Business|NZ

Business Planning Forecasts

26 May 2006

FORECASTS: JUNE QUARTER 2006

Introduction

This bulletin is designed to help plan your business. It brings together forecasts of important indicators to help you prepare budgets and business plans.

The forecasts are drawn from two main sources. The New Zealand information is based on a survey of the five main trading banks (ANZ, ASB, BNZ, National, and Westpac). The Australian information is based on consensus forecasts put together by the UK based magazine “The Economist”. Sources of other information are as shown.

We stress that the information in this publication is by its nature uncertain. Your firm is unique, and you will need to make your own decisions. However, we believe the better informed you are about the way various business people see the future, the better decisions you can make.

Where appropriate we have not only included the average value across all forecasters, but also the highest and the lowest forecast. This gives some idea of the spread of forecasts, and therefore an idea of the uncertainty involved.

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Executive Summary – The Landscape is Starting to Emerge

Last quarter our forecast summary started with a mountain analogy. Given the recent news stories about a no-legged man climbing up the biggest one and the most well known mountaineer in the world also in the headlines, we think we'll keep with this theme as it seems to be popular. During the March quarter the debate amongst economic commentators was whether the walk downwards after reaching the economic peak will hit rock bottom, or whether it will plateau out after only a few steps. Our belief is that a sudden descent to rock bottom isn't much of a bet to occur. Instead, a few steps down followed by some levelling off are more likely.

Economic indicators currently seem to be playing a game of 'Even Stephens'. A release of economic news shows a downward movement, followed by some other that shows a lift. Apart from this making the life of an economist extremely difficult, it shows that the complete downward trend many were expecting will probably not eventuate. There are simply too many insulation factors going on, particularly in the labour market for any fears of doom and gloom to hit the New Zealand economy.

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +2.2 % for the year-ended December 2005.

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period. Over the past six years GDP growth has averaged 3.9% per annum, which indicates a strongly performing economy and higher growth rates than many other countries New Zealand compares itself with. However, recent developments show that annual rates of growth are about to head south.

GDP growth for the December quarter was actually negative growth (-0.1), for the first time since the June 2000 quarter. This ended up negating the 0.1% gain for the September quarter, meaning the New Zealand economy was at a standstill for the last six months of 2005. A decrease in growth in the December quarter was largely due to a decline in the service sector, with wholesale trade (down 2%), transport & communication services (down 1.5%), and manufacturing production (down 0.9%).

The fall in wholesale trade activity came about due to a fall in motor vehicle wholesaling, while transport & communication services was influenced by lower volumes of domestic and international air transport. Most manufacturing industries recorded decreases this quarter.

In contrast, government administration & defence remained buoyant this quarter (up 3.7 percent), while construction activity increased 3.2%, after a 4.2% decrease in the September quarter.

Real Gross National Disposable Income, which is a measure of the volume of goods and services New Zealand residents have command over, increased 1.5% during the December 2005 year.

The fourth-consecutive fall in annual growth provides an indicator that further drops in growth can be expected over the medium term. On average, GDP growth is expected to fall to around 1.4% by June 2008, although there is general consensus that it will rebound during 2008 to be back over the 2% mark. However, that is still nowhere near enough growth to even contemplate a climb up the OECD rankings in terms of GDP growth per person.

Forecasts: Real GDP % Growth

	Years Ending		
	Jun 06	*Jun 07*	*Jun 08*
Highest	1.7	1.8	2.7
Average	1.6	1.4	2.3
Lowest	1.3	1.0	1.9

Source: ANZ, ASB, BNZ, National, and Westpac

Key factors to influence GDP over the next two years will include:

Interest rates – No news from the top

New Zealand's Official Cash Rate (OCR) continues to be at the summit of rates in the world, although our interest rate mountain isn't as big as it used to be as other countries are catching up.

Since the last quarterly forecast the Reserve Bank has continued with its no change policy. The OCR has been left at 7.25% for the third consecutive time. The Reserve Bank noted, *"while the economy has weakened faster than expected, short-term inflation pressures have intensified".* The Reserve Bank believes the anticipated slowdown in domestic demand will continue through 2006, although growth in exports and import substitution will kick in. Again, the Reserve Bank has reiterated their view that there appears to be no scope for a cut in the OCR during 2006.

The New Zealand Dollar – Further avalanches expected?

