BUSINESS CORNER

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Photo by Juergen Wessolowski

CURRENCY SHOCK

The fall in the kiwi dollar over March has been spectacular, even by New Zealand standards. The medium term consequences of a lower currency for the trucking industry are threefold:

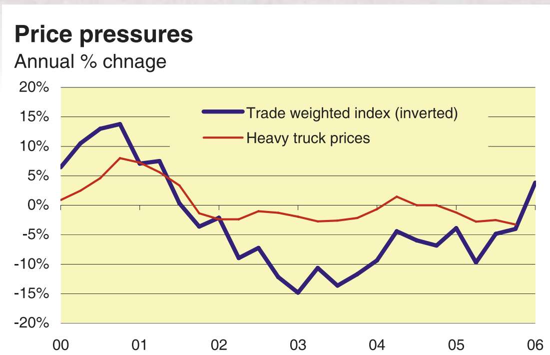
- Higher cost of fuel
- A lift in the price of trucks
- A resurgent export sector

Trucking companies will look to pass on the higher costs of fuel and trucks to customers in the form of higher freight rates. The difficulty for many transport companies, however, will be that domestic businesses will resist such cost increases given the much softer trading conditions they will be facing. Substantially weaker domestic spending growth (by both households and businesses) will make it trickier to lift prices than it has been for the past three years.

Furthermore, the Reserve Bank has been reticent about dropping interest rates despite signs of a faltering economy. The Bank is determined to ensure that inflation not only drops comfortably below 3%pa, but also stays within the 0-3% band. It will therefore be looking to create conditions that make it dangerous for businesses to lift their prices, irrespective of the need to do so.

On a trade weighted basis the New Zealand dollar has fallen by about 9% over the six weeks to the end of March. That implies that the price of imported products at the wharves has gone up by around 10%. Retail and wholesale prices shouldn't rise by quite so much because of the plethora of domestic costs that are embedded in the final selling price of the product. The falling dollar is already being seen in fuel prices which have risen by between 5% and 8% since February.

The lower currency will eventually push up the price of trucks. The speed with which this occurs will depend on the stock of trucks in the country, contracts already in the pipeline and the extent to which importers have hedged the currency they buy in. There may also be some flexibility in importers margins given the buoyant state of the new truck market over the past three years and the steady rise in the currency.



The graph shows the extent of the change in truck prices and the trade weighted exchange rate since 2000. The rise in the currency between 2002 and 2005 should have translated in lower truck prices and it did. On the face of it the appreciating currency looks as if it should have pushed the price of imports down by 10% to 15% over 2002 and 2003. But, as we noted above, there are domestic costs in the final selling price and these should have remained relatively stable. The graph suggests, though, that margins have expanded over the past three years and there may be pressure on importers to absorb some of the effects of the falling currency.

The lower dollar is likely to rejuvenate export industries. Forestry, dairying, meat, tourism and manufacturing businesses will all get a boost. That is good news for the transport industry. Exporters have generally not suffered from a lack of demand for their products. It has been the meager returns they have made that has cramped their growth, and in some cases led to businesses closing down.