

# BUSINESS MATTERS



Kiwibank Business Banking wants to help Kiwi businesses succeed. We've teamed up with Business and Economic Research Limited (BERL Economics) to bring you this economic update.

**Compiled by Dr Ganesh Nana** Chief Economist at Business and Economic Research Limited (BERL Economics).

## PREFU reveals little change in deficit forecast

- **Reaching surplus remains a challenge**
- **Current Account Balance will worsen, but this is related to the Christchurch rebuild**
- **Stronger export sector and improved international competitiveness remains essential**

The Treasury's Pre-election Economic and Fiscal Update (PREFU) confirmed this month that the fiscal accounts are still on track to return to surplus by March 2015 if it is business-as-usual. This is a big if that includes a "significant lift" from investment due to the Christchurch recovery and rebuild.

The PREFU forecasts annual growth to pick up from 1.5% in 2010/11 to 3.4% in 2012/13, before drifting back towards 2.3% by 2015/16.

Growth will be stronger than forecasted in the 2011 Budget over the short-term, but it will hit a lower peak at a later stage.

However, without such a severe dip in late 2011 and early 2012, the later growth peak will be off a higher base.

The Treasury notes, however, there is a one-in-five chance of a 'downside scenario' with a lower and slower return towards our potential economic growth path. This downside scenario has nominal GDP growing 0.3 percentage points slower than the main forecast.

The combined revenue and expenditure means net core crown debt will peak at 29% in 2014/15. This remains below the Government's 30% target, and the latest forecast has the debt track slightly lower than in May.

Government expenditure as a share of GDP, according to the Treasury's forecasts, has also peaked and is set to drop from 35.2% in 2011/12 to 30.4% by 2015/16, and is projected to be below 30% by 2017/18.

The (Total Crown) operating balance excluding gains and losses (OBEGAL) is forecast to be a surplus of \$1.45 million by 2014/15. Based on the Treasury's analysis of how sensitive its forecasts

are to key assumptions, shaving 0.75 percentage points off the nominal GDP growth rate to 2014/15 would be enough to keep OBEGAL in deficit.

If GDP growth were lower, unemployment and benefit payments would likely be higher, so it would take a smaller cut than 0.75 percentage points to hold the Government accounts in deficit.

## Inflation lower than expected this quarter

- **Inflation lower than expected, and well within target range**
- **Rising food prices continue to apply pressure on consumers**
- **No pressure on the Reserve Bank of New Zealand to increase the Official Cash Rate**

In the September 2011 quarter, the Consumer Price Index (CPI) rose 0.4% for the quarter and 4.6% for the year.

This quarterly rise was lower than that expected by the Reserve Bank of New Zealand (RBNZ). And while the headline annual rise in the CPI was outside the RBNZ's inflation target of 1 to 3%, once price rises caused by the increase in GST are accounted for, the increase in the annual CPI is only 2.5%. This is well within the target band.

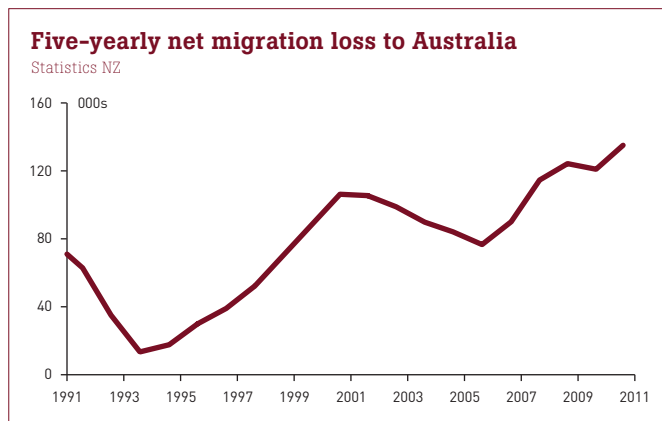
In their press release, Statistics New Zealand noted that the main component driving price rises in the September 2011 quarter was the food group. This was mainly due to an increase in the prices of fruit and vegetables, along with meat, poultry and fish.

