

Business Planning Forecasts

16 FEBRUARY 2006

FORECASTS: MARCH 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.

Business New Zealand
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Executive Summary – What Will 2006 Hold for New Zealand Businesses?

The slowdown is on. Recent economic data suggests that the peak has been reached, and the walk down the other side of the mountain has taken its first few steps. The debate currently doing the rounds amongst economic commentators (and indeed politicians) is whether the walk downwards will hit rock bottom, or whether it will plateau out after only a few steps.

Most economic indicators are now pointing south or are close to the turning point. A gradual trend downwards in the NZ\$ over recent weeks will be welcome news to exporters, who have found life difficult with an NZ\$ that has been strong during 2005. However, how quickly the dollar falls will be significant, as a steep fall could bring about imported inflation, raising the possibility of further OCR increases by the Reserve Bank.

Although the labour market remains extremely tight with unemployment at historically low levels and wage pressures high, we have probably experienced the peak of the wage inflation mountain. Other labour market indicators show that headline values are starting to head in the opposite direction, with employment pressures beginning to ease.

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

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

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period. GDP growth has averaged 3.7% per annum over the past five years, which typifies a strongly performing economy over recent years. However, recent developments may prove a turning point for growth.

GDP growth for the September quarter was down on the previous quarter (rising 0.2% compared to 1.2% for the June quarter and 0.7% for the March quarter). Growth in the September quarter was largely due to internal demand, as both household consumption expenditure (up 1%) and business investment in fixed assets (up 2.2%) continued to provide positive results. Offsetting the rise was a fall in merchandise exports (down 2.9%), as well as an increase in imports of 2.4%. Real Gross National Disposable Income, which is a measure of the volume of goods and services New Zealand residents have command over, increased 2.4% during the September 2005 year.

The fall in annual growth for the third consecutive quarter provides an indicator that further drops in growth are expected over the medium term. On average, GDP growth is expected to fall to around 1.6% by March 2007, although there is general consensus that it will rebound during 2008 to be at similar levels experienced currently.

Forecasts: Real GDP % Growth

	Years Ending		
	Mar 06	Mar 07	Mar 08
Highest	2.6	1.7	3.0
Average	2.5	1.6	2.5
Lowest	2.2	1.2	1.6

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

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

Interest rates – Holding for Now

Interest rates continue to provoke often-heated discussion amongst commentators, especially from sectors where the high NZ dollar has been negatively influencing export returns, exacerbated by high interest rates. Since the last quarterly forecast the Reserve Bank have increased the Official Cash Rate (OCR) to 7.25% in early December (which was widely picked as a certainty by the market), although choosing to leave it at that level for the late January announcement. The Reserve Bank noted, *“the economy has continued to slow in recent months”*. However, the Reserve Bank also stated that while *“we do not expect to raise the OCR further in*

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this cycle; however, this possibility cannot be ruled out until we see clear evidence of a sustained weakening in domestic demand". Certainly any talk of a drop in the OCR in the near future looks improbable, as the Reserve Bank remains concerned about the *"relatively high medium-term inflation outlook"*.

The New Zealand Dollar – Turning of the Tide?

The performance of the New Zealand dollar over recent months has been somewhat in a holding pattern against most major currencies. There is a continuing belief that the NZ\$ is considered to be over-valued by many economists with a substantial downward correction largely expected. Looking at the Trade Weighted Index (TWI) the NZ\$ continues to hover around the 69-71c mark, with a similar experience against the US\$ of 67-71c. Although some short term spikes appear, the general trend for the last 3-4 months tends to indicate a gradual lowering of the NZ\$. Although commentators have been surprised on the upside in previous estimates of the NZ\$, one would bet that the NZ\$ should head down rather than up in the months ahead, although how quickly that fall will continue in the near future will largely depend the results of economic indicators during the first half of 2006 and beyond.

Tourism and net migration flows – A Mixture of Good and Bad

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. While the prospects for tourism appear good, net migration is continuing to turn downwards at a sharp rate.

