

BNZ-BusinessNZ PMI is a monthly survey of the manufacturing sector providing an early indicator of activity levels. A PMI reading above 50 points indicates manufacturing activity is expanding; below 50 indicates it is contracting. The main PMI and sub-index results are seasonally adjusted.

pmi

Manufacturing continues expansion in January 2011

BNZ - BusinessNZ PMI for January 2011

- The BNZ - BusinessNZ seasonally adjusted PMI for January (53.7) is the fourth consecutive month the index has been in expansion, which is a positive start to 2011 and signals the sector is heading in the right direction.
- All of the five seasonally adjusted main diffusion indices were in expansion for the third consecutive month – the second time this has occurred since the end of 2007. *New orders* (56.6) experienced its highest value since April 2010, and are a good indicator of forward activity in the sector and better times ahead.
- Unadjusted results by region showed all the regions, apart from Otago/Southland (57.0) hovering under the 50 mark (over 50 is expansion under 50 is contraction) which is slightly flatter than for December.
- The *Northern* region was down 2.7 points (49.2), while the *Central* region was down 4.1 points (49.0). The *Otago/Southland* region was down 4.3 points (57.0), while *Canterbury/Westland* (43.1) fell back 5.3 points from December, possibly still experiencing a lagging effect from the earthquake disruption.
- Manufacturing by industry sub-groups tended to be a mixture of expansion and contraction during January. The categories experiencing the strongest expansion again included *food, beverage & tobacco* (56.5) and *machinery & equipment manufacturing* (54.5). *Petroleum, coal, chemical & associated products* was down 12 points on December (39.4) - a sizeable drop.
- The comments about market conditions showed the proportion of negative comments (52.6%) is slightly higher than positive comments (47.4%), with the main issues being holiday period slowdown, slow demand and exchange rate challenges. Positive comments focused on improving economic activity translating into stronger orders and improving export orders.
- The JPMorgan Global Manufacturing PMI rose to a nine-month high (57.2), with continuing expansion in the USA, the Eurozone, China and India.

The BNZ - BusinessNZ Performance of Manufacturing Index is a monthly survey of the manufacturing sector providing an early indicator of activity levels. A PMI reading above 50 points indicates manufacturing activity is expanding; below 50 indicates it is contracting. The main PMI and sub-index results are seasonally adjusted.

HIGHLIGHTS

Seasonally-adjusted PMI is in expansion for the fourth consecutive month.

All of the five main indices recorded expansion for the third consecutive month.

Unadjusted regional activity showed three of the four regions in contraction.

The proportion of negative comments slightly outnumbered positive ones.

Global manufacturing scene starts 2011 in solid expansion.

***Next BNZ - BusinessNZ PMI:
10 March 2011***

SPONSOR STATEMENT

BNZ is delighted to be associated with the Performance of Manufacturing Index (PMI) and BusinessNZ. This association brings together the significant experience of leading business advocacy body BusinessNZ, and business finance specialist BNZ. We look forward to continuing our association with BusinessNZ and associated regional organisations, and to playing our part in the ongoing development of the New Zealand manufacturing sector.

Inside BNZ Commentary this Month (page 3)

