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New Zealand Business Forecast Report Q4 2013

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Abstracts

Core Views

While we have raised our forecast for 2013 real GDP to come in at 2.5%, on the back of improving global sentiment, which is likely to support private consumption growth in New Zealand, we highlight that the uptick driven by stimulus and monetary easing is unsustainable.

As such, these upgrades in no way reduce the downside risks that the New Zealand economy continues to face.

We believe that the Reserve Bank of New Zealand (RBNZ) will keep interest rates on hold at 2.50% until 2014, keeping monetary conditions easy as the economy adjusts to a slower rate of credit growth. Indeed, we expect the central bank to concentrate on cooling the housing market through its macro-prudential rules, and note that more regulation will be likely even after the increased capital requirements and restrictions on the number of low loan-to-value ratio loans (LVR).

Volatile weather and quality/contamination concerns will persist to be key risks to New Zealand exports going forward, given the changing composition of its trade with the external world. While the return to a positive trade balance is likely to have been delayed, the reduction in external liabilities of the banking sectors has helped both the trade and income accounts. The overall narrowing of the current account deficit over the coming years will allow the country to gradually pay back its huge external liabilities and reduce its vulnerability to external shocks.

The National Party remains determined on achieving its goal of returning the fiscal budget to surplus in fiscal year 2014/15. While the issues of 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), and expect the issue of affordable housing to be one of the key issues in the 2014 elections.

In this respect, the stubbornly high unemployment rate could prove to be a problem for the National party.

Major Forecast Changes

On the back of improved sentiment surrounding global economy as respective governments and central banks pushed stimulus packages and kept monetary conditions easy, we have raised our 2013 real GDP forecast to 2.5%, as we expect households to participate in this rising sentiment. While we maintain that the economy would eventually need to return to the deleveraging process, in particular, households finances remain extremely precarious, the changing structural of the economy has afford some room as its reliance on neighbouring Australia has declined.

We have revised down our expectations for current easy monetary conditions to persist for longer despite the continual rise in house values beyond 2007 highs. The main driver of this view is our expectation for declining external demand to prove too great for businesses to ignore, which could weigh on domestic demand. We now see a growing possibility for the RBNZ to cut rates instead to support businesses and maintain our expectations for the central bank to increase its use of macro-prudential tools to help temper household credit growth.

Key Risk To Outlook

A global recession, brought about by a recession in the US and China. This would hit the price of New Zealand's export commodities and corporate profits.

A banking crisis in Australia, which would likely spread to New Zealand given the external borrowing of local banks, could cause extreme stress to the financial system as liquidity and credit dry up.

This could accelerate the debt deflation spiral in the country. A strong NZD, supported by demand for 'safe' assets as uncertainty surrounding the eurozone continues, could cause the country to accumulate even greater external imbalances. We maintain that the economy has to eventually head back on the path of deleveraging and redistributing resources to productive sectors in the economy.

Volatile weather conditions, such as the extreme dry conditions in key farming regions in the north, could adversely impact export volumes and farmers' profitability. This could affect export performance, and poses downside risks to our overall growth forecast.

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Contents

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TABLE: NEW ZEALAND – ECONOMIC ACTIVITY

Economic Analysis

Risks Remain Despite Reduced Australian Exposure

The New Zealand economy has evolved since the financial crisis in 2008/09, and changes in the composition of trade and economic structure suggest that the country is less vulnerable to economic deterioration in the Australian economy. With the effect showing up more prominently in recent data releases, we have upgraded our growth forecasts, expecting real GDP to come in at 2.5% in 2013. That said, the structural transition in the Chinese economy and possible correction in the domestic housing market remain key threats to growth over the next few years.

Fiscal Policy

TABLE: FISCAL POLICY

Fiscal Discipline Of Importance Even With Second Asset Sale

The second instalment of the ruling National government's partial-privatisation drive in New Zealand is set to take place in early November, but like its predecessor Might River Power, the sale of Meridian Energy is not guaranteed to be successful. Uncertainties surrounding its valuation and investor demand hover over this sale, and a lacklustre sale could affect the government's ability to finance its infrastructure plans and pay down debt. Indeed, growing competing needs (such as housing affordability) will increasingly test the government's resolve to stick with fiscal discipline over the coming quarters.

More Measures Likely From RBNZ If Housing Credit Growth Holds Up

TABLE: MONETARY POLICY

Balance of Payments

High External Indebtedness Still A Major Risk For NZD

New Zealand's high level of net external liabilities makes its currency vulnerable to sharp bouts of depreciation should there be a coordinated outflow of foreign investment. This is despite the general trend of a narrower current account deficit as a result of the decline in reliance of local banks on their foreign parents and associates. In the event of a currency collapse, we highlight that the impact from lower credit availability and higher import costs would hamstring the local economy, but we believe that public institutions like the central bank will intervene in the event of possible capital flight from systematically important industries such as the banking sector.

TABLE: CURRENT ACCOUNT

CHAPTER 3:10-YEAR FORECAST

The New Zealand Economy To 2022

Deleveraging Will Weigh On Growth

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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 be hard to come by, and we expect New Zealand households to enter a protracted deleveraging cycle. These factors should see real GDP growth avera ge 2.4 % over the 2014-2022 period, below the 3.6% growth rate seen over the 1999-2007 boom years.

TABLE: LONG-TERM MACROECONOMIC FORECASTS

CHAPTER 4:BUSINESS ENVIRONMENT

SWOT Analysis
BMI Business Environment Risk Ratings
Business Environment Analysis
Greater Compliance Costs Expected For Food Producers
Following the contamination scare of infant powder formula from Fonterra, New Zealand's largest dairy co-operative, the government and relevant ministry have launched two separate inquiries in a definitive attempt to show their firm commitment to food safety. While New Zealand's importance to the global food chain suggests that any negative impact is likely to be short-lived, nevertheless, we expect the government to implement more stringent food safety requirements, creating a harsher business environment for the industry.

TABLE: BMI BUSINESS & OPERATION RISK RATINGS
TABLE: BMI LEGAL FRAMEWORK RATING
TABLE: LABOUR FORCE QUALITY

Business-Friendly With A Stable Outlook
Institutions

TABLE: TRADE AND INVESTMENT RATINGS
TABLE: ASIA – ANNUAL FDI INFLOWS

Infrastructure
Market Orientation

TABLE: TOP EXPORT DESTINATIONS

Operational Risk
Pharmaceuticals
Tourism

CHAPTER 5: KEY SECTORS

TABLE: PRESCRIPTION DRUG MARKET INDICATORS, HISTORICAL DATA AND FORECASTS

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