The annual net migration gain peaked at 42,500 for the year ended June 2003 but has since fallen to 6,400 gain for the year ended September 2005, although improved slightly for the December 2005 year at 7,000. What has 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. Most commentators have predicted a stabilising mark from anywhere between 5-10,000 over the medium term.

Further falls in net migration figures will have particular knock-on effects in the property market, as people arriving in the country obviously need somewhere to live. It appears the continued falls in net migration numbers have finally started to hit the property market, after a period of catch-up when net migration boomed from 2000-2003.

Looking at recent figures, the median sell price for a house actually fell for the month of December, down to \$295,000 from \$300,000 in November, although up from \$265,000 at the start of 2005. The number of days taken to sell a house remained at 27 days, compared with 30 for June and July. However, there are warnings that a slowdown is just around the corner. Although statistics released by Quotable Value show residential property prices increasing 16.8% over the last 12 months, anecdotal

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evidence from real estate agents show a quiet January 2006 period compared with previous January results, with sales volumes dropping 30-40% for particular real estate agencies.

Short-term visitor numbers to New Zealand were down 6,000 (2%) from December 2004. Seasonally adjusted monthly visitor arrivals were up 2% in December 2005 following a fall of 1% a month earlier. The average length of stay was 22 days in both December 2005 and 2004, while there was an increase in the number of visitors from China, but fewer visitors from Australia and the U.K. Continued falls in the number of short-term visitor will have flow-on effects on the value of the NZ\$.

Commodity prices – Falls Continue

International commodity prices have boomed since 2003 although there are ongoing signs that the slip downwards has now fully kicked into gear. ANZ Bank's World Commodity Price index has fallen for the eighth consecutive month, and pulls the series down to a 1.5-year low. Leading the index fall in January were sharp drops in the prices of wool, beef, lamb, skins and apples. When converted to local currency terms, the ANZ NZ Dollar Commodity Price Index rose 1.2%, given the fall in the kiwi dollar over recent times.

Business confidence – All Bad News

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 in the year and this pessimism has continued over more recent months.

The December 2005 NZIER Quarterly Survey of Business Opinion reported that firms were the most pessimistic they had been since 1986. When the data was adjusted for the usual pattern of seasonal variation, firms were the most despondent for 35 years. Confidence was down in all sectors and regions, with manufacturers being the most pessimistic (backed up with our own PMI results – see below). Although confidence surveys can end up providing a false indication of what is actually happening (i.e. my sector is performing badly but my business is doing ok), the fact that a seasonally adjusted net 5% of firms reported a decline in their own activity, while a net 9% expect their own trading activity to decline over the next quarter certainly raises alarm bells. The fact that the opinion survey also found that obtaining skilled or unskilled labour was less difficult than recent years backs up the general signs of a turning point in labour market statistics.

The National Bank Business Confidence Index shows continued pessimism. In December 2005, a net 62% of businesses expected general conditions to deteriorate over the coming year compared with a net 66% in November. Confidence was particularly low amongst the agricultural sector (-85%), followed by the retail sector (-67%). Firms' own activity expectations also fell into negative territory for the first time in over 5 years, with a net 2% of respondents expecting conditions in their own businesses to deteriorate.

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The Business New Zealand Performance of Manufacturing Index (PMI) stood at 44.1 for January, compared with 51.4 and 52.6 in January 2004 and 2005 respectively. The January results were the worst since the survey began in 2002. Although 2004 was considered a good year for manufacturing in terms of overall activity and performance, 2005 saw 5 of its 12 months in decline, with much of the decline coming during the second half of the year. The overwhelming concern for manufacturers continues to be the high NZ\$, while labour shortages for either skilled or unskilled workers have eased.

