



# NEW ZEALAND ECONOMIC UPDATE

## December 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.

#### New Zealand Economy Was Flat in the September Quarter of 2005

Following increases of 1.2% and 0.7% in the June and March quarters of 2005, national economic activity slowed considerably in the September quarter. Gross Domestic Product [GDP] grew by only 0.2%. This result was consistent with market expectations. Annual average growth was 2.7% for the year ended September 2005 (down from the 4.3% recorded in the September 2004 year).

Weak activity was spread across all industries over the September quarter. Both primary and goods-producing industries showed decreased activity. The services industry however recorded modest growth. Activity in primary industries shrank by 0.3%.

In particular, production in the fishing, forestry and mining group dropped by 2.7% quarterly, due to a fall in all of the three sub-groups (7.5%↓ in fishing, 1.5%↓ in forestry and logging, and 2.4%↓ in mining). The agriculture group partly offset the declining trend with a rise of 0.4%, thanks to 1.4% growth in dairy products. The goods-producing sectors dipped 1.3% compared to the June quarter of 2005.

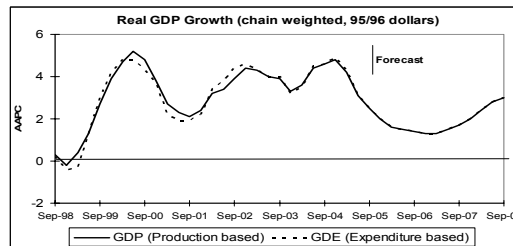
The energy sector (including electricity, gas and water) decreased by 3.8%. This was largely caused by a fall of 2.3% in electricity generation (due to a mild winter plus dry weather that led to a shift from cheap hydro to expensive thermal generation).

A retreat in both residential (5.7%↓) and commercial building activity (7.4%↓) dragged total construction down by 4.6%. This result reflects the fact that there has been a drop in net immigration as well as the effect of the continual hikes in interest rates.

Manufacturing grew slightly (0.3%↑). This result was due to positive movements that occurred in food, beverage and tobacco (2.5%↑), machinery and equipment (2.4%↑) and negative growth in wood and paper products (6.7%↓).

The services industry, was up by 0.7% and was the driving force in real GDP growth. All the key sub-groups remained buoyant, with retail trade (1.6%↑), wholesale trade (0.6%↑), transport and communications (0.9%↑), and 'finance, insurance and business services (0.3%↑).

The latest GDP figure was much lower than the 0.8% expected by the RBNZ. This implies the end of the OCR increases for the current cycle.



Source: NZIER and Statistics NZ

### A Brief Review of HYEFU

The Treasury released its Half Year Economic and Fiscal Update [HYEFU] in December 2005. Key information released included new operating expenditure of \$1.3 billion over the next three years, plus upward revised GDP growth forecasts.

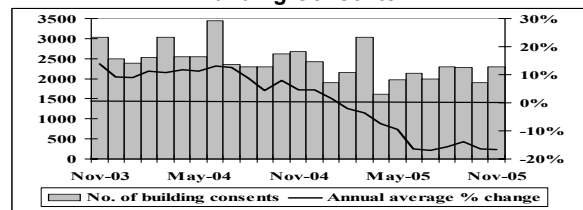
New operating spending will be \$2.4 billion, \$4.3 billion, and \$6.4 billion for the 2006/2007, 2007/2008 and 2008/2009 years respectively, bringing the total to \$13.1 billion, up from \$11.4 billion in the Pre-election Economic and Fiscal Update (PREFU). The operating balance for 2005/2006 has been revised down by \$1,736 million to \$5,557 million, as a result of the impact of the interest-free student loan policy.

Reduced investment income, expanded payments under Working for Families, together with the asset purchases will drag the cash balance from a surplus of \$492 million in 2006/2007 to a deficit of \$3,167 million by 2008/2009, leaving no room for tax cuts.

