ECONOMIC FORECAST OVERVIEW AND SUMMARY TABLE

These forecasts update and extend those released in December last year. They include information available up to 1 May. The forecast period has been extended to cover the year to March 1994. The key aggregates discussed in this release are detailed in the summary table. The inflation forecasts have since been updated in the Monetary Policy Statement released in June.

Economic activity bottomed in the June quarter of last year, and it appears that a recovery - which has good prospects of being sustained - is now underway. Based on a deliberately cautious assessment of recent trends and leading indicators, we believe that over the next 18-24 months underlying annual rates of Gross Domestic Product (GDP) growth will accelerate to around 3 per cent. At the same time, the outlook for inflation has improved since the last update of our inflation forecasts, published in the February Monetary Policy Statement. After rising a little over the next few quarters, underlying inflation remains comfortably on track to drop back below 2 per cent next year and remain within the 0-2 per cent target range thereafter.

Real GDP grew in the September and December quarters, on both expenditure and production measures. The economy has been a little stronger than we had expected at the time of our December forecasts. Consumer spending, some elements of investment, and even exports - for which the Bank already had the highest published forecasts - have been higher than we had been expecting.

Most indicators suggest that the recovery in both domestic demand and economic activity continued in the March quarter. Respondents to the March Quarterly Survey of Business Opinion (QSBO) reported improved domestic sales and increased production. Provisional figures suggest that exports were up again. Moreover, business and consumer confidence, as measured by a range of independent surveys, have both improved markedly. These trends have been confirmed in the Bank's extensive discussions with businesses.

However, even allowing for a third successive quarter of growth in March, real GDP (measured on an expenditure basis) for the full year to March 1992 is expected to have been around 1.1 per cent lower than in the year to March 1991. This measured fall occurs largely because of the very sharp fall in GDP in the June quarter of 1991, which was substantially reversed in the September quarter. Despite this annual average fall, it is likely that the level of GDP in the March quarter of 1992 will prove to have been higher than in the March quarter of 1991.

The same 'problem' - in reverse - affects the interpretation of the forecast annual average GDP growth rates for 1992/93. We are expecting the recovery to continue over the coming year. Over the four quarters of the year we expect GDP to rise by a total of around 2.5 per cent (i.e. GDP in the March quarter of 1993 to be around 2.5 per cent higher than in the March quarter of 1992). However, mainly because of the quarterly pattern of GDP growth in the middle of 1991, the total level of GDP (measured on an expenditure basis) in the full year to March 1993 is forecast to be 4.2 per cent higher than in the full year to March 1992. Because the annual averages do not accurately represent the underlying trend movements, in reading this release and interpreting our 1992/93 forecasts readers are advised to do as we ourselves have done and focus on the 2.5 per cent further growth expected from now to next March, rather than on the 4.2 per cent annual average number. Further out, the differences between the two calculations are much less significant, and discussion of 1993/94 is generally cast in the more traditional annual average terms.

All indicators now suggest that output will continue to rise. We are now more optimistic about 1992/93 than was the case in our December forecasts, although the growth we are projecting does not represent an acceleration from that recorded over recent quarters. In this respect, the risks to the forecast economic outlook for 1992/93 are probably more on the upside. For instance, we are picking that investment will begin to rise significantly only in late 1992/93, whereas the strength of business confidence could bring this timing forward. In addition, we are forecasting a modest slowdown in the rate of consumption growth (consistent with the only modest growth in incomes) for the remainder of this year, despite the recovery in incomes and confidence which could lead to consumption growth rates holding up. Moreover, out into next year, we have not assumed any further acceleration in the underlying rate of growth in manufactured exports beyond that achieved in 199192, whereas faster growth rates could well result from the recent strong competitiveness gains or if the worldeconomy recovers relatively strongly.

An important reason why more growth is now expected in 1992/93 than we had expected at the time of our December forecasts is that it appears that, in its early stages, the recovery is proving to be more broadly based than we had expected. The export sector continues to be the fundamental driving force; particularly manufacturing and newer primary products, as traditional agricultural exports are expected to grow only slowly. But consumer spending now appears to be making a positive contribution to growth, and housebuilding and plant and machinery spending both appear to be stronger than had first appeared likely. In addition to these expenditure items, total commercial stocks appear likely to bottom out a little later than we had expected in December - giving a stronger boost to growth in 1992/93 (as additional sales have to be met from higher production rather than stocks) than had previously been expected.[1]