There was a key period of just less than two months between February and March whereby the New Zealand dollar took a tumble against most major currencies. The drop was fast and significant, causing the NZ$/US$ exchange rate to fall from around US68.2c to just under US60c. Likewise, the TWI fell from 69 to under 63, following a period of indifferent results where the NZ$ appeared to hover. Since then the NZ$ has stabilised somewhat, although expectations of another short and sharp fall cannot be ruled out in the coming months.

Tourism and net migration flows – Have we knocked the %^&#$% off?*

Over the past two to three years strong tourism numbers have helped maintain retail sales growth, and large migration inflows have boosted domestic consumer spending, car sales and house building. Migration has also, to an extent, helped mitigate some of the pressures that have built up in the labour market. Currently, tourism numbers remain high but have probably reached their peak, while migration numbers show some improvement after a steady decline since 2003.

The annual net migration gain peaked at +42,500 for the year ended June 2003 but fell as low as a +6,000 gain for the year ended October 2005 before improving to stand at +10,080 for the year ended April 2006. While arrivals of New Zealanders and non-New Zealanders have remained relatively stable over recent years, what has mainly halted the decline has been a drop in the number of departures from New Zealand, which had previously been steadily rising since the later half of 2003. Arrivals into New Zealand have remained relatively stable for around a year, at around 80,000 per annum, with total departures at around 70,000. The key difference between New Zealand and Non-New Zealand arrivals and departures is that we are continuing to lose New Zealanders at a greater rate, with a net loss of 23,900 for the year ended April, up 12% over the previous time period.

Continuing positive net migration figures will breath life into the property market, as people arriving in the country obviously need somewhere to live. Although one could argue that the property boom of 2000-2003 is over where capital gains in some areas were nothing short of spectacular, latest figures show the trend is still upwards, although at a much more leisurely pace.

Looking at recent figures, the median sell price for a house continues to increase, after a period towards the end of last year where prices oscillated just under the $300,00 mark. However, the median price for a house in April was $305,000, up from $302,000 in March. In comparison, the median price in April 2005 was $272,000, an annual increase of 12.1%. The number of days taken to sell a house however is now firmly entrenched over the 30-day mark, taking an average 34 days to sell for April 2006, compared with 28 days in April 2005. Overall, the market is still relatively steady, although some price adjustment downwards after years of strong price increases can never be ruled out in the short-medium term.

Short-term visitor numbers to New Zealand were up 16,900 (10%) from April 2005. Seasonally adjusted monthly visitor arrivals were up 2% in April 2006 following no change a month earlier. The annual increase was probably due to the change in the timing of the Easter holidays, as the annual visitor numbers show April 2005 and 2006 at fairly similar levels after 7 years of considerable tourist growth. The average length of stay was 17 days in both April 2006 and 2005, with a boost in the number of Australian and U.K visitors, although numbers from Japan were down.

Commodity prices – Is it a blip in the slide?

Although New Zealand's key commodity prices had been declining since May 2005 after reaching historic highs, the latest results bucked the trend showing a 1.6% increase for April. The turnaround was mainly due to rises in prices of apples, aluminium and skins. The decent decline in the New Zealand dollar exchange rate has boosted returns to exporters, when converted to New Zealand dollars. The NZ Dollar Commodity Price Index rose a further 4% in April, pushing the series to a four-year high.

Business confidence – Some reprieve from the slide evident

Business confidence influences the propensity for businesses to invest in capital and employ staff, so is an important determinant for future economic growth. Businesses were somewhat pessimistic late last year and this pessimism has continued over more recent months.

The March 2006 NZIER Quarterly Survey of Business Opinion (QSBO) reported that much of the drop in the general business situation recorded in December 2005 had been recovered. Although businesses are still more negative than positive (a net 41% of firms expect deterioration), the sharp depreciation of the NZ dollar during the last three months helped confidence bounce back to some extent. Also, the fact that the Reserve Bank did nothing to the OCR and indicated it may be at the peak helped allay fears for many businesses in respect to the cost of borrowing.

Another interesting (and perhaps more worrying aspect) is that a net 7% of firms reported a decline in their own trading activity during the past three months.

Typically, the correlation between how their business is going compared to how all businesses are going is not normally strong (i.e. my sector is performing badly but my business is doing ok). This certainly raises questions about the dreaded 'R' word, as it was also the case in the December 2005 survey. The next GDP result will help to provide some handle on this.

Like the QSBO, the National Bank Business Confidence Index shows a turn around in pessimism during 2006. During April a net 32% of respondents expected business conditions to deteriorate over the coming year, an improvement from a net 51% anticipating a decline in March. Again, the fall in the NZ dollar played a substantial part in the change of sentiment, although there are enough inhibitors such as tight monetary conditions and high petrol prices to stop businesses getting too excited about the near future.

