Performance of Manufacturing Index

19 January 2018

Aberration or Warning Sign

An aberration or a warning sign of things to come? That's the question on our lips as we look at the data provided in the December Performance of Manufacturing Index (PMI). Whichever way you look at it, the data are disconcerting at face value. The 51.2 reported for the month of December was the lowest reading since December 2012, and the 6.5 point drop in the index between November and December has only been exceeded twice before (and one of those occasions was during the GFC).

Widespread Retreat

Moreover, all components of the index were in retreat with production levels, new orders and deliveries of raw materials driving the slowdown. Unlike business confidence indices which should, in theory, foretell future developments, the PMI is telling it as it is, and it doesn't look great right now.

Anecdotal evidence, across the economy, suggests there was a post-election hiccup in activity as businesses put off major spending, investment and hiring decisions until there was greater clarity and, more importantly, understanding of likely policy shifts. Today's data are consistent with this hypothesis.

Unfortunately, there are also signs in this data that future production may come under some pressure as the decline in new orders is proving greater than the decline in inventory. Consequently, stocks of finished products still sit above average levels even though new orders are well below.

Manufacturing GDP has been having a good run of late with Q3 manufacturing GDP up 1.1%. We had assumed a softer result through Q4 and Q1 anyway but the PMI suggests there is some downside risk to our expectations which will be further exacerbated by recent weather-affected agriculture production.

GDP Headed Sub-Consensus

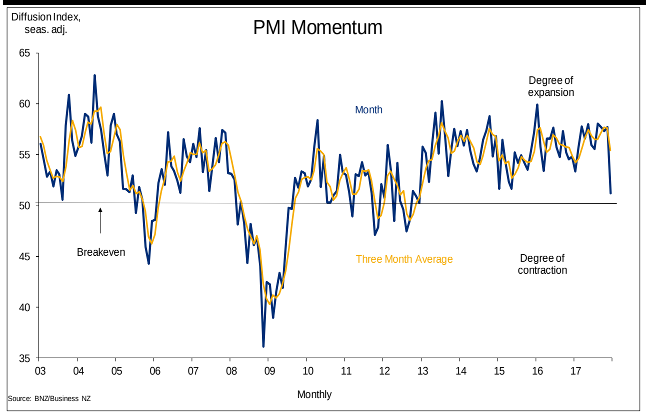
As things stand, we are already forecasting a sub-consensus 0.5% increase for Q4 economy-wide GDP. There appears to be increasing downside risk to this pick. Importantly, as a point of reference, the RBNZ has estimated the economy grew 0.9% through Q4 and Treasury 0.8%. The potential for surprise is thus clear.

Be that as it may, we think it premature to conclude that the recent weakness in these data is a sign of impending doom.

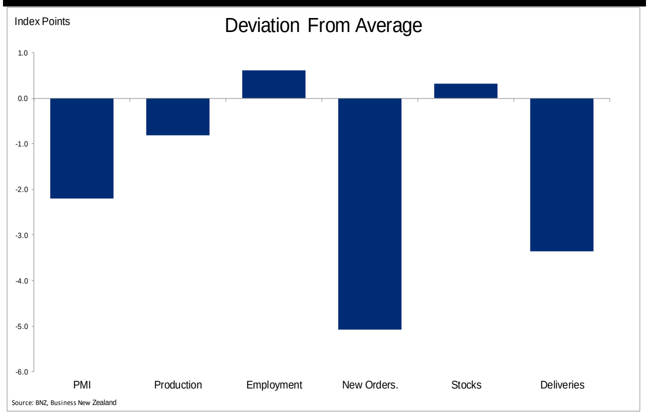
- We would expect some bounce back in activity once political uncertainties diminish;
- These data are weaker than their equivalents in the NZIER QSBO;
- We still believe that the key drivers of manufacturing (retail spending and housing construction will remain robust).
- An improving international environment is a plus for exporters.

All in all then, a set of data that sees us more nervous about New Zealand's state of affairs but not sufficiently so, yet, for us to pull the trigger on a forecast downgrade.

PMI Slumps



Weakness Widespread



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