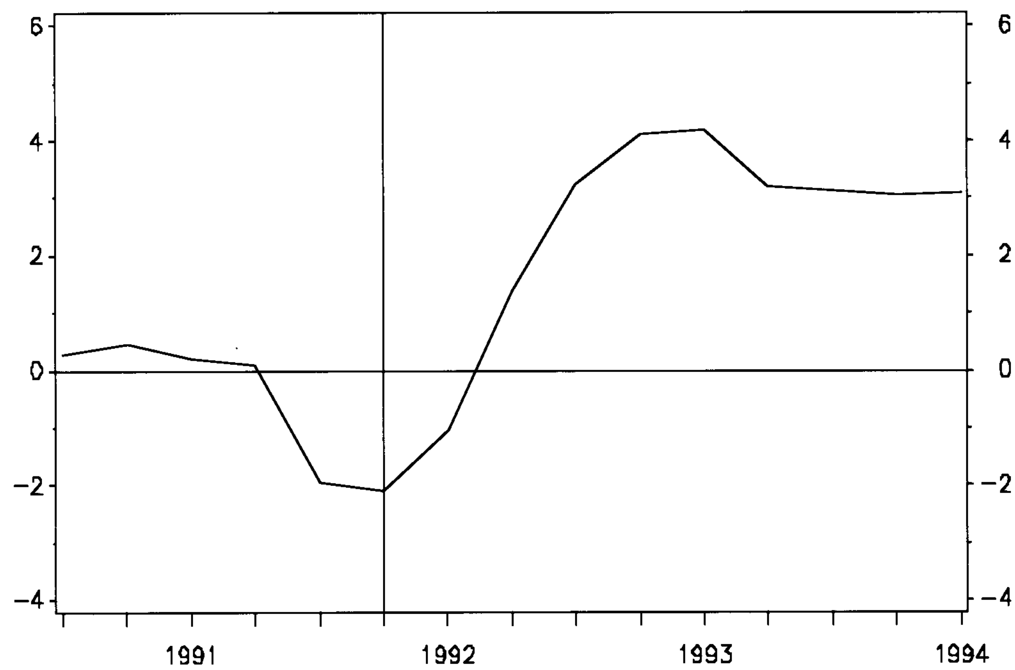
The reasons why consumer spending has picked up are still not entirely clear. In part it will have represented a correction to sharp falls in early 1991 when sentiment became so negative. More fundamentally, household incomes appear to have held up more

1 Indeed, with no growth in any other component of GDP after December 1991, the levelling out of stocks alone would be sufficient to give a 2.7 per cent annual average growth rate for 1992/93.

strongly than we had expected, fear of redundancy has probably diminished, and general confidence about New Zealand's longer-term prospects appears to have improved. Consumer spending is now expected to have risen slightly over 1991/92 as a whole, but is forecast to rise only modestly this year from the level reached in March. Consumption is expected to rise more strongly in 1993/94 (on a point-to-point basis).

FIGURE 1

REAL EXPENDITURE ON GDP
(Annual Average Growth Rate, %, March Years)



After falling somewhat over the last couple of years, we expect the household savings rate to level out, and to rise slightly in real terms over the next few years. Real interest rate considerations aside, it is not clear that there are any particular imperatives driving households, as a whole, to increase their savings rate rapidly over the next few years.

Growth in business investment is also expected to exceed our December projections - particularly investment in plant and machinery. A number of indicators point to a strong and quick recovery in plant and machinery spending. However, we are conscious of the relatively low current levels of capacity utilisation (even after a couple of quarters of recovery) and the continuing pressures on some firms to reduce debt. Moreover, our own recent discussions with businesses did not suggest that there was yet any surge in investment getting underway. We have assumed that investment will not begin to pick up significantly until later in 1992/93. By 1993/94, we expect investment to be growing relatively rapidly.

Despite a fall in the terms of trade, the sharp rise in the volume of exports and the fall in imports were sufficient to allow the merchandise trade balance to move strongly into surplus last year. The merchandise trade surplus is expected to continue to increase, but at a slower pace than during 1991/92.

Improvements on the goods and services side are likely to be partly offset by a further widening in the investment income deficit (partly because, as the economy recovers, profits of foreign-owned firms operating in New Zealand are expected to improve). Nevertheless, the current account deficit is still expected to shrink further, reaching around $110 million in 1993/94.

The Government released revised fiscal projections for 1991/92 on 28 April. Excluding revaluation effects, the financial deficit is likely to be around $3,425 million in the 1991/92 fiscal year (4.6 per cent of GDP); the latest deterioration mainly reflects substantial reductions in tax on business incomes. Based on currently announced policies, and adjusting for our macroeconomic outlook, we are projecting financial deficits of $2,625 million in each of 1992/93 and 1993/94, a little worse than appeared likely at the time of the December forecasts.

