-owned firms operating here is likely to widen the investment income deficit. However, these factors are expected to be offset by the growth in exports, the improvements in the competitiveness of New Zealand producers competing against imports, and the modest forecast improvements in the terms of trade.

Given its parliamentary mandate, the Bank's principal interest in macroeconomic developments is in the implications for inflation. Inflation has been picking up this year, broadly as expected, mainly because of the impact of the fall in the exchange rate last year. Indeed, without the impact of the lower exchange rate, underlying inflation in 1992 would have been likely to have been near zero, as domestic cost and price pressures in the non-tradeables sectors have continued to slow. We expect that the largest effects of the fall in the exchange rate will be seen in high quarterly underlying inflation rates in the September and December quarters of 1992. The impact on fresh produce prices of the recent bad weather will also boost inflation over the next couple of quarters, offset a little by house prices which look likely to have been weaker than previously expected.

For the year to December 1992, we expect to see underlying inflation rise to 2.0 per cent, the same rate forecast in the June Monetary Policy Statement. Looking further ahead, the outlook for inflation is also little changed. As the effects of the exchange rate drop out, they will be only partly offset by some gradual rises in both domestic and international inflationary pressures. Accordingly, we expect that underlying Consumer Price Index (CPI) inflation will fall back comfortably to around the middle of the 0-2 per cent target range in 1993 and beyond, even as the domestic recovery gathers pace.