The seasonally adjusted Business New Zealand Performance of Manufacturing Index (PMI) stood at 53.1 for April, compared with 52.4 and 59.3 in April 2005 and 2004 respectively. So far, the results for the PMI in 2006 have mostly shown expansion in activity, after the later half of 2005 was mainly in decline. Interestingly, the QSBO found that manufacturers recorded the sharpest bounce in the net balance relating to the general business situation. The fact that many manufacturers rely on the value of the NZ dollar and its subsequent fall would have provided many with a sense of relief for future activity.

Consumer confidence – Rocky Mountain High

The Westpac McDermott Miller Consumer Confidence Index continued to slide, being at its lowest level in five and a half years. Although there continues to be more optimists than pessimists, the trend indicates that expectations are for the economy to weaken both over the next 12 months and over a longer 5-year horizon.

1.2 Inflation

Most recent outcome: +3.3% year-ended March 2006

The rate of inflation, as measured by the Consumer Price Index (CPI), provides an indication of the extent to which price levels have increased and is indirectly a benchmark for wage demands. It is also the key reference point for monetary policy.

Inflation rose 0.6% in the March quarter, with the impact of housing, food, and recreation & education leading the way, with increasing petrol prices playing the lead role as far as single item inflation is concerned. Overall, the inflation rate stood at 3.3% for the March year, which was the third consecutive time it exceeded the 1-3% inflation target by the Reserve Bank, although it was still not as high as the 3.4% for the September 2005 year.

The Reserve Bank is continuing to watch these figures with extreme scrutiny. Although the headline rate is still above the upper threshold, the good news is that the figure is not continuing to blow out well beyond the 3% mark. However, the longer it remains above this level the more uncomfortable they are going to get.

Concerns remain over wage inflation and the ever-increasing price of petrol. Both these factors are also causing issues for businesses, who may decide that such increases will have to be passed on to consumers (again, the QSBO has picked up on this fact with a rise in businesses looking to pass on higher costs through higher output prices).

CPI forecasts show a further increase in annual inflation to 3.6% in the near term, although easing below the 3% upper limit by June 2007 and continuing to ease into the following year.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Jun 06	*Jun 07*	*Jun 08*
Highest	3.7	3.2	2.9
Average	3.6	2.8	2.5
Lowest	3.4	2.5	2.0

Source: ANZ, ASB, BNZ, National, and Westpac

1.3 Labour Costs

Most recent outcome: +3.3% year-ended March 2006

Statistics NZ produces an index that measures movements in the total cost of employing labour, the Labour Cost Index (LCI). The LCI has fixed industry and occupation weights and measures changes in wages and salaries for a fixed quantity and quality of labour input. As such, the LCI is preferred by the Reserve Bank as a measure of labour costs.

Stronger demand for labour over recent years has caused skills shortages in a number of industries and regions, so pushing up average labour costs. Growth in the LCI has increased steadily since 1999 which reflects stronger employment growth and lower levels of unemployment. The latest wage inflation results continue to show the ongoing stretch in the labour market, with wage inflation at historic highs (the March annual result was the strongest since the LCI began in 1992). Private sector salary and ordinary time wage rates increased 0.6%, taking the annual rate up to 3.2%, again another historic high.

Unlike previous quarters, the public sector did not attract the largest rise in labour costs for the March quarter. Over the quarter, wage and salaries rose 0.4%, well down on the 1.2% and 1.5% for the December and September 2005 quarters respectively. However, annual increases in the public sector (+4%) are far higher than that of the private sector (+3%).

Just when we think we have probably experienced the peak of the wage inflation mountain, further data comes through that shows there is still life in the increase yet. However, as other labour market indicators show that headline values are starting to head in the opposite direction, there should be a gradual unwinding of wage inflation pressures in the near-medium term.

Labour cost forecasts show this to be the case, with average expectations generally in line with overall inflation levels.

Forecasts: Labour Cost Index % Change

	Years Ending		
	Jun 06	*Jun 07*	*Jun 08*
Highest	3.4	3.0	2.5
Average	3.2	2.6	2.2
Lowest	2.9	2.1	1.9

Source: ANZ, ASB, BNZ, National, and Westpac

An alternative measure of labour costs is the Quarterly Employment Survey (QES). The QES tends to be much more volatile than the LCI, mainly because it reflects compositional changes in the labour force. The most recent QES release shows that average total hourly earnings for all sectors grew by 4.6% for the year-ended March 2006. Although this was a drop from the previous quarter, it was still the second highest annual growth since 1990.