The HLFS unemployment rate is expected to have risen to around 11.6 per cent in the March 1992 quarter - less than we were previously expecting. Looking ahead, the improving economic outlook means that our employment and unemployment forecasts are now more optimistic than they were in December. Over the next two years as a whole, we expect that employment growth will be sufficient to absorb the natural growth of the labour force. However, we expect the participation rate to rise slightly as employment prospects improve. As a result, the unemployment rate is likely to rise a little further from the March 1992 level, probably to a little over 12 per cent (compared with our 13.1 per cent figure for March 1993 in our last forecasts).

Revised Historical Data

In conjuction with the release of the September quarter 1991 real expenditure on GDP accounts, the Department of Statistics released revised estimates of real GDP back to 1983. Real GDP growth was revised downwards in both 1989/90 and 1990/91, with the most significant changes occurring in the domestic expenditure components. The previous estimate of zero growth in 1989/90 was revised down to a 0.7 per cent contraction (as a result of downward revisions to investment growth and stockbuilding). More significantly for the interpretation of recent history, growth in 1990/91 was revised down to 0.2 per cent (compared with the previous estimate of 1.0 per cent), after previous estimates of consumption and investment growth were revised down. The revision to the 1990/91 numbers brought the expenditure-based estimate of growth more into line with the production-based measure. On a production basis, GDP is now estimated to have fallen by 1.3 per cent in 1990/91.

The underlying annual rate of CPI inflation has fallen further in recent months, to 1.3 per cent in the year to March. We expect inflation to rise temporarily, peaking at just over 2 per cent in the year to next March. The inflation outlook has improved in recent months. Productivity growth appears to be a little stronger and wage growth weaker than expected (although in an improving market some of these gains may be captured by firms in the form of increased profits, rather than passed on in lower prices). The exchange rate has firmed a little, and new data and further investigations suggest that the foreign currency prices of our imports are still falling. Taken together, these factors mean that New Zealand dollar costs facing New Zealand firms are rising less rapidly than we had expected. However, as demand is picking up, any cost increases are now more likely to be passed into prices, rather than absorbed in a further compression of margins. Once the exchange rate effect on year-on-year inflation drops out in 1993, there appear to be few cost or demand pressures that would prevent underlying inflation falling back to around 1 per cent and remaining there, even with a more buoyant economy.

SUMMARY OF ECONOMIC FORECASTS

(Annual percentage changes of annual totals of averages)

	Actual	Estimate	Forecasts	
March years	1991	1992	1993	1994
Real Expenditure on GDP				
Final Consumption Expenditure:				
- Private	-0.9	0.1	1.9	1.4
- Public authority	1.2	-1.4	0.7	0.1
- TOTAL	-0.5	-0.2	1.6	1.1
Gross Fixed Capital Formation				
- Market Sector:				
- Residential	11.6	-1.2	-1.6	1.2
- Business	20.8	4.4	2.2	1.2
- Non-Market Government Sector	-2.7	2.2	-9.0	-2.0
- TOTAL	-1.4	-15.6	4.0	6.1
Final Domestic Expenditure	-0.7	-4.2	2.2	2.3
Stockbuilding [1]	-0.4	-2.7	2.2	0.5
Gross National Expenditure	-1.1	-6.6	4.4	2.8
Export of goods and services	8.8	9.7	4.3	3.7
Imports of goods and services	3.4	-6.2	4.7	2.9
EXPENDITURE ON GDP	0.2	-1.1	4.2	3.1
(Expenditure on GDP, March qtr to March qtr)	-2.2	2.1	2.5	2.6
Government Accounts [2]				
Financial balance ($m)	-2342 [3]	-3000 [4]	-2625	-2625
as a % of GDP	-3.2 [3]	-4.0 [4]	-3.4	-3.2
Primary Balance as a % of GDP	2.3 [3]	0.8 [4]	1.8	1.9
External Account				
BOP current account balance ($M)	-2335	-515	-420	-110
as a % of GDP	-3.2	-0.7	-0.5	-0.1
SNA Terms of trade	-5.4	-3.6	3.2	1.2
Incomes				
Real household disposable incomes	-1.6	0.0	2.1	2.0
Inflation [5]				
Consumer price inflation	4.5	0.8	1.7	0.7
Underlying CPI Inflation	3.6	1.3	2.1	0.7
Labour Market [5]				
HLFS employment	-0.5	-1.5	1.1	1.3
HLFS Official Unemployment ('000's)	160.4	189.9	198.3	207.8
HLFS Official Unemployment Rate (%)	9.9	11.6	11.9	12.3

1 Percentage point contribution to growth rate of GDP.
2 June years
3 Excludes proceeds from the sale of Crown Forestry Assets.
4 Includes estimated revaluation effects on the Government's foreign currency assets.
5 March quarter to March quarter % changes or rate/level as at March quarter.