



# NEW ZEALAND ECONOMIC UPDATE

October 2005

## NATIONAL ECONOMIC UPDATE

This New Zealand Economic Update is produced monthly and presents current information on recent national business events, along with an update of key economic indicators.

### Inflation Exceeded the RBNZ's Three Per Cent arget

The latest statistics from Statistics New Zealand show that the Consumer Price Index [CPI] rose by 1.1% in the September 2005 quarter. This result was slightly below the market expectation of 1.2%. The increases of 0.9%, 0.4% and 0.9% were recorded in the Jun-05, Mar-05 and Dec-04 quarters respectively. Annual CPI climbed to 3.4% for the year to September 2005. This was the first time in four years that inflation exceeded the 3% target inflation band.

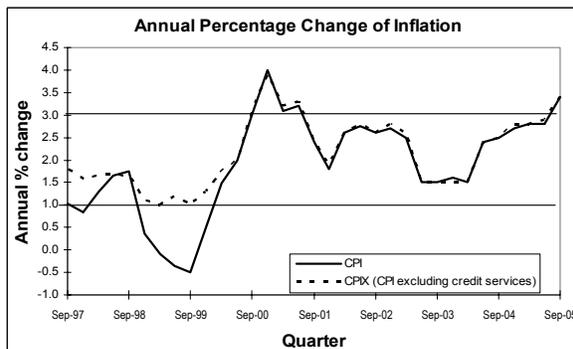
Price spikes were concentrated in two groups, transportation and housing. Among the total increases (13.15 points for all CPI groups), 6.5 points came transportation and 4.24 came from the latter. Over the last three months, transportation prices increased 3.5%. In particular the price of petrol price increased by 13.1%. Had this item been excluded, the CPI would have increased 0.7%.

International airfares rose by 3.0% quarterly and also made a significant contribution to the price increase in the transportation group. However, a fall of 2.2% in used car prices partly offset the upward movement. On an annual basis, price prices in this group shot up by 5.8%.

The housing group was another area to push up inflation, with a rise of 1.6% over the third quarter. Local authority fees lifted by 6.2% (which normally come into effect on the first of July).

Prices for purchase and construction of new dwellings were up 1.0%. It was worth noting that construction prices have increased for 26 consecutive quarters. Less significant, but positive, price movements occurred in credit services (2.4%↑), personal and health care (0.8%↑), food (0.4%↑), recreation and education (0.4%↑), and household operation (0.1%↑). The apparel group was the only category in CPI that showed downward movement, with a fall of 0.3% over the quarter.

Looking ahead, inflation is forecast by Westpac to remain above 3% until the second half of 2006.



Source: RBNZ and Statistics NZ

## RBNZ Raised the OCR

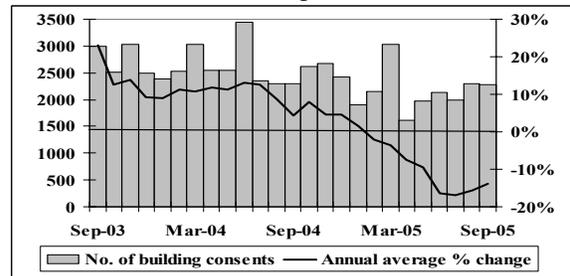
As widely expected, the Reserve Bank of New Zealand [RBNZ] raised the Official Cash Rate [OCR] by 25 base points to 7.0%. This was the eighth time since January 2004 that the RBNZ has lifted the OCR.

The key factor behind the hike in interest rates, according to the RBNZ was the strength of the housing market. Construction prices have showed relentless growth (26 quarters in a row). The median house sale price has increased by 16% over the last 12 months.

The RBNZ also noted that higher oil prices, strong household spending and "a more expansionary fiscal policy are all of concern". Therefore, it has concluded that tighter monetary policy will be necessary to pre-empt the escalation of inflation in the medium term. In this regard, another 25 base point lift in the OCR in December is still possible if prices continue to increase in both the domestic housing market and the international price of oil.

## Key Indicator Trends

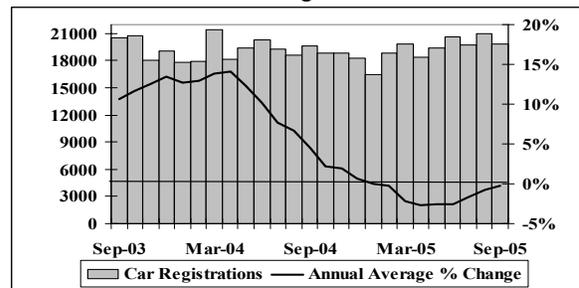
### Building Consents



Source: Dept of Statistics Building Surveys and Vitals Section

September was the third time over the last four months that the monthly number of new permits issued for dwellings exceeded 2,000. However, the 2,274 remained below the 2,301 and 2,291 issued in August 2005 and September 2004 respectively. The annual average growth rate in the number of new building consents issued was -13.9% for the current September year.

### Car Registrations

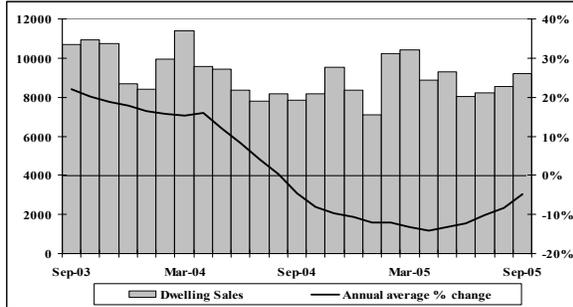


Source: Land Transport Safety Authority

While motor vehicle registrations decreased by 1,117 from August (the highest over the last 18 months) to

19,816 (including both new and ex-overseas types) in September, they still rose by 0.8% in September 2005. The annual average growth rate in the number of new car registrations was -0.3% for the year to September 2005.

