BERL Monthly Monitor

April 2011

Awaiting Budget decisions

Yes, as regular as clockwork, it is Budget time again. But, for numerous reasons, this year's event is of more than the normal degree of importance.

Many rate the importance of this year's event because of its proximity to the next election. Others view it is important because the government is "borrowing $300m per week" and are anticipating some response.

Some highlight its importance because the government has "grown too large" and are expecting a reversal. Meanwhile others assert its importance because the economy is weak and are awaiting the announcement of a magic solution.

Some note the impact of the Christchurch earthquakes and see the need for visionary leadership, while others note a languishing country and economy performing well below its potential and see the need for a focus investment in long-term skills, infrastructure and export sector capacity.

Needless to say there are many issues and factors to consider. In addition to the many advisors and commentators, each with their own wish list of 'necessary and unavoidable' actions.

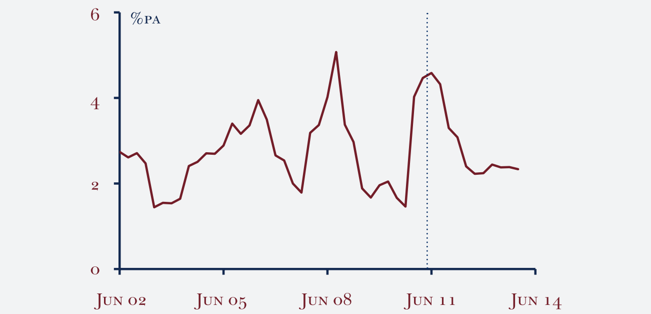
Predicting just what will be announced seems more difficult than normal as the fine lines between these competing and compelling objectives appear sharper than is usually the case.

We await the announcements of 19 May with more than the standard level of anticipation, as the government negotiates a balance between these numerous tensions and interests within the background of a more than challenging economic environment.

Inflation remains within target

The Consumer Price Index (CPI) was up 0.8% in the March 2011 quarter compared to the December 2010 quarter. On the year, the CPI increased by 4.5%. These increases are lower than what we expected reflecting the uncertainty around the domestic and global economic environment.

Consumer Price Index (CPI)
annual % change



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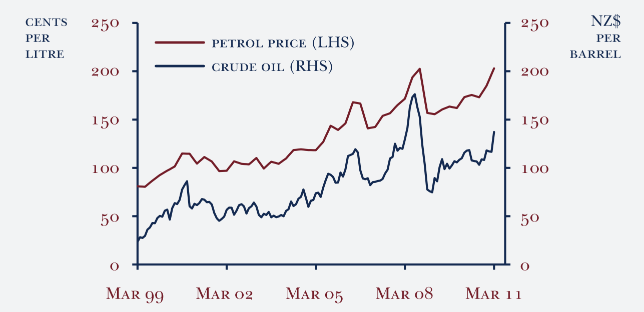
While there has been upward pressure from increasing petrol and food prices, the major driver of the annual increase was from the December 2010 quarter GST increase from 12.5% to 15%. A further excise tax saw tobacco prices increase by 25% on the year. The recent spike in the reported headline inflation shown in the chart is largely a reflection of these tax increases.

With petrol close to $2.20 per litre and food prices up 4.8% on a year earlier, there is no doubt that these price surges are having a direct impact on individual households. These factors are reflected in the CPI groups where prices have increased the most over the last quarter and year – transport; housing and household utilities; food and alcoholic beverages and tobacco.

However, in spite of these increases, the major component of the 4.5% annual increase remains the GST rise. Taking out the 2.2% that is estimated to be related to the GST increase leaves us with an increase on the year of 2.3%, which is well within the Reserve Bank target range of 1 to 3 percent on average over the medium term.

With businesses struggling to maintain market share in the face of lower consumer spending, increases in input prices are, where possible, being absorbed. There is also the influence of the high NZ$ that is helping to keep the price of imported goods down, particularly audio-visual equipment, and clothing and footwear.

