Statement of Responsibility

On the basis of the economic and fiscal information available to it, the Treasury has used its best professional judgment in supplying the Treasurer and the Minister of Finance with this Economic and Fiscal Update. The Update incorporates the fiscal and economic implications both of Government decisions and circumstances as at 27 April 1998 (as well as Cabinet agreement on 4 May 1998 to the motor vehicle industry request to remove motor vehicle tariffs) that were communicated to me, and of other economic and fiscal information available to the Treasury in accordance with the provisions of the Fiscal Responsibility Act 1994.

Dr A E Bollard
Secretary to the Treasury
6 May 1998

This Economic and Fiscal Update has been prepared in accordance with the Fiscal Responsibility Act 1994. The Treasurer accepts overall responsibility for the integrity of the disclosures contained in this Update, and the consistency and completeness of the Update information in accordance with the requirements of the Fiscal Responsibility Act 1994.

To enable the Treasury to prepare this Update, we have ensured that the Secretary to the Treasury has been advised of all Government decisions and other circumstances as at 27 April 1998 (as well as Cabinet agreement on 4 May 1998 to the motor vehicle industry request to remove motor vehicle tariffs) of which we were aware and that had material economic or fiscal implications.

Hon Winston Peters
Treasurer
6 May 1998

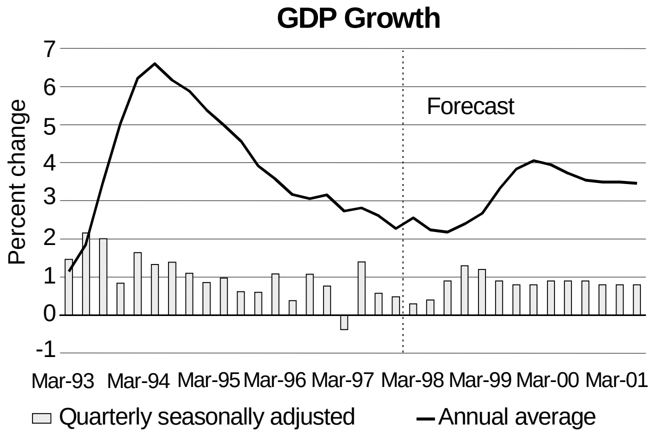
Rt Hon W F Birch
Minister of Finance
6 May 1998

Economic and Fiscal Forecast Summary

Overview

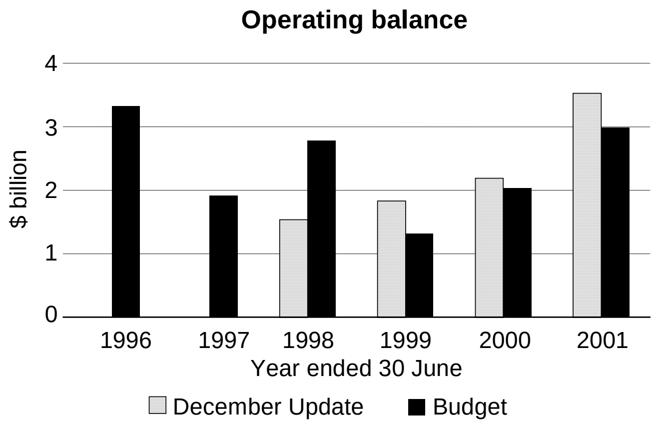
- Growth in the economy is forecast to weaken over the first half of 1998 as the economy slows, owing to the downturn in Asia and higher short-term interest rates.

- The economy is forecast to grow by 2.7% in 1998/99, supported by a forecast acceleration in growth from the second half of 1998.



- Growth is projected to rise to 3.9% in 1999/2000. Firming monetary conditions from mid-1999 will see growth moderate to around 3.5% in 2000/01.

- Lower real growth and inflation mean that the nominal economy is forecast to be smaller than expected in the *December Update*. This flows through to lower tax revenue, particularly in 1998/99.



- The fiscal surplus of $1.3 billion in 1998/99 is around $500 million lower than in the *December Update*. Surpluses rise after 1998/99 as steady growth in revenue outpaces increases in expenses.

