SUMMARY OF ECONOMIC FORECASTS

(Annual percentage changes of annual totals of averages)

	Actual	Estimate	Forecasts	
March years	1992	1993	1994	1995
Real Expenditure on GDP				
Final Consumption Expenditure:				
- Private	0.3	2.1	2.9	2.3
- Public authority	-0.8	-2.2	-0.9	-1.1
- TOTAL	0.1	1.2	2.1	1.7
• Gross Fixed Capital Formation				
- Market Sector:				
- Residential	-17.1	6.7	7.6	6.4
- Business	-13.2	6.7	7.6	9.0
- Non-Market Government Sector	-30.9	0.0	1.7	-0.8
- TOTAL	-16.0	6.1	7.1	7.7
Final Domestic Expenditure	-4.0	2.2	3.3	3.1
Stockbuilding [1]	-1.8	2.9	-0.1	-0.2
Gross National Expenditure	-5.6	5.0	3.1	2.8
Export of goods and services	5.0	2.4	4.6	6.6
Imports of goods and services	-5.1	7.8	4.4	5.6
EXPENDITURE ON GDP	-1.7	2.8	2.9	3.0
(Expenditure on GDP, March qtr to March qtr)	0.9	3.1	2.5	3.2
Government Accounts [2]				
Financial balance ($m)	-2449[3]	-3030	-2570	-2200
as a % of GDP	-2.1[3]	-4.0	-3.2	-2.6
Primary Balance as a % of GDP	2.8[3]	0.8	1.5	2.3
External Account				
BOP current account balance ($M)	-265	-2059	-1851	-1531
as a % of GDP	-0.4	-2.7	-2.3	-1.9
SNA Terms of trade	0.1	0.6	2.0	0.9
Incomes				
Real household disposable incomes	2.5	2.9	1.5	3.0
Inflation [4]				
Consumer price inflation	0.8	1.3	1.3	0.7
Underlying CPI Inflation	1.3	1.9	1.0	0.9
Labour Market [4]				
HLFS employment	-0.8	1.3	1.7	2.0
HLFS Official Unemployment ('000's)	181.4	182.6	190.4	186.6
HLFS Official Unemployment Rate (%)	11.1	11.0	11.2	10.8

1 Percentage point contribution to growth rate of GDP.
2 June years
3 Excludes proceeds from the sale of Crown Forestry Assets, and the effect of currency revaluations on the value of Crown financial assets.
4 March quarter to March quarter % changes or rate/level as at March quarter.

Economic Forecast Overview and Summary Table

These forecasts update and extend (by a further year) the full Economic Forecasts published in September 1992, and the inflation forecasts published in the Bank's December Monetary Policy Statement. The key aggregates discussed in this release are detailed in the summary table opposite. The forecasts incorporate material available up to 5 March.

New Zealand's economy now appears to be firmly on the recovery path, almost two years on from the low point reached in mid-1991. Despite the continuing rather sluggish state of the world economy, all indications continue to suggest that average GDP growth rates of around 3 per cent per annum over the next few years are well within reach. In that sense, these forecasts largely represent a continuation of the sort of outlook for growth which appeared in both our sets of forecasts last year. There are three important differences from last year's forecasts. First, domestic demand appears set to continue to grow more strongly than we had anticipated, and it has picked up strongly a little sooner - late last year - than we had allowed. Second, we now expect a rather wider balance of payments deficit than we had previously forecast. In 1992/93 that stems from the joint impact of stronger demand and the weather-hit agricultural exports. Beyond 1992/93, stronger cyclical import demand, and a continuing mismatch between the New Zealand and world growth cycles, which is expected to continue over the next 12-18months, mean that the deficit narrows only slowly from here. The third important difference, and one of particular relevance to the longer-term inflation forecasting horizon, is that, by the very end of the extended forecast period (i e, from late next year onwards), we now envisage that some reasonably strong impetus to the local economy will be beginning to appear from a more vigorous world recovery.

Against this background our inflation forecasts have been revised up a little. In the early part of the period, this primarily reflects a change to the starting exchange rate assumption. However, the stronger outlook for domestic demand is also reflected in the inflation forecasts. Now that last year's exchange rate linked pressure on inflation is almost behind us, inflation should remain comfortably within the 0-2 per cent target range over at least the next 12-18 months, with all major sources of cost and price pressures still reasonably well in check. Beyond that, the extent of any pressures on our price level is likely to depend primarily on the precise timing and strength of the world recovery, and on the response of the goods and labour markets, under the new legislative and competitive regimes, to several successive years of solid growth.

Despite the positive medium-term story, GDP fell in the September quarter -as foreshadowed in our last forecasts, although by rather more than we had expected at that stage. The fall primarily reflected the electricity "crisis" of mid-1992, together with the impact of a major strike. Even in the September quarter, however, domestic demand grew strongly. The succession of very favourable indicators in recent months suggests that strong GDP growth occurred in the December quarter, more than reversing the fall in September. A more recent potential hiccup was the impact of the recent rise in interest

rates. However, the results of the latest business and consumer confidence surveys, which have generally seen confidence move higher, tend to set to one side any major concerns on that score. Despite the continuing impact on exports of the unusually bad run of weather last year, the economy now appears to be firmly back on a growth path.