Fuel prices



Statistics NZ, Economist, BERL

Eventually, when business confidence returns and demand conditions are more robust, we are likely to see businesses attempt to claw back some of the margins they have been absorbing. However, at least for the remainder of this year, we believe that the difficult trading environment will continue to act as a brake on price increases.

The exception to this will be construction costs, which will inevitably surge over the next year or three as Christchurch rebuilding activity gathers momentum.

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Commodity export revenue roars ahead

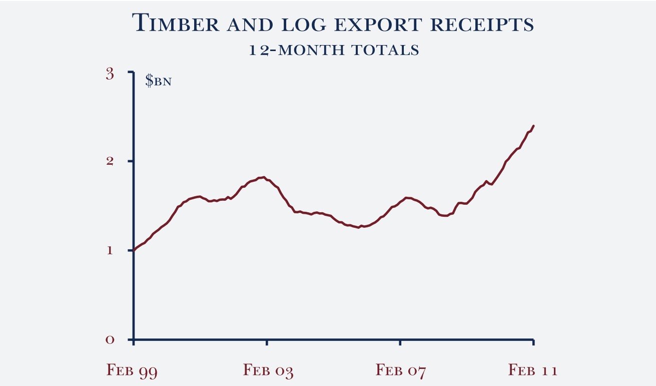
International prices for both soft (milk, wool, meat) and hard commodities (metals and wood) are skyrocketing and the Reserve Bank's commodity outlook report suggests that such high commodity prices are here to stay.

In essence, demand for most commodities are outstripping a restricted or depleted supply. Prices for soft commodities have been driven primarily by increasing wealth and urbanization in Asia, which has increased demand for higher protein food (meat and milk). Prices for hard commodities such as logs are soaring due to Asia's industrialisation and infrastructure investment.

While Asia is keeping the demand for commodities high, supply has been restricted as combinations of biological, climatic, political, productivity and land-space issues have their impact. With an expected continuation in this imbalance between demand and supply, it seems likely that these high commodity prices will be here for some time.

Despite the high NZ$ exchange rate, the high commodity prices have translated into some impressive growth figures for export receipts. In particular, for the year ending February dairy receipts have soared 30.4% from the previous year; forestry receipts are up 27.9%; and fish receipts are up 12.68%. Meat receipts though, register only a 1.8% rise on the previous year.

For forestry, developing countries increasing investment in infrastructure and increased industrialisation has pushed log prices higher to an average 15% up over the year to February. With these high prices, export volumes have responded with an increase of 17.6% on the previous year. The surge in prices for logs has recently been accompanied by rising timber prices – up 7.1% in the year to February. This has also seen timber export volumes rise – up 9.6% over this period.



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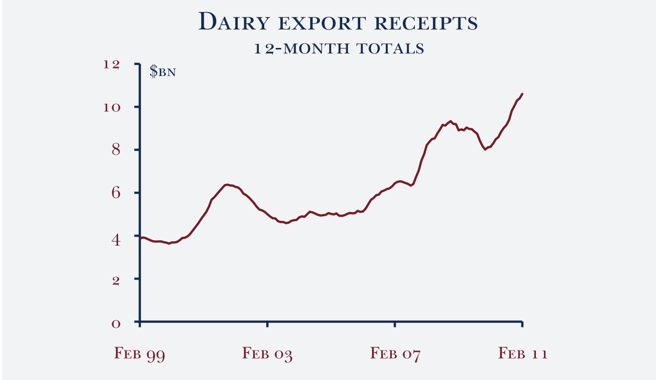
Wood pulp demand over the past two years curtailed with the global recession. However, demand for wood pulp is resuming with economies recovering, and Asia growing, with prices staging a similar recovery. Over the year to February, export prices in NZ$ terms rose 28%, leading to a 24% rise in annual revenue albeit from a low base.