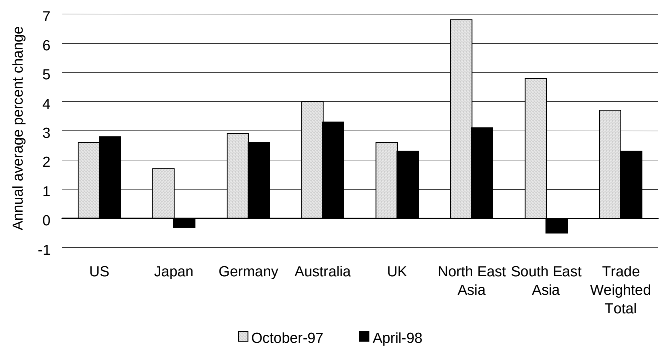
- There are uncertainties surrounding the timing and speed of the economic pick-up. In particular, there are risks around the timing of the expected recovery in Asia and vulnerability from a high current account deficit. However, operating surpluses and debt reduction are still expected to be maintained.

Economic Outlook

The Outlook for the First Half of 1998 is Weaker than Previously Forecast for Exports…

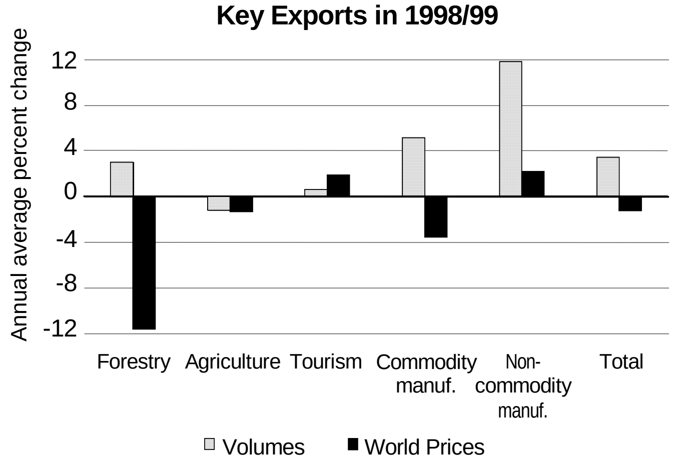
- During 1997 the economy continued to grow at a similar rate to the previous year, recording growth of 2.3% in the year to December. However, the pick-up in growth expected to occur in the second half of 1997 has been put on hold, in part by a shock to the international economy from the financial crisis in Asia.

Consensus Forecasts for World Growth in 1998



- Forecasts for economic growth in Asia in 1998 have been revised down. Consequently, forecast growth for New Zealand's top 10 trading partners in 1998 has been lowered from 3.7% in October to 2.3% in April Consensus Forecasts.

Forecast Growth for Volumes and Prices of Key Exports in 1998/99



- The most significant effect of the Asian downturn is expected to come through lower export prices, although the lower exchange rate will cushion the effect on exporters.

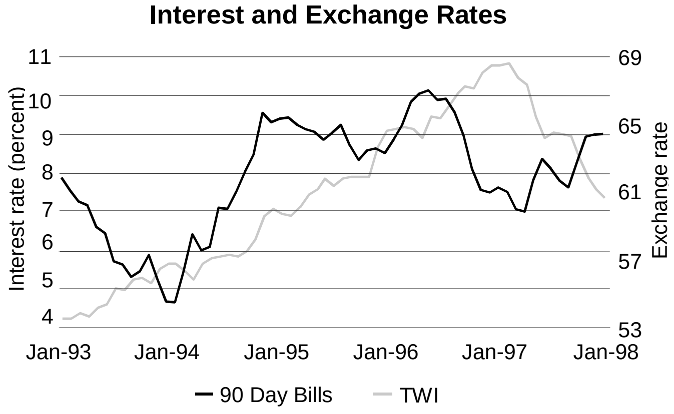
- Growth in export volumes is also expected to weaken, particularly for tourism and log exports. The drought conditions experienced in early 1998 are expected to undermine agricultural exports in 1998/99.