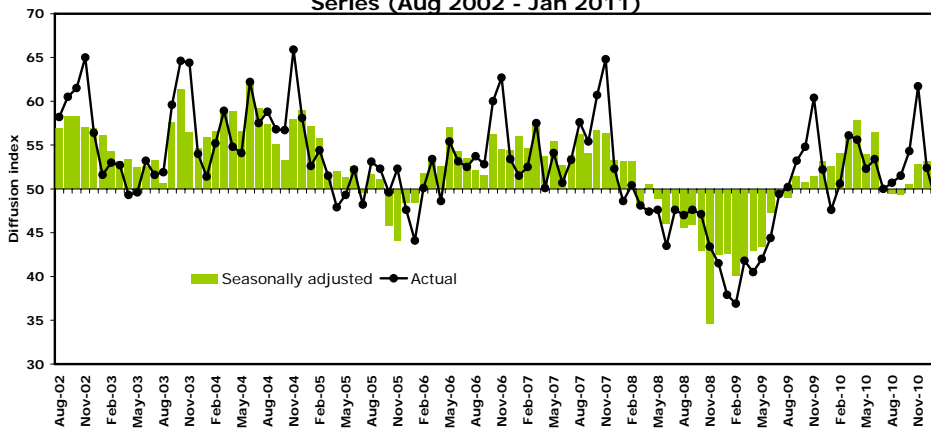
In this edition the Bank of New Zealand Research team discusses the disappointing recovery to date, where the economy now sits in the bigger picture, and prospects for the year ahead and beyond. In short, the economy has broadly flat-lined recently but 2011 is brighter with some highly visible one-off boosters on the horizon.

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pmi

BNZ - BusinessNZ Performance of Manufacturing Index Time Series (Aug 2002 - Jan 2011)



January time series tables

National Indexes	Jan 2006	Jan 2007	Jan 2008	Jan 2009	Jan 2010	Jan 2011
BNZ - BusinessNZ PMI (s.a)	48.4	55.9	53.2	42.7	52.5	53.7
Production (s.a)	49.1	57.3	52.3	41.1	53.6	52.8
Employment (s.a)	45.4	51.6	49.6	42.9	49.3	52.8
New Orders (s.a)	50.4	58.1	54.4	41.3	56.0	56.6
Finished Stocks (s.a)	49.2	51.3	54.8	49.1	47.8	50.7
Deliveries (s.a)	47.4	58.5	55.9	43.5	51.0	52.4

National Indexes	Jan 2006	Jan 2007	Jan 2008	Jan 2009	Jan 2010	Jan 2011
BNZ - BusinessNZ PMI (s.a)	48.4	55.9	53.2	42.7	52.5	53.7
Northern	42.3	51.6	47.2	34.4	45.8	49.2
Central	44.8	52.6	42.3	40.7	48.9	49.0
Canterbury/Westland	49.4	53.7	55.2	36.8	49.7	43.1
Otago/Southland	42.8	43.4	58.8	48.4	48.8	57.0

(s.a denotes seasonally adjusted)

The BNZ - BusinessNZ PMI contains data obtained through Business NZ's regional organisations:



Northern (Employers and Manufacturers Association - Northern): Northland, Auckland, Waikato, Bay of Plenty



Central (Employers' Chamber of Commerce Central): Gisborne, Hawke's Bay, Taranaki, Manawatu, Wanganui, Wellington, Nelson, Tasman



Canterbury/Westland (Canterbury Employers Chamber of Commerce): Canterbury, Marlborough, West Coast



Otago/Southland (Otago Southland Employers Association): Otago, Southland.

17 February 2011

Disillusioned With Recovery?

- Economy flat-lining for now
- But outlook for 2011 remains bright
- On numerous visible factors
- Interest rates headed higher

New Zealand's economic data for the second half of 2010 has been disappointing. There is probably a bit more disappointment to come as the remainder of the partial indicators for that period are published in the lead up to the full GDP accounts for the December 2010 quarter to be published in late March.

But taking a step back from the data, perhaps it is not that surprising that consumers and business were on the cautious side regarding spending and expanding, given the major economic, if not distressing, events that the country endured in the second half of last year. A brief (non-exhaustive) recap of what went on:

- Savage storms in September that severely hit agricultural production including a 10% reduction in the lamb crop
- Major earthquake(s)
- South Canterbury Finance receivership
- Drought – through late spring / early summer again hurting primary production
- Higher electricity costs as the next piece of the ETS scheme was rolled out
- 50bps of OCR hikes
- A hike in GST
- A lift in petrol excise tax and RUC
- Income tax cuts
- Auckland restructuring into a supercity
- 'PSA' disease outbreak that had the potential to severely dent \$1 billion worth of kiwifruit exports
- Pike River mine explosion with a tragic loss of life (and the receivership of a major company)