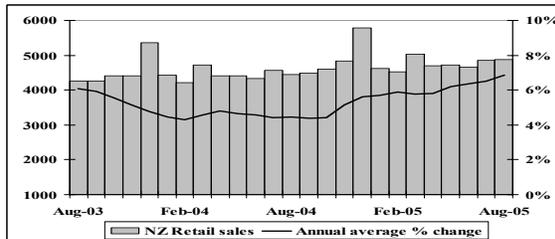
### Real Estate Sales



Source: Real Estate Institute of New Zealand

Compared with the 8,537 housing sales recorded in August 2005, the volume of sales rose by 649 to 9,186 in September. This figure was also well above the 7,855 sold in September 2004. The median sale price remained stable with \$290,000 recorded in the last two months. The annual average growth rate in the volume of real estate sales was -4.8% for the year ended September 2005.

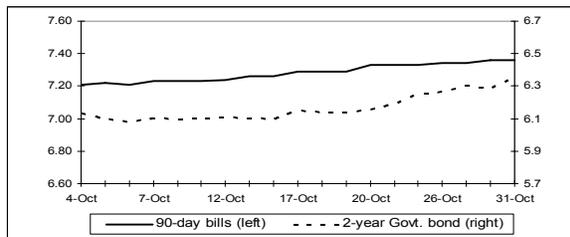
### Retail Sales



Source: Business Statistics Section, Statistics New Zealand

Retail sales edged higher nationwide in August 2005. The total value of retail sales reached \$4,871.9 million during the month, an increase of \$19.4 million on July 2005, and 9.3% above the level of \$4,457.5 million recorded in August last year. The annual average growth rate in the value of retail sales was 6.9% for the year to August 2005.

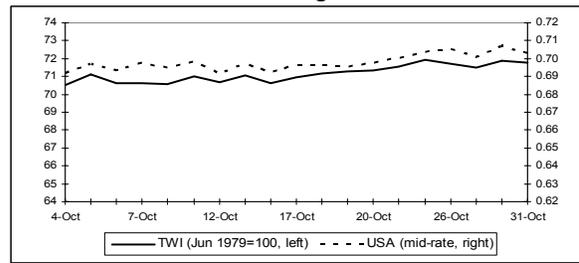
### Interest Rates



Source: Reserve Bank of New Zealand

The New Zealand wholesale interest rate market showed positive movement in October. This was due to expectations of high inflation and the actual rise in OCR. Ninety-day bill rates stood at 7.36% by the end of the month.

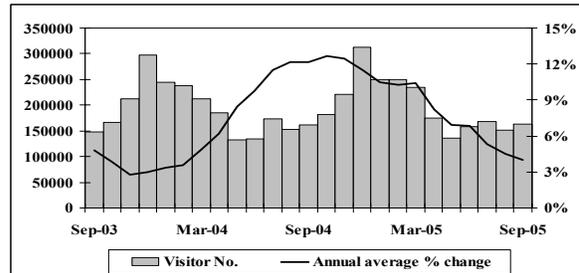
### Exchange Rates



Source: Reserve Bank of New Zealand

The New Zealand exchange rate appreciated against its major trading partners during most of October thanks to the OCR hike. By the end of the month, one New Zealand dollar exceeded US \$0.7, and the trade-weighted index [TWI] stood at 71.8 points.

### International Arrivals



Source: Statistics New Zealand

Short-term international arrivals rose from 150,700 recorded in August to 163,785 in September. While tourists from America, Asia and Europe were all down compared to September 2004, more visitors from Australia (7.5% increase) boosted annual growth by 1.6%. The annual average growth rate in the number of International visitor Arrivals to New Zealand was 4.0% for the year ended September 2005.

### Summary

The NZIER's Consensus forecasts suggest that a slowing in economic growth will occur over the next 12 months.

According to the September Quarterly Survey of Business Opinion [QSBO] published by the NZIER, a net 32% of firms expected the general business conditions to deteriorate over the next six months. This pessimism is similar to that reflected in the June QSBO results when a net 34% predicted a gloomy outlook.

The services sector was the most pessimistic, with a net 35% expecting a bad time ahead. However, a net 4% of respondents reported an increase in their business activity over the last three months (this was the lowest level since the third quarter of 2000).

Looking ahead, a net 4% of firms expect to increase their business activity over the next three months. Capacity utilisation remained at 92%, a historically high level.

The National Bank's business confidence survey, showed that a net 55% of firms expect the overall economic situation to worsen in the coming year. Similar to the QSBO, firms feel optimistic about their business future. A net 12% intend to increase their business activity in the next 12 months. However, a net 16% anticipated a fall in their profit.

In brief, these two survey results reinforce the opinion that the New Zealand economy will slow down considerably over the next 12 month time period.

### **New Zealand Economy Overview**

The housing market remains buoyant although the number of building consents issued have been falling over the last year. The level of retail sales remain robust.

Overall, the domestic economy is strong and is underpinned by growth in credit. There does however exist a degree of weakness in the external sector with the merchandise trade deficit widening in the September quarter.

Inflation was 3.4% in the September quarter and has mostly been fuelled by increases in housing costs and high oil prices. At the moment, firms' prices appear contained although firms are operating in an environment where capacity constraints remain at high levels, notably with a very tight labour market.

Results for the latest Statistics New Zealand's Labour Cost Index and the Quarterly Employment Survey show that salary and wage rates are at record high levels and there is continuing growth in employment.

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