- Strong growth in Australia and the United States is expected to provide support for New Zealand's exports. Exports of non-commodity manufactures are forecast to continue growing at around double-digit rates through 1998/99. Other exporters have also indicated an ability to divert goods away from Asia.

... and for the Domestic Sector

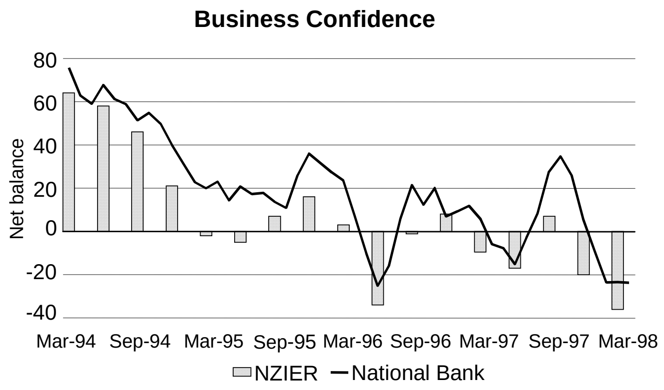
- The mix of monetary conditions has shifted further in favour of the tradeable sector. Together with an easing of monetary conditions, concern over the impact of the Asian downturn on New Zealand and the widening current account deficit has placed downward pressure on the exchange rate. To maintain monetary conditions near the Reserve Bank's desired level, 90-day interest rates have risen.

- Higher short-term interest rates will dampen domestic activity in the first half of 1998, particularly in the housing market.



- Reflecting the deterioration in the near-term outlook, business and consumer confidence has fallen.

- Given the pessimism in the economy, firms are expected to delay their investment and employment plans. Weakening demand for labour is expected to see the unemployment rate rise to around 7% in mid-1998.



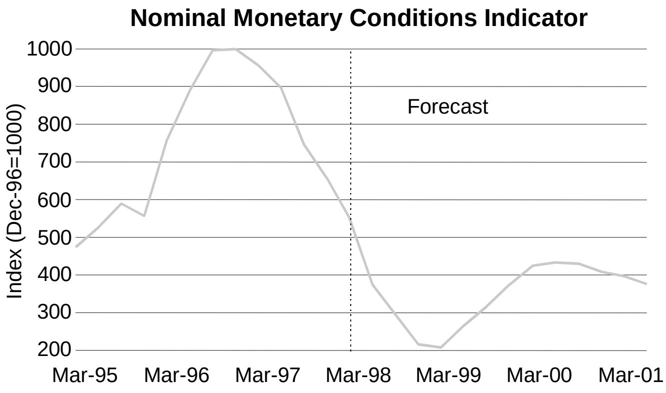
- Rising unemployment and a weaker housing market will dampen household spending. Instead, households will increase their savings.

- Forecast growth for the first half of 1998 is only around ½%. The economy is forecast to grow by 2.7% in 1998/99. Much of this growth is expected to come in the second half of the year.

A Pick-Up is Expected in the Second Half of 1998...

- Export growth is expected to strengthen from the second half of 1998 as firms begin to benefit from the lower exchange rate. In particular, exports of non-commodity manufactures are expected to accelerate as they face fewer supply constraints than the primary sector of the economy.

- Monetary conditions are forecast to ease further through 1998 as a slowing domestic economy and weak commodity prices help to dampen inflationary pressures.

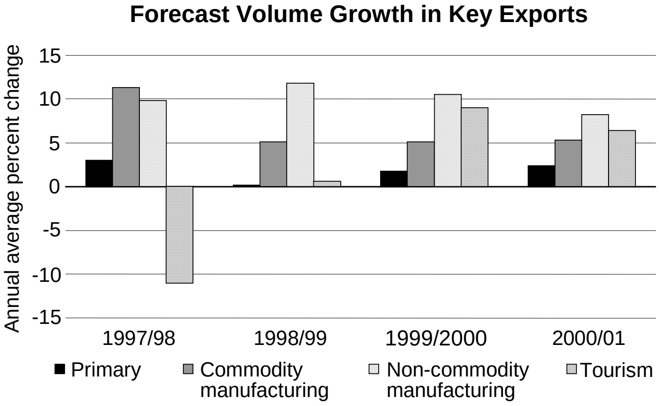


- Lower short-term interest rates, in conjunction with the tax reductions and the AMP demutualisation, are expected to provide a boost to domestic activity in the second half of 1998.