The bond programme has been adjusted accordingly, from \$2,663 million in 2005/2006 to over \$3,000 million for each of the following three years. GDP forecasts have been revised up from 2.2% to 2.9% for the March 2006 year but down from 2.5% to 1.7% for the year after.

### Key Indicator Trends

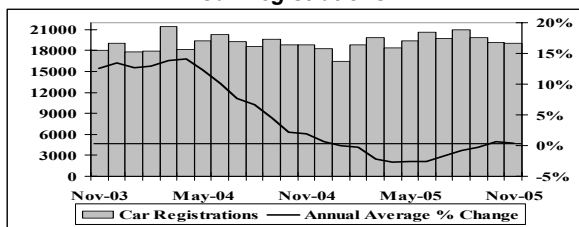
#### Building Consents



Source: Dept of Statistics Building Surveys and Vitals Section

New Zealand's residential building industry improved in November 2005. A total of 2,295 new building consents were issued for residential dwellings during the month. This figure was an increase from 1,901 consents issued in November 2004, but was less than the 2,675 consents issued in November 2004. The annual average growth rate in the volume of building consents issued for residential dwellings in New Zealand remained subdued at -16.8% for the year ended November 2005.

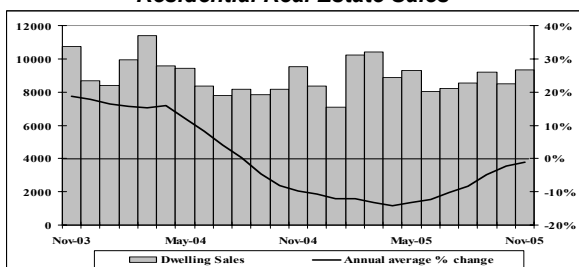
### Car Registrations



Source: Land Transport Safety Authority

Car registrations have stabilised over the last two months. There were 19,038 cars (including both new and ex-overseas car types) registered during November 2005. This figure was slightly below the 19,160 car registered in October 2005, but better than the 18,874 cars registered in December 2004. The annual growth rate in the number of car registrations was 0.4% for the year to November 2005.

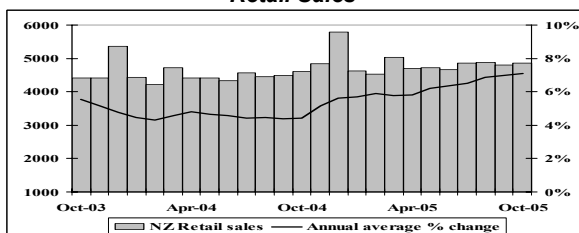
### Residential Real Estate Sales



Source: Real Estate Institute of New Zealand

The national median sale price for a house in New Zealand was \$300,000 in November 2005. The volume of residential house sales increased from 8,513 in October 2005 to 9,357 house sales in December. The annual average growth rate in the volume of residential real estate sales was -1.2% for the year ended November 2005.

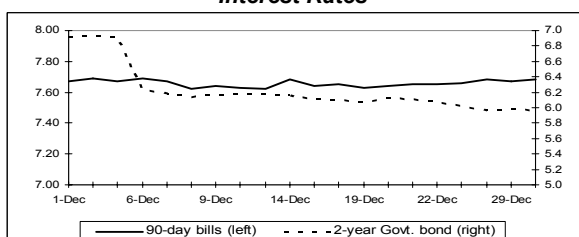
### Retail Sales



Source: Business Statistics Section, Statistics New Zealand

Compared with \$4,791.3 million of retail sales in September 2005, the national value of retail sales increased to \$4,859.5 million in October 2005. This figure was a 5.6% increase on the value of national retail sales recorded in October 2004. The annual average growth rate in the value of retail sales was 7.1% for the year ended October 2005.

