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info@marketpublishers.com

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,

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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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central bank are likely to weigh on debt-driven consumption. Together with softening milk prices and export volumes, we believe
income, job opportunities and overall growth will be capped.

Table: Economic Activity

Fiscal Policy

Weaker Revenue Growth To Slow Fiscal Consolidation

Although the New Zealand government will continue to pursue fiscal consolidation, we believe that further fiscal surplus widening will
be constrained by a slower pace of revenue growth. Dependence on financial and non-financial instruments performance, together with
overly optimistic growth and employment forecasts, suggests the fiscal surplus will widen at a slower pace.

Table: Fiscal Policy

Monetary Policy

RBNZ To Keep A Tight Rein On House Prices

Declining affordability ratios and hawkish policy measures from the Reserve Bank of New Zealand will likely cap growth in house
prices, supply-side constraints notwithstanding. We believe that stability concerns with regards to the property and banking sectors will
persuade the central bank to maintain its conservative stance.

Table: Monetary Policy

Balance Of Payments

NZD: Bearish Case Still Dominates Despite Rate Hikes

With interest rate hikes largely priced in, our more dovish-than-consensus outlook for rates and the New Zealand dollar trading at
extreme valuations, we believe that at current levels, a bearish outlook is still warranted. We further highlight that sentiment surrounding
the NZD is still very bullish, but note that weaker US growth could lead to further monetary easing, which could outweigh any kiwi
weakness from the fundamental factors.

Table: Current Account

CHAPTER 3: 10-YEAR FORECAST

The New Zealand Economy To 2023

Deleveraging Will Weigh On Growth

The main factors that contributed to New Zealand's solid real GDP growth outturn over the past decade will not be in play to the same
degree over the next 10 years. Population growth will slow, terms of trade support will

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CHAPTER 6: BMI GLOBAL ASSUMPTIONS

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