BUSINESS CORNER

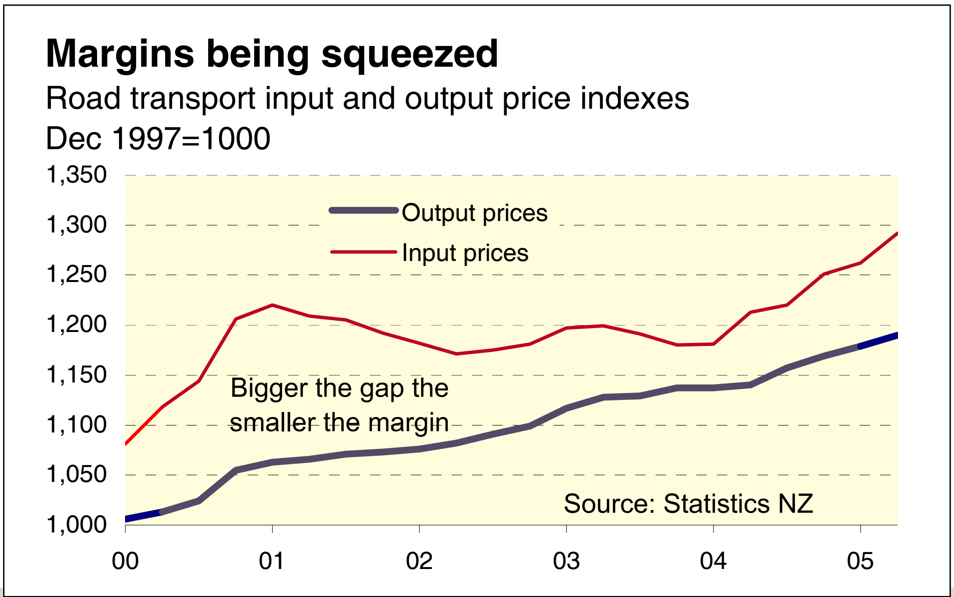
THE BIG SQUEEZE

The governor of the Reserve Bank, Alan Bollard, has made it clear that the pace of economic growth will have to slow to bring inflation to heel. He has raised interest rates more than any other central banker over the past two years and has recently taken to berating various sectors of the financial market – real estate agents, banks, and foreign investors.

Given Dr Bollard's determination, and indeed responsibility, for taming inflation we can expect business conditions to get tighter over the next year or so. Margins in the road transport industry have already been pinched by a combination of higher fuel prices, eye-watering wage increases and a lift in the cost of finance. As the graph below shows, transport operators have not passed all of these cost increases through to output prices (what they charge their customers) and hence margins and profits are being squeezed.

We think fuel prices have peaked, and so long as the New Zealand dollar does not fall out of bed (drop more than 10% in a year) we expect the price of diesel to drift lower as international oil prices stagger back under $50/bl by late 2006, early 2007. Wage increases of between 6% and 10% are common for truck drivers. That reflects an ongoing shortage of suitable drivers and will clearly flow through to higher labour costs unless companies can lift productivity substantially.

The cost of capital has been remarkably low over the past five years as interest rates have fallen and the appreciating currency has reduced the price of trucks. In fact, the price of a new truck today is the same as it was in 1995 implying a marked fall in real prices, especially given the improvements in fuel efficiency and reliability over the past ten years. Interest rates are clearly on the rise and the general consensus is that the currency will fall over the next year or so. The latter will raise the cost of new trucks and prevent the full effect of lower oil prices reaching the pumps.



As the rate of economic growth slows it will become increasingly difficult to claw back from clients the higher capital and operating costs faced by trucking businesses. The squeeze on margins and profits will force them to search for productivity gains or new ways of servicing their clients.

Although truck operators always face these sorts of pressures, we suspect that over the past two or three years demand has been so strong that operational efficiency has taken a backseat to simply responding to clients. With more slack in the domestic economy we expect to see greater emphasis on the quality and cost of the services being offered. The trick for trucking companies is to ensure clients are offered and understand the value of the service being provided so that they are comfortable paying the true cost of it.

The big squeeze will lead to further rationalisation within the road transport industry.

Andrew Gawith
Managing Director
Infometrics