Consumer confidence – Very Pessimistic

The Westpac McDermott Miller Consumer Confidence Index fell sharply during the December 2005 quarter, being at its lowest level in five years. However, the overall result remains at historic highs. While ongoing strength in the housing and labour market has made consumers feel financially better off than a year ago, there is growing pessimism over future conditions. Higher interest rates and further signs of a cooling economy are also cooling consumer sentiment

1.2 Inflation

Most recent outcome: +3.2% year-ended December 2005

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 0.7% in the December quarter, with the impact of housing, transportation and food groups leading the charge. Overall, the inflation rate stood at 3.2% for the December year, which is again above the limit of the 1-3% inflation target by the Reserve Bank, although down from 3.4% for the September 2005 year. The booming housing market continues to be the main driver of inflation (up 2.9% for the December quarter due to higher prices for the purchase and construction of new dwellings). Transportation saw an increase of 2%, due to a rise in international air travel costs (up 12.3%).

Although annual inflation has gone beyond the upper band set by the Reserve Bank for the second consecutive month, the fact that the December annual value was lower than September's and given other indicators showing a softening in the economy, any increase in the OCR in the immediate future looks doubtful, although not completely out of the question. While non-tradables inflation looks set to remain high for some time yet, any significant fall in the value of the NZ\$ could bring about an acceleration of tradables inflation, which in turn may see the Reserve Bank revising the OCR upwards.

CPI forecasts have remained the same for the medium-term, as the average shows the figures for 2007 onwards still below the all-important 3% inflation rate upper threshold. Most are predicting that current levels of inflation beyond the 3% upper threshold will not persist for much longer.

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Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Mar 06	Mar 07	Mar 08
Highest	3.5	2.9	3.2
Average	3.4	2.7	2.4
Lowest	3.3	2.4	2.0

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

1.3 Labour Costs

Most recent outcome: +3.0% year-ended December 2005

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. Not surprisingly, labour costs tend to have an inverse relationship with unemployment levels. The December quarter 2005 saw an increase of 0.8% for all salary and wage rates from September 2005, and an increase of 3.0% for the year ended December 2005. The December quarterly increase in all salary and wage rates was the largest for a December quarter since the series began in the December 1992 quarter.

The public sector continues to attract the largest rise in labour cost. Over the quarter, wage and salaries rose 1.2%, compared with 0.8% for the private sector. This partially reflects the significant rise in the number of public servants over the last five years and the need to attract staff to fill new roles in the public sector.

Although the labour market remains extremely tight with unemployment at historically low levels and wage pressures high, we have probably experienced the peak of the wage inflation mountain. Other labour market indicators show that headline values are starting to head in the opposite direction, with employment pressures beginning to ease.

Labour cost forecast have been revised up compared with the previous quarter with expectations that wage and salary pressures will continue over the medium to long-term.

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Forecasts: Labour Cost Index % Change

	Years Ending		
	Mar 06	Mar 07	Mar 08
Highest	3.2	3.1	2.7
Average	3.1	2.7	2.3
Lowest	2.8	2.3	2.0

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 5.2% for the year-ended December 2005.

1.4 Employment

Most recent outcome: +1.5% year-ended December 2005

Employment growth has been increasing on an annual basis since 1999. According to the Household Labour Force Survey, the number employed has grown by 32,000 in the year to December 2005, which represents an annual increase of 1.5%. Although this represents a sizeable increase, it is much smaller than recent gains, indicating the growth momentum of the labour market is slowing. For instance, the year to September 2005 showed an increase of 64,000 - exactly double that of the latest result. The December 2005 result produced the lowest annual growth rate (1.5%) since the March 2003 quarter. Moreover, an increasing number of recent new jobs are "part-time", which is yet another indicator that the labour market is slowing.

The unemployment rate now stands at 3.6%, down from an adjusted figure of 3.7% for the September quarter. New Zealand remains in top spot in terms of the lowest unemployment rate in the OECD, ahead of South Korea at 4.1%. Although this rate remains low and probably below the natural rate of unemployment (which represents a rate that does not inhibit future capacity building of businesses), a slowing economy will tend to cause the rate to lift over time. Recent announcements by manufacturing firms laying off workers are a recent piece of anecdotal evidence that this is starting to occur.