Wool receipts were up a staggering 21.6% over the year to February, with demand coming from Europe. However, prices have shown signs of easing over recent months.

More concerning is the picture for wine. Export receipts appear to be declining, possibly showing the impact of the wine glut with more wineries going into receivership. Export revenue for the three months to February were down 8% from the same quarter last year.

The kiwifruit industry has just entered its new export season and is forecasting bumper crops due to good weather conditions. Last season recorded mixed success, with volumes up 1.7% but disappointing prices taking total export revenue down 6.3% on the previous season. Similarly, the apple export season has just commenced. Apple exporters will be hoping for a better return than last year's poor performance, which saw export receipts drop by more than 19%; comprising a 14% fall in volumes and a nearly 6% plummet in prices.

The star performer though, in many eyes, has been dairy. A closer look at this sector's performance suggests that latterly it is a story dominated by soaring international prices. In contrast, volumes at first receded and have since remained flat over the past year. The latest year recorded a 30% rise in export receipts that saw the annual total dairy export revenue top $10.6bn in February. However, the same period reported a 1.7% fall in export volumes.



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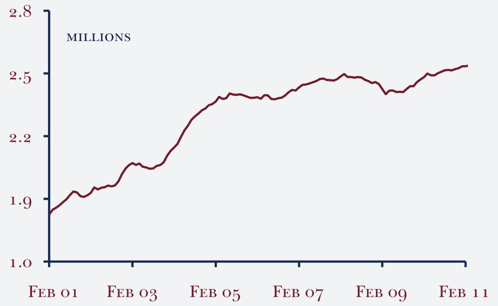
Tourism and migration ease further

Visitors to New Zealand totalled more than 268,000 in February. This was an increase of less than 1% compared to February 2010, taking average growth for the year to February to 2.1%. Compared with a year earlier, February saw the flow of visitors from Asia up almost 14.7%, with over 28,000 tourists coming from China (up 6.0%) and Japan (up 4.2%). These indicate solid visitor flows from the 4th and the 5th largest tourist source markets for New Zealand.

In seasonally-adjusted terms, visitor arrivals are flat compared to year-earlier levels. Chinese, Korean and Japanese markets remain stable, whilst other markets such as the Americas (down 2.6%) and Europe (down 6.6%) are trending down. Clearly, the industry is placing high hopes on the Rugby World Cup potentially creating the boost the tourism sector needs. Undoubtedly though, the outlook is not as promising as it was a few months ago.

The monthly net permanent and long-term (PLT) migration inflow eased to 470 persons in February. The annual net migration inflow, at 8,249 persons, is significantly below the net inflow of 21,600 persons in the year ending February 2010. PLT arrivals for the year declined 2.4% (from 84,000 to 82,000), whilst departures were up 17.9 % (from 63,000 to 74,000). Net inflows have declined primarily due to a surge in departures to Australia. A total of 34,550 (up 30.1% on a year

International visitors
annual totals



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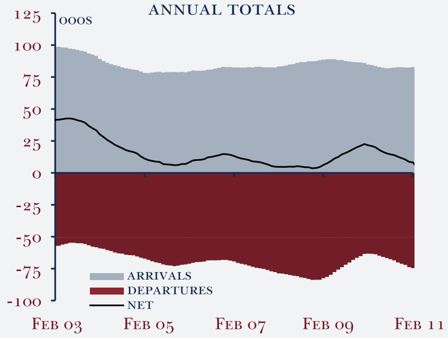
ago) New Zealanders emigrated to Australia. There were also fewer New Zealanders returning, as a 7.1% drop is recorded in permanent arrivals.

Overall, the slow growth in visitor numbers and lower net migration flows indicate a less rosy tourism sector and modest support for the domestic economy in the coming months. Although we expect an increased surge of visitors for the Rugby World Cup, the migration numbers are not expected to provide any significant impetus for New Zealand's housing market and retail sector. With rather shaky support to the economy from immigration, we must look elsewhere for any impetus to growth. With higher wages and a stronger economy across the Tasman expected for some time to come, the prospect of losing more high-skilled people to shores abroad remains very real.