... and Gains Momentum Through 1999

- Exports of other goods and services are expected to pick up through 1999 as the lower exchange rate leaves exporters well placed for growth. The moderate recovery expected in Asia in 1999 should also provide a boost to export volumes and, more importantly, to commodity prices.

- Strengthening activity is forecast to lead to a pick-up in investment. Relative to previous slowdowns there is little spare capacity in the economy, so firms cannot postpone their investment plans very long.



- Employment growth is expected to pick up with a lag as activity rises, leading to a fall in unemployment. A stronger labour market will provide support to household consumption.

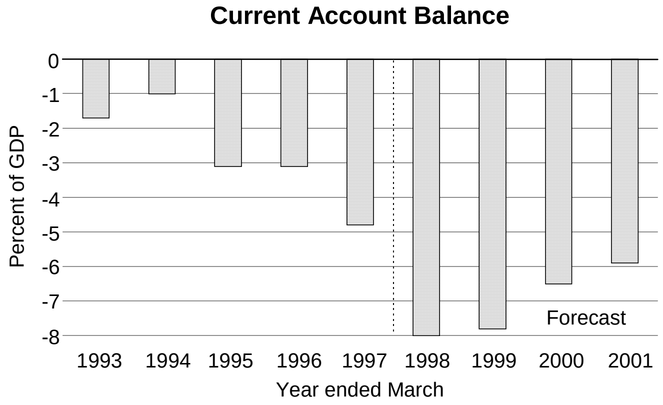
- Growth is expected to rise to 3.9% in 1999/2000. As the economy accelerates inflationary pressures are expected to build. To offset this, monetary conditions are forecast to firm from mid-1999. This is expected to cause growth to moderate to a more sustainable 3.5% in 2000/01.

The Current Account Deficit Remains Large

- The current account deficit is estimated to peak at 8% of GDP in the year to March 1998. It is expected to remain around these levels in the year to March 1999, when the second ANZAC frigate is scheduled to arrive.

- From 1998/99 the deficit is expected to fall gradually to below 6% of GDP in 2000/01. The improvement is expected to arise from a gradual improvement in the trade surplus. However, strengthening exports will be partly offset by stronger imports as the domestic economy picks up.

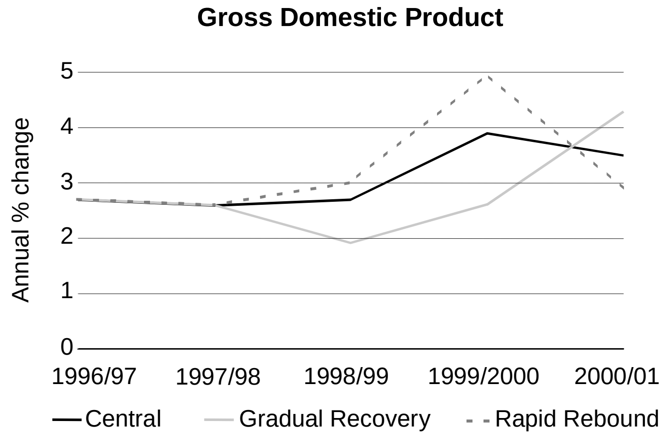
- The international investment income deficit is expected to narrow slightly over the forecast period. Returns on foreign investments in New Zealand are expected to remain steady as a percentage of GDP, while inflows to New Zealand residents from their offshore investments are expected to gradually recover.