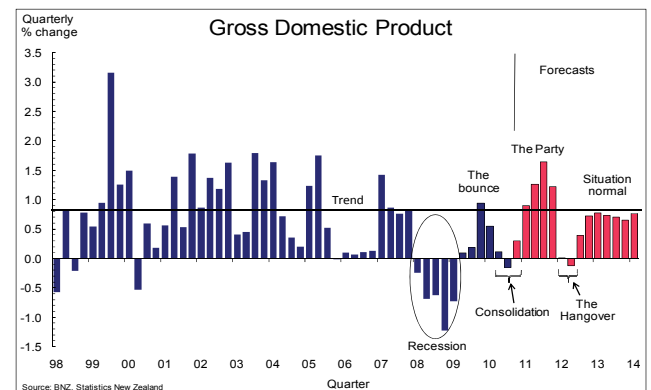
This was surely enough change, disruption and angst to dampen any recovery at home, let alone what was going on overseas at the time (think European sovereign deficit and debt issues, stalling share markets, talk of double dip recessions etc).

The recent experience was neatly summed up by one respondent to the PMI survey this month as 'an economic rollercoaster'.

The outlook for 2011 is brighter, but no doubt the rollercoaster ride will continue within the context of a likely improving trend. Not only will the economy continue to be buffeted by international events but, also, it faces significant domestically-induced volatility. This means businesses will have to be cautious in their approach, reduce financial risk where possible and be sufficiently flexible to react to both threats and opportunities as they arise.

Right now the economy is in the midst of what we are referring to as a six stage process. The stages are as follows:

- The recession
- The post-recession bounce
- A period of consolidation
- A relatively strong event induced expansion
- The hangover from such
- The new normal.



Currently, we are in the period of consolidation immediately following the post-recession bounce. Indeed, it is conceivable that this may have turned into a mini-recession. However, rising business and consumer confidence, strengthening corporate balance sheets and a stabilising labour market all suggest that the consolidatory period will be relatively short-lived.

Today's further improvement (albeit minor) in the PMI is another small step in the right direction.

Performance variation across the manufacturing sector is particularly wide at present – no doubt a reflection of various exposures to the many and powerful forces at play. For example, performance will depend on one's

relative exposure to the weak domestic property market, cautious domestic consumer, generally stronger demand in emerging market economies, competition from foreign competitors, high commodity export incomes, high commodity input costs, a high NZD against the USD, EUR and GBP, a low NZD against the AUD, and the changed market conditions following the earthquakes in Canterbury and floods on the east coast of Australia. Averages tend to hide a lot when such strong and diverse factors are in play.

As we move through 2011 the economy will be buoyed by a series of positive factors including:

- The Rugby World Cup
- Soaring commodity prices
- Primary production recovery post the recent drought(s)
- Solid global growth
- The post-earthquake Canterbury repair and rebuild
- An improving labour market
- The lagged impact of tax cuts (both personal and corporate) and
- The inventory cycle.

On the latter, it is interesting to note that the PMI results offer support to the story that the inventory cycle is swinging in favour of growth. The new orders-to-inventory ratio lifted again in January to be at its highest level since April last year. The widening gap between new orders and inventory is a pointer to more production ahead and a positive manufacturing contribution to GDP growth.

The combination of the above positive factors could see annual GDP growth peak at as much as 5.0% later this year, in our view. Again, future industry performance will partly depend on exposure to the various drivers outlined above.