Permanent migrant flows
annual totals



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Building industry struggle continues

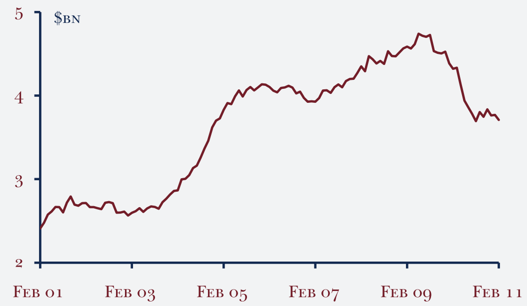
The latest building consent numbers indicate that activity in the building and construction sector is slowly picking up and possibly even close to a rebound.

The industry has been trending down since the beginning of 2009, but the year to February 2011 has signalled that this slide has halted . The number of non-residential building consents is down 0.3%, but this trend is an improvement, compared to the sharp decline (down 19.1%) seen in the year to February 2010.

Across the sub-sectors, increases in building consents were recorded in the shops and accommodation category (up 9.4% over the year to February), factories (up 5.2%) and office building (up 3.6%). However, the number of consents for social infrastructure such as education building (down 13.3%), religious and cultural buildings (down 6.4%) and hospital and nursing homes (down 2.1%) eased over the year.

Overall, the value of non-residential consents in February totalled $257m, or $3.7bn for the year to February. The monthly total represented a 19.0% decline compared to that of February 2010, while the annual total was a 14.2% decrease on that of the previous year.

Non-residential building consent values
12-month totals



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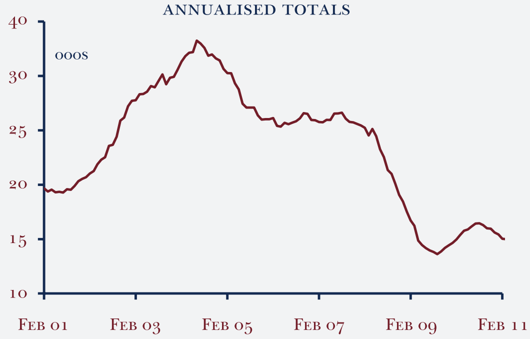
The downward trend in the non-residential construction sector began in earnest in early 2009. The latest numbers reflect the continued shortage of development finance, as major banks tighten their lending criteria to avoid riskier lending areas, and the effect of the absence of the second-tier lenders (previously filled by finance companies). This situation exacerbates the current downturn in the sector.

At the same time, the residential portion of the building sector remains sluggish with new house consents running at an annual rate of 15,000. As the chart illustrates, this is significantly below levels of the mid-2000s and is also well below the 22,000 to 25,000 range that is consistent with requirements from population growth. However, declining migration inflows could well see subdued activity continue here despite an increasing demand-supply imbalance in various regions.

Residential building consents
annualised totals



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Increased infrastructure spending and rebuilding effort in Christchurch will undoubtedly provide vital impetus in reviving the building sector. In this context, a much greater challenge lies in providing capability to do so. The building sector needs to restore capacity and capability that has been lost (mainly overseas) over the past couple of years. Close co-operation between government, industry, educational training organisations will be necessary to address, again, a growing skill shortage in the construction and related trades sphere.