With the quarterly increase in the CPI lower than expected, and with the annual CPI - once adjusted for the increase in GST - well within the RBNZ's target range for inflation, there should be no pressure on the RBNZ to increase the Official Cash Rate from its current level of 2.5%.

## Australia continues to tempt Kiwis

- **Migrant flows to Australia at 30 year high**
- **At current rates, by early 2012 New Zealand will have a net migration loss of over 4,000 people a year**
- **New Zealand needs some sound economic growth to plug this outflow**

The migrant flow to Australia has hit a 30 year high, with 48,829 people trekking across the Tasman in the year to 30 September 2011. This number is undoubtedly swelled by people leaving Christchurch, but no matter what the cause, it has contributed to a drop in the net migration figures.



Our projections indicate that by early 2012 New Zealand will have a net migration loss of over 4,000 people per annum. This is concerning as buoyant growth in the New Zealand economy has previously occurred when we have had reasonably strong net migrant inflows.

Further, work completed by BERL indicates that economic growth tends to attract migrants to New Zealand rather than vice versa. We need to get some sound economic growth back into the country so we don't lose any more skilled people.

We had hoped for some net inflow of migrants as a by-product of RWC 2011, but so far that is not showing through in the data. The dominant factor is the increasingly strong flow to Australia.

## Australia unfazed by tough economic conditions

- **Strong quarterly GDP growth at 1.2%**
- **Massive investment in minerals to continue to support future growth**
- **The Reserve Bank of Australia cutting OCR to 4.5%**

The Australian economy has shown its resilience in the June quarter, after rebounding from a significant drop in the March 2011 quarter.

After a 1.2% drop in quarterly GDP growth in the March 2011 quarter, it grew by 1.2% in the June 2011 quarter. This quarterly increase has come mainly from two sources: the manufacturing sector (up 2.8%) and the transport and postal sector (up 4.4%).

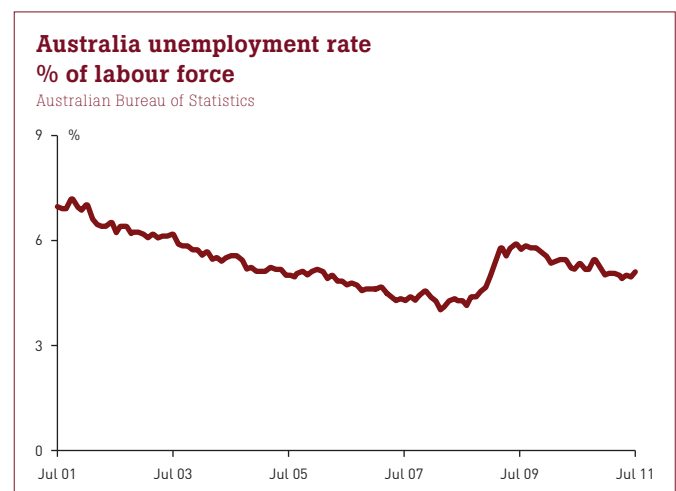
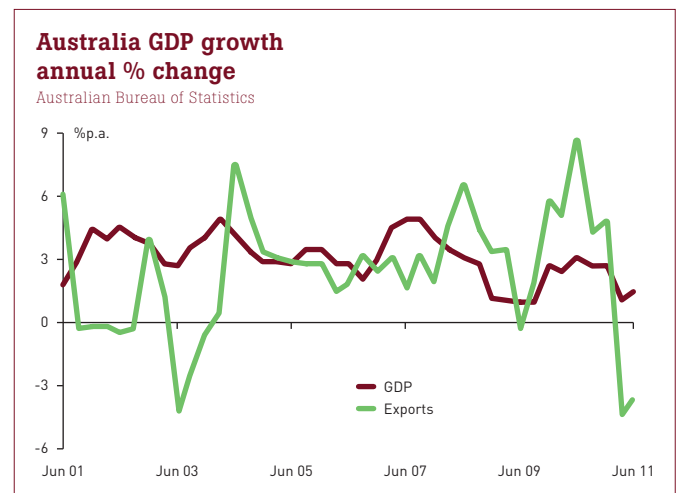
While global financial markets are experiencing turbulence, caused by recent events in the US and Europe, the Australian economy is continuing to grow mainly on the back of strong mineral exports to Asia, particularly China. This growth in mineral exports by Australia is evidenced by the recent approval of the A\$30 billion expansion of the Olympic Dam gold, copper and uranium mine by the South Australian, Northern Territory and Australian Federal governments.