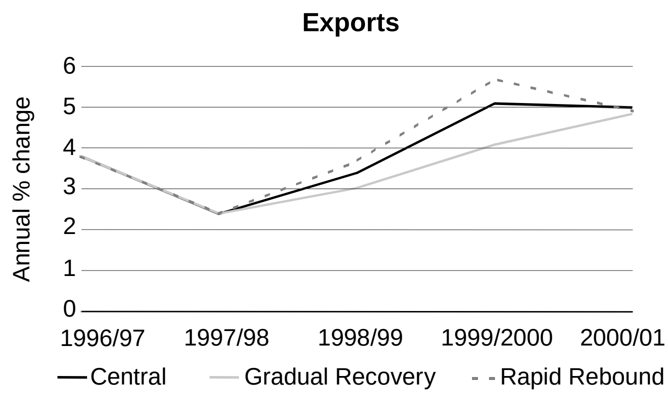


There are Uncertainties Around the Timing and Speed of the Pick-Up

- Weak business and consumer sentiment creates uncertainty around the timing and the speed of the pick-up. In addition, the international environment could turn out differently from expected. Therefore, the profile of growth from the second half of 1998 may turn out differently from that projected in the Central Forecasts.

- The economy could pick up later and perhaps more slowly than assumed in the Central Forecasts, owing to weaker export growth. Growth would then be around 1 percentage point lower in both the 1998/99 and 1999/2000 years. Growth in investment, employment and consumption would also be weaker than projected in the Central Forecasts. Monetary conditions would ease further, leading to stronger growth in 2000/01.



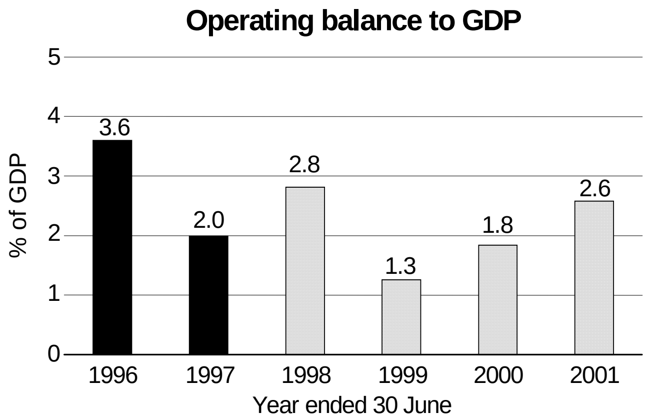


- The economy could instead pick up more rapidly. The export sector may respond more quickly to the depreciation of the exchange rate. Or the domestic sector could pick up more sharply given the combination of a projected monetary easing and tax reductions. In this case, growth would be stronger in both 1998/99 and 1999/2000, relative to the Central Forecast, but slower in 2000/01 as monetary conditions have to tighten more sharply to offset stronger inflationary pressures.

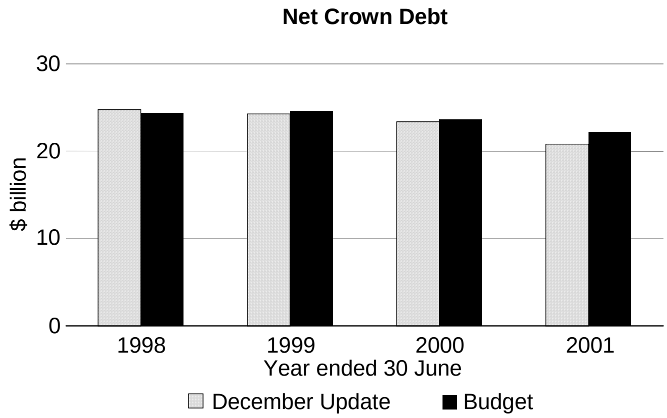
Fiscal Outlook

The Fiscal Outlook Remains Sound

- The fiscal forecasts show operating surpluses of 2.8% of GDP in 1997/98 falling to 1.3% in 1998/99, and then rising to 2.6% in 2000/01.
- The operating surplus decline in 1998/99 relative to 1997/98 reflects lower nominal economic growth, tax and tariff reductions, and the absence of one-off factors that boosted the 1997/98 surplus.



- Beyond 1998/99, the surplus rises as economic growth accelerates and revenue grows at a faster rate than total expenses.
- Net Crown debt falls over the forecast period, to around $22 billion by 2000/01 (19.2% of GDP).
- Net worth improves over the forecast period, reaching $16.7 billion by 2000/01.