The ANZ Job Vacancy series shows some easing off during the December quarter, down to 9.2% from 9.4% in the September quarter. The series, which matches job advertising against employment, fell as job advertising in the December quarter fell more than a dip in the level of employment over the same period.

Unemployment forecasts have remained unchanged for the short-medium term, but an increase in the unemployment rate to around 4.3% has been speculated for the first quarter of 2008 (forecasts were received after the December quarter unemployment rate of 3.6% was announced).

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Forecasts: Unemployment % (HLFS)

	Years Ending		
	Mar 06	Mar 07	Mar 08
Highest	3.7	4.4	4.5
Average	3.7	4.2	4.3
Lowest	3.6	4.1	4.2

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

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 7.52% as at 15 February 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).

Although there was no change by the Reserve Bank in the most recent OCR announcement, the previous two resulted in a 50 basis point increase with the OCR to 7.25%. The Reserve Bank is still 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.

While the Reserve Bank has hiked interest rates, the impact has been largely felt by exporters in the form of a high \$NZ rather than domestic consumers. The Reserve Bank's moves have had muted effect on domestic consumption given that most householders have tied in mortgages for 1-2 year terms. Secondly, competitiveness within the banking sector has resulted in banks trying to "buy" consumers business in the fixed rate sector.

Predictions for the 90-day bill rate have largely stayed the same for the short-medium term, but have been revised downwards for 2008. Although further increases in the OCR cannot be ruled out over the short-medium term, 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		
	Mar 06	Mar 07	Mar 08
Highest	7.6	7.3	6.4
Average	7.5	6.8	6.1
Lowest	7.4	6.0	5.7

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

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1.6 Exchange Rates

Most recent outcome: NZD = US\$0.677 as at 15 February 2006

NZD = AU\$0.913 as at 15 February 2006

TWI = 69.8 as at 15 February 2006

The NZ\$ has generally fallen over recent months, when compared with the major currencies. After a spike in the value of the NZ\$ towards the end of 2005 (particularly for the AUS\$ and TWI), the general result has been a gradual movement downwards, although the term “hovering” best sums up what seems to be occurring at the moment when taking into account the overall movement of the NZ\$ since post float in 1984.

Forecasters have not revised their expectations to any large extent from the previous quarter given the slow track downwards.

AUD (cents)			
	Mar 06	Mar 07	Mar 08
Highest	93.1	86.0	90.0
Average	92.0	84.7	85.1
Lowest	91.0	83.9	80.3

USD (cents)			
	Mar 06	Mar 07	Mar 08
Highest	68.0	60.0	63.0
Average	67.3	57.0	59.3
Lowest	67.0	53.0	56.0

TWI			
	Mar 06	Mar 07	Mar 08
Highest	71.1	62.0	63.8
Average	69.8	59.2	60.2
Lowest	68.8	55.7	57.7

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: +2.8% for the year-ended September 2005.

Forecasts (averages):

- Mid 2005: +2.7%
- Mid 2006: +3.2%

Source: The Economist

Australia's annual GDP rose to 2.8% for the September 2005 year, rising from 2.3% during the June year and 1.5% for the March year. Forecasts point to further increases in growth, with a growth rate over 3% by mid 2006.

Some key recent economic statistics:

- Real retail sales up 3.2% in December 2005 compared to December 2004.
- Motor vehicle sales down 2.2% for December 2005 compared to December 2004.
- Manufacturers sales up 0.6% for September 2005 compared to September 2004.
- Dwelling unit approvals down 4.3% for December 2005 compared to December 2004.
- Employment up 1.6% for January 2006 compared to January 2005.
- Unemployment rate of 5.2% as at January 2006 compared to 5.0% in January 2005.
- Company profits before tax up 14.9% for September 2005 compared to September 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 four of the last seven months.