1.4 Employment

Most recent outcome: +2.6% year-ended March 2006

Employment growth has been increasing on an annual basis since 1999. According to the Household Labour Force Survey, the number employed has grown by 54,000 in the year to March 2006, which represents an annual increase of 2.6%. The March quarter result bucked recent developments that showed a slowdown in the growth of numbers employed. The March quarter result in particular was stronger than most predicted, with a 23,000 gain for that quarter, almost all in full-time employment.

The unemployment rate now stands at 3.9%, up from 3.6% for the December quarter and the highest level since June 2004. New Zealand has slipped from 1st to 2nd on the OCED rankings, behind South Korea at 3.6%. The increase in the unemployment rate comes as no surprise, given the extremely low base it has increased from. A slowing economy will tend to cause the rate to lift over time, although the current rate is still near historic lows.

The ANZ Job Vacancy series continued to ease during the March quarter, down to 9% from 9.2% in the December quarter. The series, which matches job advertising against employment, fell, as an increase in job advertising in the March quarter did not match the increase in the level of employment over the same period.

Unemployment forecasts show a continuing upwards movement of the unemployment rate over the next two years, hitting near the 5% mark by mid-2008. The increasing unemployment rate should help relieve labour shortages many firms have faced over recent years.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	Jun 06	*Jun 07*	*Jun 08*
Highest	4.0	5.3	5.6
Average	3.9	4.6	4.9
Lowest	3.7	4.1	4.4

Source: ANZ, ASB, BNZ, National, and Westpac

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 7.47% as at 26 March 2006

In general, overdraft and mortgage interest rates move in line with the 90-day bill rate, which is in turn heavily influenced by the Reserve Bank's OCR (although they may be in variance if the markets price in future increases or decreases in the OCR).

The Reserve Bank remains concerned that strong inflationary pressures exist, with certain economic data showing the catalysts for further high levels of inflation have not subsided to the level they would want (wage inflation is a particular concern at the moment, along with the possible passing on of costs to consumers by businesses).

Predictions for the 90-day bill rate have largely been revised down for the medium-long term, with the short-term level largely unchanged. Although further increases in the OCR cannot be ruled out over the short-medium term, we reiterate that it would be somewhat surprising if they were raised given the general slowing of the economy now evident.

Forecasts: Interest Rates (90 day bills)

	As at End of		
	Jun 06	*Jun 07*	*Jun 08*
Highest	7.5	6.7	6.1
Average	7.5	6.3	6.0
Lowest	7.4	5.9	5.9

Source: ANZ, ASB, BNZ, National, and Westpac

1.6 Exchange Rates

Most recent outcome: NZD = US$0.638 as at 25 May 2006
NZD = AU$0.844 as at 25 May 2006
TWI = 63.4 as at 25 May 2006

As mentioned above, the NZ$ has fallen over recent months, much to the relief of many export orientated businesses. Over recent weeks, there has been some rallying of the NZ$, in part due to weakness in the US$ as the Federal Reserve has suggested further increases in their OCR may not be on the agenda.

Due to the recent drop, forecasters have significantly revised their expectations downwards for the short-medium term, while exchange rate values for 2008 have largely remained unchanged.

AUD (cents)			
	Jun 06	*Jun 07*	*Jun 08*
Highest	86.0	80.5	85.0
Average	83.5	77.1	82.4
Lowest	81.8	72.0	78.0

USD (cents)			
	Jun 06	*Jun 07*	*Jun 08*
Highest	63.0	58.0	61.0
Average	62.5	55.5	58.5
Lowest	62.0	53.0	56.0

TWI			
	Jun 06	*Jun 07*	*Jun 08*
Highest	64.5	58.4	62.3
Average	62.7	55.3	60.9
Lowest	62.0	52.0	58.5

Source: ANZ, ASB, BNZ, National, and Westpac

Part 2: The Australian Economy

Monitoring the performance of the Australian economy is critical in that firstly, it provides a measure of how well New Zealand exporters are likely to fare (a stronger Australian economy will be generally 'suck in' imports) and secondly, it provides an indication of the likely strength of competition from Australian sourced products on the domestic market.

2.1 Economic Growth (GDP)

Most recent outcome: +2.7% for the year-ended December 2005.

Forecasts (averages):
- Mid 2006: +3.1%
- Mid 2007: +3.3%

Source: The Economist

Australia's annual GDP fell to 2.7% for the December 2005 year after recording 2.8% growth for the September 2005 year. However, forecasts point to increases in growth, with a growth rate over 3% by mid 2006.

