A YEAR OF TWO HALVES

Road freight transport operators were slugged with a nasty one-two combination over the first six months of this year. A slowdown in economic activity weighed heavily on demand for road freight transport services, while soaring diesel prices and surging wage costs put the squeeze on margins. But after a tough start to the year trading conditions appear to be improving.

The extent to which the slowing economy crimped demand for road freight transport services is illustrated clearly in Road User Charge (RUC) and diesel sales data. RUC kilometre and revenue purchases for both medium and very heavy trucks were well down on year-earlier levels over the first half of the year, while June quarter commercial diesel sales fell 2.1% from the June quarter 2005.

The slowdown in activity was compounded by surging input costs. Skyrocketing diesel prices and skilled labour shortage induced wage inflation were the primary culprits, driving input costs 15% higher over the year to June. Hamstrung in their ability to pass the rising costs on to clients by weakening trading conditions (output prices rose just 7% in the June year), operators were forced to absorb the rising costs in their bottom lines.

The heavy going has had a dramatic impact of demand for new big rigs. First-time registrations of new very heavy trucks have plummeted so far this year, with year-to-date sales in October down some 28% on a year ago.

But a number of indictors point to an improvement in trading conditions over the past few months. RUC purchases have bounced back – medium (2.4%pa) and very heavy truck (2.6%pa) kilometre purchases both recorded healthy annual growth in the October quarter – while diesel sales showed similar improvement, up 2.5% in the three months to October on the same period last year.

Operators have also received some much welcome relief on the margin front. The price of diesel has fallen 29 cents from its $1.28/litre high, and September quarter labour market data show annual wage inflation in the road freight transport sector slowing to 1.6% – the slowest rate in two years.

The improving conditions in the road freight transport sector are indicative of the broader lift in activity throughout the economy. Underpinned by a tight labour market and persistently high house price inflation, and boosted by the sharp fall in petrol prices, consumer sentiment has picked up over recent months, bringing with it renewed retail sales growth. Residential construction activity has surged, while the strengthening dollar has so far had little impact on growth in the export sector.

The 'soft landing' scenario for the economy that these indictors point to is good news for the road freight transport sector: demand for freight services is closely tied to the fortunes of the overall economy (see graph below). Combined with encouraging signs of the long awaited increase in forestry exports (October quarter exports from the Port of Tauranga were up 12% on year-earlier levels), our forecast for GDP to expand by 2.7% over 2007 should ensure steady demand for transport services over the next 12 months.