Published in the National Business Review 03/02/2012

Tracking the Economy

Interest rates firmly on hold

The RBNZ left the OCR unchanged at a historical low of 2.5% in the latest review. The continued European sovereign debt crisis and a high exchange rate will weigh on exports and tourism. Rising funding costs for New Zealand banks could weigh on investment and property markets. The government will be reducing spending, which will slow the economy.

Risks to local and global growth are to the downside and inflation is comfortably contained. The RBNZ will be hold interest rates at current levels until mid-2013. If the global situation deteriorates, interest rates may have to be lowered.

Disappointing government finances

Government finances are disappointing. The tax take is $0.8b below forecasts and growth in taxes has petered out. Expenses continue to grow in almost every area, except for insurance and interest payments. The operating deficit excluding valuation changes was $4.5b in the five months to November 2011, $0.3b behind forecasts published before the elections.

The Prime Minister reiterated the government's goals to return to surplus by June 2015. Future tax revenue take will be weaker than the Treasury's overly optimistic forecasts, so the government will have to make deeper spending cuts to achieve that.

Fiscal consolidation is an important goal, but there is nothing magical about returning to a budget surplus by 2015. A committed, transparent and cohesive plan to return to surplus over a slightly longer period would not penalise New Zealand's ability to borrow from the global market at competitive rates or inflict a rating downgrade.

Manufacturing bounce

The manufacturing sector bounced into expansion in December 2011, after two months of contraction. New orders are up and inventories are stabilising, suggesting a brightening outlook. The rebound was broad based across the region, except for a steep deterioration through the lower North Island.

Flow of milk

Dairy production is very strong, which is boosting exports. Exports of all goods rose by 8% in the December 2011 quarter from a year earlier. Two thirds of this was from dairy (mostly) and crude oil.

Strong dairy production has been helped by very good growing conditions. In November milk production was up 5% from a year earlier. This will sustain dairy exports through much of 2012.

However, exports of other goods are flattening. This remains a risk to the economic outlook.

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Word count: 382

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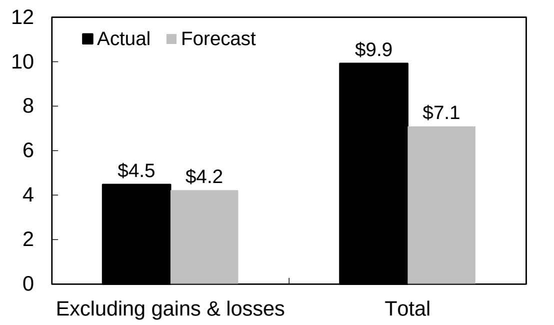
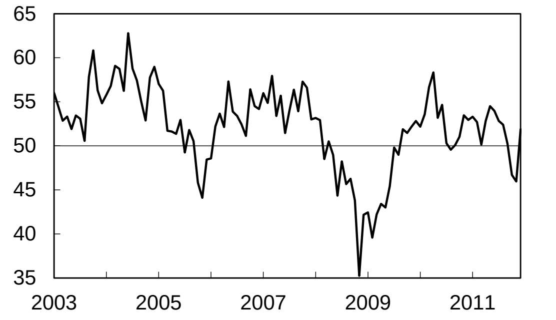
Government fiscal deficit
$b, five months to November 2011



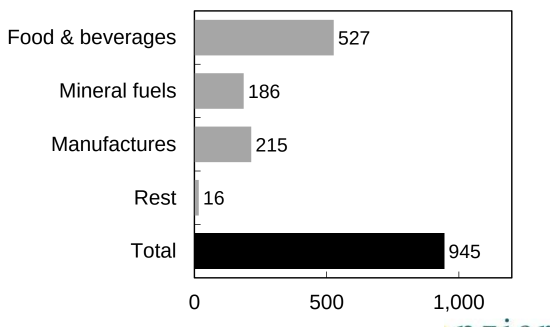
Source: The Treasury

Performance of manufacturing index
Index, >50 is expansion



Source: BNZ-Business NZ

Export growth
December 2011 quarter vs year ago, $m



Source: Statistics NZ

Dairy production
Annual % change, 3 month moving average

Source: DCANZ