Some key recent economic statistics:

- Real retail sales up 5.0% in March 2006 compared with March 2005.
- New motor vehicle sales down 3.3% for March 2006 compared with March 2005.
- Manufacturers sales up 0.8% for December 2005 compared to December 2004.
- Dwelling unit approvals down 8.0% for March 2006 compared to March 2005.
- Employment up 1.2% for April 2006 compared to April 2005.
- Unemployment rate of 5.1% as at April 2006 – the same as at April 2005.
- Company profits before tax up 19% for December 2005 compared to December 2004.

The latest Australian PMI results show that Australian manufacturing faces a similar situation to New Zealand. The PMI experienced a low 44.2 in November 2005, and was in decline for the later half of 2005. However, things have improved, with results showing a moderate level of activity.

2.2 Headline Inflation

Most recent outcome: +3.0% for the year-ended March 2006

Forecasts:
- Mid 2006: 2.9%

Source: The Economist

Inflation in Australia continues to hover around the upper threshold of 3%. Most of the inflationary effects for the March quarter have come from health and education, which is also the case when examining the change over the March year. Commentators are predicting inflation to continue to hover around the 3% mark by mid 2006.

Australia's wage cost index increased by 4.0% for the year ended March 2006, while Australia's unemployment rate stands at 5.1% - considerably higher than New Zealand's current rate of 3.9%.

2.3 Interest rates (90-day bills)

Most recent outcome: 5.81% as at April 2006

Late in 2003 the Reserve Bank of Australia (RBA) increased its OCR twice (from 4.75% to 5.25%) but left it untouched during the whole of 2004. In March 2005, the RBA decided to increase the OCR by 25 basis points, due to reduced capacity, stronger inflationary pressures, stronger domestic and global demand, and increased prospects of spending growth. The RBA then increased it by another 25 basis points in May 2006, lifting the rate to 5.75%.

Consumer price inflation continues to hover at the upper threshold of 3%, and the latest increase in their OCR by the RBA was in reaction to increased international developments stimulating growth in Australia, as well as domestic spending growing at a solid pace that is likely to continue. Another increase in the short term cannot be ruled out.

Part 3: Rest of the World

The economic picture in the rest of the world is very important for New Zealand. Over recent quarters, growth in the world economy has picked up, which will lift demand for New Zealand products and commodities.

United States

General consensus shows that America's growth is expected to dip over 2006. Currently, growth stands at 3.2%; with predictions growth will slow to 2.8% sometime in 2006, as record-high personal debt levels lead to decreased domestic demand.

The US PMI continues to fair better than most other countries, with values indicating healthy expansion (latest figures show a value of 57.3 for April).

Industrial production increased 0.7% in February, which means America's industry is now running at 81.2% capacity, slightly above its long run average of 81%. However, construction is lagging, and housing starts dropped by 7.9% in the same month.

The US Federal Reserve tightened interest rates in March and May by another 25 basis points, making it sixteen straight increases. However, the Federal Reserve has alluded to the fact that further increases in the short term are not a sure bet.

America's unemployment rate continues to hover around the 4.7% mark, largely unchanged during the first four months of 2006. Inflation has now been positive for 4 months, after a period last year when deflation was evident, however annual inflation continues to linger around 3.5%.

Asia

Most Asian countries are continuing to perform well, with strong GDP results forecast for the next year ahead. China's latest GDP growth rate is almost at 10%, with industrial production also strong. The sheer size of demand for basically everything the world has to offer has helped provide increased growth for its economic neighbours.

Europe

In the Euro area, industrial production was flat for the start of 2006, but still up 2.5% than a year earlier. Labour costs, including wages and benefits increased by 2.4% in the year to December. In France alone, they rose by 3.3%.

In Britain, consumer prices rose by 2% in the year to February, right on the Bank of England's inflation target. Growth in Britain is expected to remain above 2% for 2006 and 2007.

Forecasts: World GDP Growth (Selected Trading Partners)

Country	*Latest*	*2006*
Australia	2.7%	3.1%
Canada	2.9%	3.1%
Japan	4.0%	2.9%
United Kingdom	1.8%	2.1%
United States	3.2%	3.3%
Euro Area	1.7%	2.0%

Source: Economist

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

Country	*Latest*	*2006*
Australia	3.0%	2.9%
Canada	2.2%	2.1%
Japan	0.5%	0.3%
United Kingdom	2.0%	1.9%
United States	3.6%	2.9%
Euro Area	2.3%	2.1%

Source: Economist