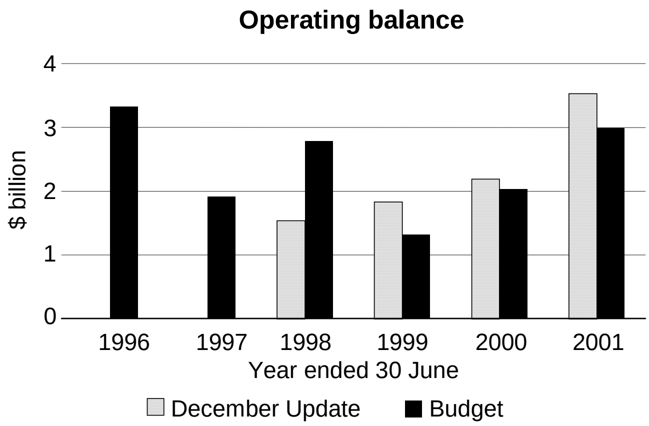
- However, these forecasts do not include the recognition of the ARCIC unfunded liability, which is due to occur at 30 June 1999. This will reduce net worth by around $8 billion. Net Crown debt will remain unchanged as the recognition has no cash impact.

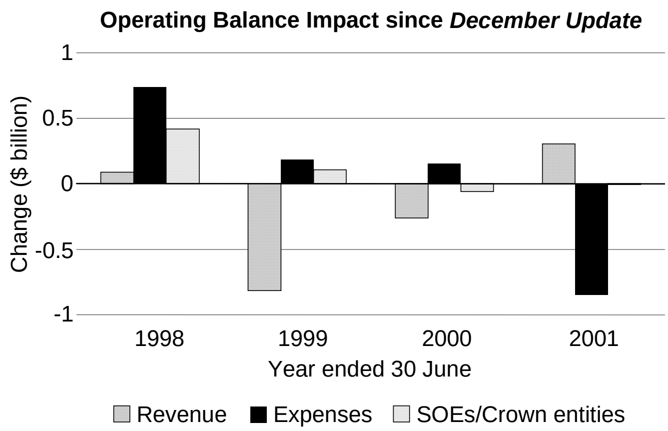
Surplus Track has Changed Since the *December Update*

- Lower short-term nominal economic growth and the removal of tariffs on motor vehicles together reduce tax revenue in 1998/99 and 1999/2000 by $850 million and $300 million respectively.

- Much of the downward revision in short-term growth falls on businesses, as subdued growth in domestic demand and continuing wage growth squeeze profits.

- As the economy picks up in 1999 and beyond, tax revenue rebounds to be $220 million higher than in the *December Update* for 2000/01.





- Compared with the *December Update,* the gross surpluses of Crown entities are significantly higher in 1997/98, largely owing to a higher-than-forecast surplus in ARCIC. In the outyears, SOE and Crown entity surpluses remain relatively unchanged.

Expense Changes Significant in 1997/98 and 2000/01

- Compared with the *December Update*, expenses are around $750 million lower in 1997/98, $150 million lower in 1998/99 and 1999/2000 and $850 million higher in 2000/01.

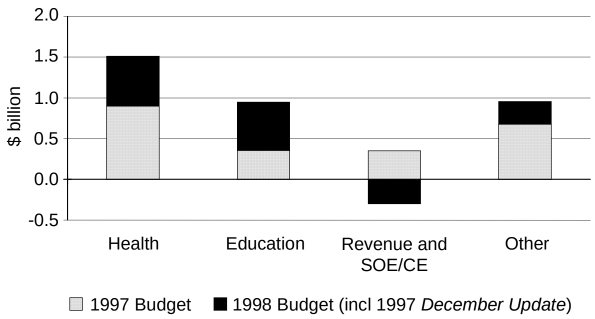
- One-off factors, such as the downwards revision in the GSF unfunded pension liability and a lower-than-forecast Equiticorp settlement, reduce expenses in 1997/98.

- The Government's decision to reduce its spending intentions by $300 million within the $5 billion package bolsters the surplus in 1998/99 and 1999/2000.