In fact, we believe that the economy will prove to have grown a little more rapidly between March 1992 and March 1993 than we expected in September (and those forecasts had, in turn, been revised up a little from May). Late last year, it appeared that the impact of the weather on sheepmeat exports and other agricultural industries would force a modest downward revision in 1992/93 forecasts. However, recently it has become clear that domestic demand picked up more strongly during the second half of last year than most commentators had been expecting. The rise in each of the components - consumer spending, investment spending, and stockbuilding - had generally been in line with the indicators and in the direction we had forecast, but occurred rather more sharply and earlier than we and most other forecasters had allowed for (much of the rise had been forecast to occur in 1993/94).

Allowing for these two, largely offsetting, effects, GDP is now estimated to have risen by 3.1 percent between the March quarter of 1992 and the March quarter of 1993. (This GDP figure, and all others in this release, refers to the production-based measure. As we noted last year, and as the Department of Statistics commented publicly at the time of the release of the September expenditure-based GDP measure, the production-based measure has proved to be a far superior indicator of short-term movements in the economy.)

Looking out over the next two years, we expect GDP to rise by 2.5 percent between March 1993 and March 1994, and then by a further 3.2 percent between March 1994 and March 1995. The confidence which appears to have helped boost demand over the last year, is expected to prove increasingly well-justified. Output, employment and incomes are expected to continue to rise at solid, if unspectacular, rates. A modest slowdown in growth is forecast for the coming year. This is a reflection of the same unexpected timing of the rise in some of the key components of demand, which led us to revise up our 1992/93 forecast growth rate. In effect, we see some of the growth having been transferred from one year to another. The forecast for 1993/94 should not, therefore, be interpreted as implying any slowing in the underlying pace of the recovery. Indeed, over 1992/93 and 1993/94 taken together, both final demand and Gross National Expenditure (the sum of consumption, investment and stockbuilding) are expected to grow more rapidly than were forecasting last year. Continued strong growth in manufactured exports helps underpin solid GDP growth throughout the forecast period.

Overseas forecasts of the outlook for growth in the world economy have generally been revised further down in recent months. We noted last year our considerable scepticism about the likely speed and extent of the world recovery. However, with the passing of time and the continued flow of bad news from Japan and Europe, we too have pushed back our view of the likely timing of a generalised recovery. Of the economies of our major trading partners, only in the United States does the outlook appear more favourable than it did six months ago, and even there, there appear to be some doubts about the pace of growth that can be sustained over the next year or two. General sentiment on the immediate prospects for the Australian economy has become less optimistic in recent months, although, of course, trends there are likely to be influenced

by the results of the imminent election. In Japan and most of western Europe there are few signs that the bottom of the economic cycle has yet been reached. Non-Japan Asian economies continue to grow quite rapidly, but these are not major markets for our fast-growing manufactured exports, nor a large enough component of world output to be likely to make a major difference to most commodity prices.

By 1994/95 we expect the world economic recovery to be beginning to provide more support for the local recovery, but the overall contribution still appears likely to be relatively weak until the following year. The continuing relatively weak international backdrop is a key reason why, despite a series of solid years of forecast growth, we are not forecasting growth rates to match, say, those of 1981/82 to 1984/85 (when the economy averaged just over 4 percent annual GDP growth) when a strong world recovery provided considerable impetus to the New Zealand economy.

Despite the indifferent recent performance of the world economy, the growth rates of New Zealand's non-commodity manufactured exports have remained higher than we had forecast. Australia remains the single most important destination market, although by no means the fastest growing. There are no indicators suggesting that manufactured export growth is about to slow. Indeed, given the magnitude of the rise in investment, the time lags in getting into exporting, the fact that general world demand should improve - if slowly -over the next few years, and that New Zealand producers should at least maintain their current level of competitiveness over the next few years, there are few reasons to expect such a slowdown. Our forecasts of manufactured export growth have been revised up, although they remain lower than therecent very rapid annual growth rates. Rapid growth in manufactured exports helps provide the impetus for further investment growth.

Returning to the domestic economy, almost all components of demand have been growing relatively strongly. The surge in spending in these components late last year is presumably reflecting growing confidence that recovery in demand and output is here to stay - the sort of confidence that has increasingly shown up in survey measures over the last 12-18 months.

Consumption spending, now estimated to have risen by over 3 percent between the March quarters of 1992 and 1993, appears to have been boosted by improvements in household incomes, as employment has improved and private business incomes have risen. Measured consumer confidence has improved, rising to relatively high levels. Farm prices are up, and house prices have also begun rising again, boosting perceptions of household wealth. We expect some slowing in the recent strong rate of growth in consumer spending, but can see nothing over the next year or two that is likely to induce any significant rise in the rate of savings, or, hence, anything more than a brief pause in the rate of growth of spending.