2.2 Headline Inflation

Most recent outcome: +2.8% for the year-ended December 2005

Forecasts:

- Mid 2006: 2.9%

Source: The Economist

Inflation in Australia has eased from the 3% value for the year ended September 2005, and now within the target range for the Australian Reserve Bank of 2-3%. Most of the inflationary effects for the December quarter have come from food and financial insurance services. Commentators are predicting inflation to hover close to the 3% mark by mid 2006.

Australia's wage cost index increased by 4.2% for the year ended September 2005, while Australia's unemployment rate stands at 5.2% - considerably higher than New Zealand's current rate of 3.6%.

2.3 Interest rates (90-day bills)

Most recent outcome: 5.62% as at 16 February 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.

Consumer price inflation continues to hover at the upper threshold of 3%, and commentators are predicting that the Reserve Bank of Australia is likely to increase the OCR sometime in the first half of 2006, either by 25 or 50 basis points as the economy continues to improve, creating further inflationary pressures.

Part 3: Rest of the World

The economic picture in the rest of the world is very important for New Zealand. Projections show that the world economy will grow by slightly less than 3% during 2006, following a similar pace in 2005 and moderating from the historically high growth rate of 4% in 2004.

United States

The U.S continues to be a mixed bag in terms of its economic performance.

US GDP growth dipped slightly to 3.6% for the year to December 2005, following on from a value of 3.8% and 3.6% for the September and June years respectively. Despite the fall, it represents a healthy level of growth at this stage, although lower growth is expected through to 2007.

The US PMI continues to fair better than most other countries, with values indicating healthy expansion.

The US Federal Reserve tightened interest rates in January by 25 basis points, the fourteenth straight increase, which has meant interest rates are continuing to catch up with other countries, although they have some way to go to reach New Zealand's 7.25% mark.

Job growth has improved, with the unemployment rate did falling to 4.7% for January, the lowest figure since July 2001. Productivity fell 0.6% during the December 2005 quarter, while inflation on a monthly basis fell for the second consecutive time, although standing at 3.4% for the December 2005 year.

Japan

Japan's economy continues to recover, albeit with mild de-inflation issues remaining. GDP growth at 2.9% is healthy, although expectations are that it may fall to below 2.5% by the middle of the year. Domestic demand and strong exports, bolstered by shipments of cars and electronic parts, are driving a recovery in Japan's economy. As the economy strengthens, there is an expectation that the Bank of Japan will end its ultra-loose monetary policy in the coming months and pave the way for interest rates to come off near-zero levels.

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Asia

Asian economies continue to boom with GDP in many Asian countries showing GDP growth well over 4% (some over 8%). Although down from recent double-digit growth rates, China's recent values show growth close to 10% (currently 9.4% for the September 2005 year). China's trade surplus has more than tripled, although imports rose by 22%, faster than the 18% rise in exports.

India's GDP growth now stands at 8%, while its economic neighbour Pakistan fares slightly better at 8.4%.

Europe

The United Kingdom continues to show weak economic results, with its trade deficit widening to a record 6 billion pounds for November due to large oil imports. Current growth rates in Britain stand at a rather lowly 1.7%, although this is expected to pick up slightly to 2.1% by mid year.

Overall Euro growth closely mirrors that of the UK, standing at 1.6%. On a brighter note, business optimism in Germany continues to improve, while the growth rates for Germany, Italy have been projected upwards.

Forecasts: World GDP Growth (Selected Trading Partners)

<i>Country</i>	<i>Latest</i>	<i>2006</i>
Australia	2.8%	3.2%
Canada	2.8%	3.1%
Japan	2.9%	2.4%
United Kingdom	1.7%	2.1%
United States	3.6%	3.3%
Euro Area	1.6%	1.9%

Source: Economist

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

<i>Country</i>	<i>Latest</i>	<i>2006</i>
Australia	2.8%	2.9%
Canada	2.0%	2.3%
Japan	-0.8%	0.3%
United Kingdom	2.1%	2.0%
United States	3.5%	2.9%
Euro Area	2.2%	2.0%

Source: Economist