- In terms of the Government's three-year package, the net impact of policy decisions in the 1997 and 1998 Budgets is $3.5 billion. Policy decisions to date have included health, education, surcharge removal and law and order expenses.

- Policy decisions made have already been factored into the fiscal forecasts through the provision for future initiatives.

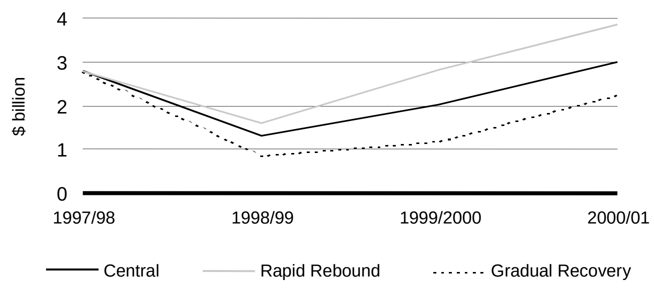
Allocated portion of $5 Billion



- As signalled in the *Budget Policy Statement*, a $900 million technical provision for new policy initiatives is included in 2000/01, which may consist of expense, revenue or SOE/Crown entity initiatives.

- The underlying fiscal position remains sound, even if the timing and speed of the economic pick-up were to differ from the Central Forecast. Ongoing operating surpluses, rising net worth and falling net Crown debt over the forecast period are still projected under alternative growth profiles.

Operating Balance



Economic Outlook[1]

(Annual average % change, March years)	1996/97 Actual	1997/98 Estimate	1998/99 Projection	1999/00 Projection	2000/01 Projection
Private consumption	4.1	3.3	2.0	2.7	2.5
Private investment	3.7	(1.9)	3.9	12.2	6.6
Exports	3.8	2.4	3.4	5.1	5.0
Imports	6.9	4.7	2.2	4.3	4.9
GDP[2]	**2.7**	**2.6**	**2.7**	**3.9**	**3.5**
Unemployment rate (%)[3]	6.5	6.9	6.7	6.0	5.6
Nominal MCI[4]	961	712	274	346	418
90-day bill rate (%)[4]	9.0	8.0	8.0	8.8	9.1
CPIX inflation (%)[5]	2.0	2.0	1.6	1.7	1.5
Current account balance[6]	(4,522)	(7,834)	(8,026)	(7,029)	(6,757)
Ratio to GDP (%)[7]	(4.8)	(8.0)	(7.8)	(6.5)	(5.9)

Fiscal Outlook[1]

($ billion June years)	1996/97 Actual	1997/98 Estimate	1998/99 Projection	1999/00 Projection	2000/01 Projection
Total revenue	34.8	36.0	36.3	38.2	40.2
Ratio to GDP (%)[7]	36.2	36.5	34.9	34.8	34.8
Total expenses	33.0	34.3	35.8	37.1	38.3
Ratio to GDP (%)	34.3	34.7	34.5	33.8	33.1
Operating Balance	**1.9**	**2.8**	**1.3**	**2.0**	**3.0**
Ratio to GDP (%)	2.0	2.8	1.3	1.8	2.6
Net worth	7.5	10.4	11.7	13.7	16.7
Ratio to GDP (%)	7.8	10.5	11.3	12.5	14.5
Gross Crown debt	36.0	36.9	36.9	36.3	35.4
Ratio to GDP (%)	37.5	37.3	35.5	33.0	30.6
Net Crown debt	25.3	24.4	24.6	23.6	22.2
Ratio to GDP (%)	26.4	24.7	23.7	21.5	19.2

Notes:
1 Economic forecasts were finalised on 7 April 1998, fiscal projections on 4 May 1998.
2 Production based measure.
3 HLFS unemployment as a percentage of the labour force, seasonally adjusted, March quarter.
4 Average for year to March.
5 Annual percent change in the Consumers Price Index excluding credit services, March quarter.
6 $ billion.
7 All ratios are of nominal GDP on an expenditure basis, March years for the economic outlook, June years for the fiscal outlook.

Sources: Statistics New Zealand
The Treasury