### Interest Rates

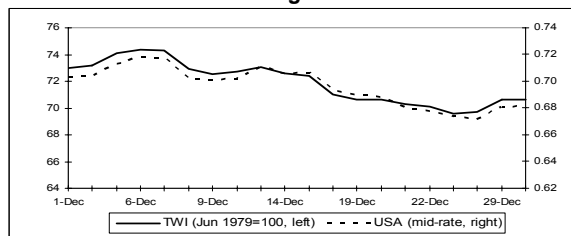


Source: Reserve Bank of New Zealand

After a 25 percentage point hike in the OCR implemented by the RBNZ in early December, the New Zealand wholesale interest rate market was stable for the rest of

the month. By the end of the December, 90-day bill rates stood at around 7.68%.

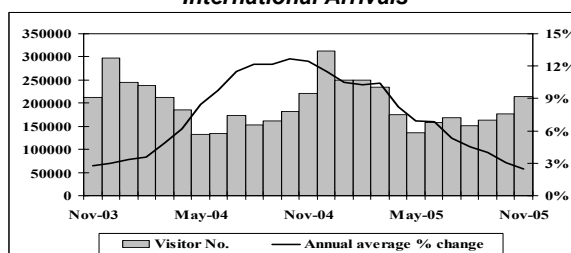
### Exchange Rates



Source: Reserve Bank of New Zealand

A downward trend showed in the value of the New Zealand dollar for most of December 2005. This result was due to weak GDP data and a large current account deficit. However, the Kiwi dollar rebounded slightly by the end of the month with NZ \$1.0 trading against US \$0.6814, and the trade-weighted index [TWI] stabilising at 70.6 points.

### International Arrivals



Source: Statistics New Zealand

A total of 214,700 short-term overseas visitors entered New Zealand during November 2005. This figure was an increase from the 176,200 visitors in October 2005, but down from 220,610 (or 2.7%) on visitor numbers recorded in November of 2004. Notably, this result was partly due to a fall in Japanese and Korean arrivals. The annual average growth rate in visitor arrivals to New Zealand was 2.4% for the year to November 2005.

### Summary

It is no surprise that both business and consumer confidence have fallen in recent months. According to the National Bank's monthly survey, business confidence was low in December 2005. A net 61.7% of respondents expect that general business conditions will deteriorate in 2006. This survey result was only marginally better than November's result when a net 66.2% took a similar view.

The pessimistic attitude was spread across all sectors, with agriculture the most affected. A net 84.8% of farmers expect the overall economic situation to become worse in 2006. Firms' expectations of their own activity, a key business indicator, has fallen into negative territory for the first time in five and half years. A net 2.4% of firms anticipate their business activity in 2006 to decrease. A net 23.6% of firms also expect a drop in profit, while a net 3.4% thought employment would decline in 2006.

According to the Westpac McDermott Miller Survey, consumer confidence fell sharply in the December quarter of 2005. The Westpac McDermott Miller Consumer Confidence Index was down from 120.2 in the September quarter of 2005 to 110.1 in the December quarter, the lowest level over the last five years (>100 indicates more optimists than pessimists). A net 15.1% of consumers expected the economy will slow down in 2006, while only a net 17.7% considered it was a good time to buy a major household item. A net 11.7% of consumers reported being financially better off than a year ago, suggesting

robust wage growth and the wealth effect due to a strong housing market in 2005.

#### **Economic Overview Looking Ahead**

Exporters will likely have to wait till 2007/2008 for relief in the form of exchange rate depreciation. In the meantime export volume growth is reasonable.

As exchange rate depreciation occurs investment will slow as imported capital equipment prices start to increase.

Businesses face slowing activity in 2006 as costs increase and domestic demand eases due to rising interest rates. Government will maintain an expansionary fiscal stance with the delivery of social and investment expenditure whilst the Reserve Bank will continue with a reasonably tight monetary policy stance.

After seven years of strong growth, New Zealand's economy is now slowing down. The New Zealand Institute of Economic Research [NZIER] forecasts that annual average growth in real GDP will fall to a low in March 2007 of 0.9% but will recover to 2.4% in the year to March 2008.

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