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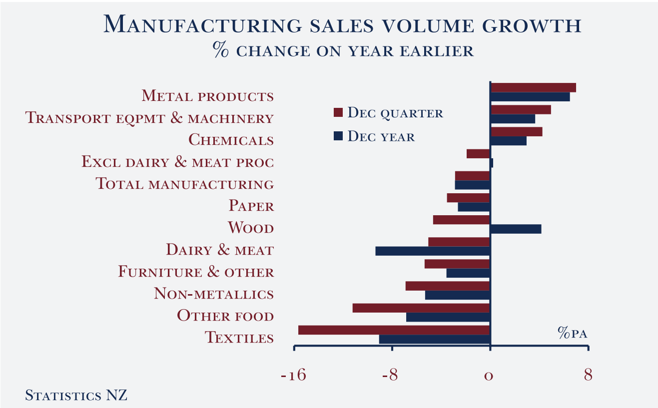
NEXT ISSUE: BERL Forecasts May 2011, available 28 May 2011

April 2011

Manufacturing in tentative recovery

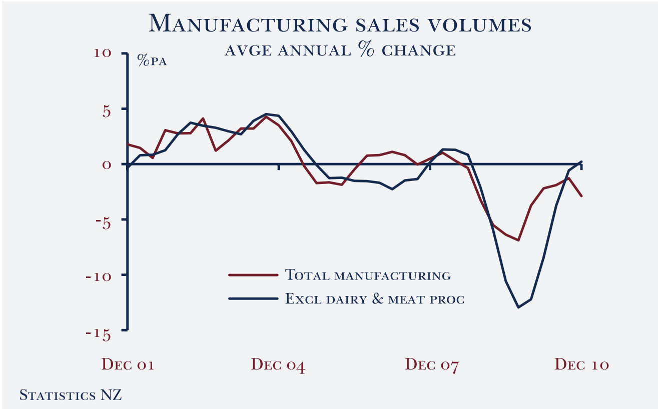
The Business New Zealand Performance of Manufacturing Index (PMI) stood at 50.1 in March, with two of the five sub-indices recording expansion this month, employment (53.2) and production (50.4).

While the February PMI was not gathered it is difficult to compare data over the quarter, but the survey does provide an indication of activity levels and business sentiment. Overall, manufacturing by industry sub-group continues to be mixed, with sectors such as food, beverage and tobacco manufacturing, and metal product manufacturing expanding, while textile, clothing, footwear and leather manufacturing continues to contract.



These observations are further reflected in the Statistics New Zealand's Economic Survey of Manufacturing for the December 2010 quarter. This survey indicates that the volume of manufacturing sales increased by 3.3% in the December 2010 quarter, following three consecutive quarters of decreases.

The main contributors to the increase in volumes over the latest quarter was chemical, polymer and rubber product manufacturing; meat and dairy product manufacturing; and metal product manufacturing. However, this increase was partly offset by a decrease in wood and paper product manufacturing, and textile, leather, clothing and footwear manufacturing.



The Global Manufacturing PMI has continued to slowly expand throughout the first quarter of 2011. In March 2011, the JPMorgan Global Manufacturing PMI sat at 55.8. The PMI has now remained above 50.0 for 21 consecutive months, which is a positive sign given that a PMI reading above 50 indicates manufacturing activity is expanding while below 50 indicates it is contracting.

Manufacturing activity in the United States has continued to recover this quarter, but not quite at the same pace as manufacturing outputs from China. Japanese manufacturing outputs and new orders fell in the February-March period following the earthquake, and this output will continue to be curtailed until capacity is restored. The New Zealand Treasury estimates that the damage resulting from the earthquake and tsunami could be as high as 25 trillion yen, the equivalent of 5% of Japan's annual GDP. It could also reduce Japan's GDP growth by half a percent in 2011, to around 1%.

In the United States, the continued recovery in manufacturing is having a positive impact on employment and new job growth. Seasonally adjusted unemployment rates in the US were highest in the West at 10.7% in March, while Northeast and Midwest had the lowest rates at 8.2 and 8.3% respectively. In terms of state unemployment rates, Michigan, Illinois and Indiana, all of which are large areas of manufacturing, experienced decreases month-on-month. However, US consumer confidence and spending is still low due to high oil prices and nasty winter weather.

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