Exports of its mineral wealth have fuelled Australia's GDP growth over the last few years, though more recently a number of adverse natural weather events have affected the mineral sector and has seen mineral exports drop off in early 2011.

In early November 2011 the Reserve Bank of Australia (RBA) announced it was cutting its official cash rate (OCR) to 4.5% in the face of continued uncertainty in the US and European financial markets and lower than expected domestic inflation.

The RBA noted that with global finance markets struggling recently, Australian consumers and businesses are still being cautious about their spending and investments habits. This cautious behaviour, combined with a recent softening in the labour market, which will no doubt increase households worry about unemployment, is likely to push inflation down in Australia in the coming months.

Quarterly Australian unemployment rates in the June 2011 quarter were 4.9% down from the revised March 2011 quarter when it was 5% and was also down from the June 2010 quarter when the unemployment rate was 5.2%.



## Will the new deal save the EU?

- **A new deal to solve the Greek debt crisis is agreed**
- **The future of Euro is still in the balance as market fears continue**
- **The rest of the world taking a wait and see approach to the Euro**

In late October 2011, a three part deal was reached by the EU and banks holding Greek debt. In the first part of the deal, European Union member countries agreed to increase the size of the European Financial Stability Facility (EFSF) to one trillion euros. The second part of the deal will see banks that hold Greek bonds write off 50% of their holdings. The third part will see banks increasing their capitalisation by 106 billion euros by June 2012.

The EFSF will provide financial assistance to those European countries struggling to avoid defaulting on debt commitments, such as Greece, Ireland, and Portugal.

How the Euro will function in the future is on everybody's watch list. Strengthening the structures surrounding the Euro is essential to anchor market expectations and dispel the prevailing uncertainty. In addition, a strengthening of the fiscal and economic governance of the monetary union is required.

Despite the deal European stock markets continued to fall among fears that still remain in the Eurozone, namely around the ability of Italy to finance itself, as its costs of borrowing continue to rise.

These fears abounding in the financial markets were unfortunately boosted by a shock announcement on 1 November from the Greek Prime Minister George Papandreou that a referendum would be held on bailout measures. The announced referendum was cancelled within days as the two main political parties in Greece announced they planned the formation of a unity government with a new prime minister in order to get through new regulations required as part of the bailout conditions. The financial markets will still be in a state of worry until this new unity Greek government has been fully set up and shows its commitment to pushing through required measures. This is needed as messy debt default for Greece would cause widespread damage to global financial markets, and would mean countries like New Zealand could experience problems and pay more to access global debt funding.

Otherwise the global economy has provided little good news over the past month, as all eyes and ears are still transfixed on the Euro area. For months now, the business and financial sectors of countries have been held hostage by debt and financial worries in Europe. With these concerns, growth prospects and recovery of export-reliant countries like New Zealand are also uncertain.

As to the New Zealand economy, it seems to be very much a story of 'watch and wait'. Undoubtedly, the economic conditions in New Zealand are nowhere near as bad as those in parts of Europe, the UK and the US.

Disclaimer – While best endeavours are used by BERL to ensure that the information, opinions and forecasts provided are accurate and reliable, errors or omissions may occur. BERL does not accept liability for any loss or damage resulting from reliance on, or the use, or misuse, of information, forecasts or opinions provided.

If you'd like to receive future issues of Business Matters simply register at [www.kiwibank.co.nz/newsletter](http://www.kiwibank.co.nz/newsletter)

If there's anything we can help you with call us on 0800 601 601, Monday to Friday, 8am-6pm, or email [business.banking@kiwibank.co.nz](mailto:business.banking@kiwibank.co.nz)

**kiwi**bank It's ours

Kiwibank Limited – All content is for information only, is subject to change and is not a substitute for commercial judgement or professional advice, which should be sought prior to entering any transaction. To the extent permitted by law the Bank disclaims liability or responsibility to any person for any direct or indirect loss or damage that may result from any act or omission by any person in relation to the material.