Investment spending grew very strongly in the September quarter, with the growth concentrated in spending on plant and machinery and transport equipment. Plant and machinery spending is now around 30 percent up on the low reached in mid-1991. Compared with our September forecasts, the strength and, particularly, the precise timing of this surge clearly was a surprise (although as our previous releases have noted, that is almost in the nature of investment cycles). Further such strong growth is unlikely to be repeated immediately, and capital equipment imports fell back in the December

quarter. However, almost all the investment indicators remain extremely positive, and we are continuing to forecast relatively strong investment growth over the next couple of years, resulting in a higher continuing level of investment spending than we had previously allowed for. Reasonable recoveries in both residential and non-residential construction activity appear to be getting underway. They are expected to continue.

Changes in stocks have played a significant part in explaining developments in recent quarters. Retailers, wholesalers, and manufacturers had all been looking to increase their stock levels last year, presumably as they became more confident that the early signs of recovery would endure. We had allowed for some growth, but again the large increases in stocks occurred earlier than expected. The rise in stocks reinforced the impact of the strong growth in the other components of demand on production and imports. Further significant growth in commercial stocks is expected in the next few quarters of data, before settling into a growth path consistent with expected growth in sales and output.

With all domestic demand components having grown more strongly than expected, it is not surprising that imports grew considerably more rapidly in late 1992 than we had previously predicted. In particular, investment spending in New Zealand is very import intensive. Further analysis has also led us to change our view about the extent to which a growing economy will need to draw in imported goods and materials. As a result, the expected level and growth rate of imports has been raised over the entire forecast period.

Whereas the negative impact of the weather on agricultural production and exports offset the impact of the surge in domestic demand to leave GDP little changed, in the current account the effects of these two events are cumulative. As a result the current account deficit for the year to March 1993 is now expected to be a little over $2,000 million. Looking ahead, with continued strong investment growth and relatively buoyant consumer spending, we expect only a gradual narrowing in the deficit over the next two years, reaching around $1,500 million (around 2 percent of GDP) by the year to March 1995. Although growth in export revenues will outstrip continued strong import growth, these trends in the goods and services balance will be partly offset by an increase in net outflows of investment income (interest and profits).

With the overall GDP growth outlook consolidating, but little changed, the outlook for employment growth is also little changed from the relatively positive picture we envisaged last year. It is, however, becoming clear that cyclical productivity growth is a little less than we had been allowing for. Because of the sharp cuts in job numbers many employers implemented during the years of recession and restructuring, many appear to have less scope than in previous recoveries to increase output substantially without taking on additional staff. With demand and output now growing, this is now translating into employment growth. Unemployment is expected to be 11 percent in March 1993, and with a rise in the share of the population either working or actively looking for work, we expect a further slight rise over 1993/94. However, the unemployment rate is expected finally to begin to edge down in 1994/95. Average wage settlements are likely to rise over the next few years, as labour market conditions improve. However, several indicators suggest that very little of the acceleration will be occurring in 1993.

The Bank's principal responsibility, and hence its prime interest in forecasting, is to implement monetary policy with the aim of keeping inflation continuously in the 0-2 per cent target range. Inflation picked up a little last year, and in underlying terms is expected

to peak at 1.9 per cent in the year to March. The rise in inflation last year was mainly due to the impact of the late 1991 fall in the exchange rate. Looking ahead, we expect that the annual rate of underlying inflation will fall away over this year, although as the exchange rate effects drop out they will be partly replaced be stronger pressures from domestic sources, in turn generated in part by the impetus to the economy from the improvement in competitiveness. House prices are now rising, and unit labour costs are no longer expected to be falling to any significant extent, if at all.

Our inflation forecasts over the next couple of years have been revised up slightly, partly on account of the stronger level of demand in the economy. In addition, we have changed our starting exchange rate assumption from a TWI of 54 (used in the forecasts contained in the December Monetary Policy Statement) to a TWI of 53.5 - around the level the TWI has averaged in recent months. On this occasion we have assumed, as a working assumption only, an average TWI of 53.5 throughout the forecast horizon. This change in the assumption affects the quarterly track of inflation through 1993, but not thereafter.

Looking further ahead, as the world recovery gathers pace, our forecasts for the year to March 1996 do show a rise in inflationary pressures towards the top end of the 0-2 per cent range. That pressure can be expected to stem principally from the direct and indirect effects of higher commodity prices, coming on top of a domestic economy already 4-5 years into the growth phase. At this stage, forecasts for 1995/96 are primarily illustrative, and outcomes are largely beyond the current reach of monetary policy. However, such forecasts do point to the risks to the inflation outlook, which could arise earlier if our relatively unfavourable view of immediate world economic prospects is wrong.