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New Zealand Business Forecast Report Q3 2014

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Abstracts

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Core Views

New Zealand's economic performance remains on a stable trend, with indicators showing that the manufacturing and services sectors remain firmly in expansion. We maintain that the pace of expansion will remain broadly the same as 2013, with just a slight acceleration to 2.7% in 2014, from 2.5% previously. While we had originally held the view that the Reserve Bank of New Zealand (RBNZ) will hold its official policy rate at 2.75%, intensifying price pressures and strong economic indicators have led us to revise up our rate forecast to expect another 25 basis points. This would bring our forecast for the official cash rate to hit 3.00% by end-2014. Accordingly, we maintain that the next rate hike will be largely pre-emptive in nature, in response to cool domestic price pressures that have been on the rise.

Volatile weather and a trend of increasing compliance/regulations will continue to pose risks to New Zealand exports, given the changing composition of its trade with the external world. While dairy exports have surged of late, we believe this is unsustainable, driven mainly by Chinese importers fearing a possible lack of supply as new regulations are set to be implemented in March. Taking a longer term view of things, we believe that the trade balance will record a surplus and continue to head in the right direction as the interest rate hike by the RBNZ to help rein in import consumption, and reduce external liabilities in the banking sector as housing-related lending cools the banking sectors. This will help narrow the current account deficit over the coming years and will allow the country to gradually pay back its huge external liabilities and reduce its vulnerability to external shocks.

While the government looks on track to record a budget surplus in fiscal year 2014/15, we maintain that debt reduction will remain sometime away as much of the surplus growth is dependent on highly optimistic forecasts in income and employment increases.

We maintain that the National party will be re-elected to office, even though there may be changes to the constitution of the ruling coalition. Issues such as economic planning, housing affordability, drought assistance for farmers and controversial decisions on the country's pull-out from the second commitment period of the Kyoto Protocol remain contentious topics that could affect the ruling party's popularity as it approaches parliamentary elections in 2014. That said, we do not see any immediate threat to its ability to formulate policy. We maintain our Short-Term Political Risk Rating at 84.0 (out of 100).

Major Forecast Changes

We have raised our interest rate forecasts for 2014, as the RBNZ has shown signs of adopting a more hawkish stance for the near term. As such, we see another 25 basis points worth of rate hikes, which will take the official cash rate to 3.00% by end-2014. Beyond this, we expect the central bank to maintain its macro-prudential rules, as there remain concerns about financial system stability given the high levels of household debt.

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