Unfortunately, calendar 2012 will see the reversal of many of the one-offs resulting in a period of very subdued growth. By calendar 2013 the economy should have returned to the new normal where it should stay for

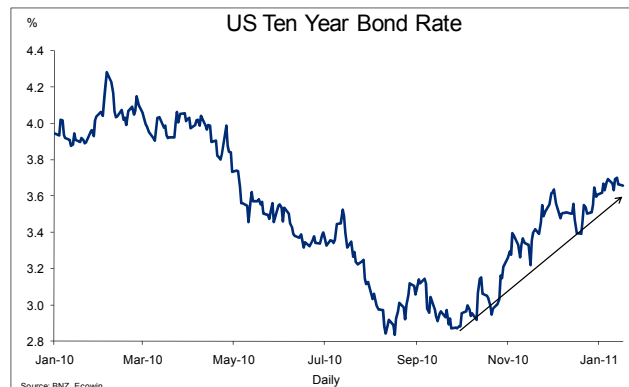
some time. The new normal will entail growth rates of 2.0 to 2.5% per annum as growth will be constrained by ongoing fiscal consolidation, labour supply concerns, weak recent past investment and a raised household sector savings ratio.

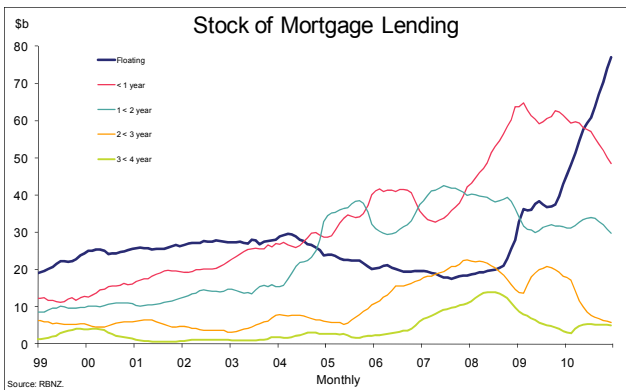
Employment will largely follow the economic cycle with a lag and, typically, property will then follow this employment profile. Property will be negatively affected by excess capacity following the current period of subdued activity but the outlook for manufacturing, exporters and builders is improving and this should provide some support.

There is certainly the potential for some large growth rates off what is now a low base in many macro economic indicators – such as building consents, concrete production, retail sales, and property transactions to name a few.

Against this backdrop, we believe the central bank will keep its cash rate on hold until the second half of this year. We are formally forecasting the first rate increase in September. However, once the process starts, we believe rates will move steadily higher to peak at around 5.0%. The longer the cash rate looks set to stay where it is the greater the downward pressure on short-term swap yields. However, we caution that three events pose significant upside risks to rates across the curve over the next year or so:

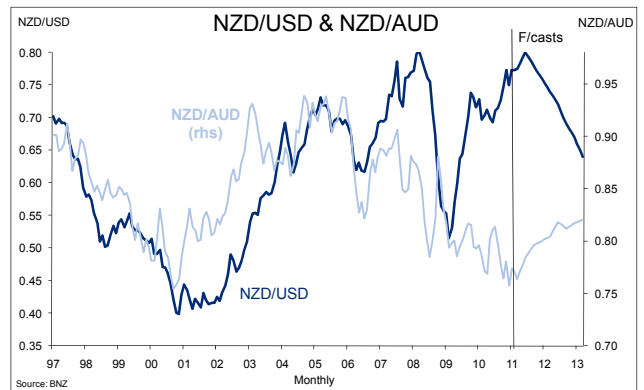
1. We believe the market is currently underpricing likely cash rate increases and that any reassessment could result in sharply higher short-dated swap yields;
2. Ongoing demands for funds by Government, the world over, and increasing international inflation concerns are already resulting in significantly higher long term bond yields in some parts of the world. This could well drag domestic swap rates up across the curve.
3. Currently, domestic borrowers continue to migrate toward floating rate debt at a rapid rate. At some stage this strategy will reverse and there is the risk that it will do so aggressively driving up swap yields, particularly in the one to three year part of the curve.





Nervous borrowers would be well advised to contemplate protection against these sorts of risks.

As for the New Zealand dollar, we believe it will find support against the USD in the short term but as soon as confidence in the US economy grows a sharp reversal can be expected. That, however, is most likely to be a late 2011/early 2012 story.

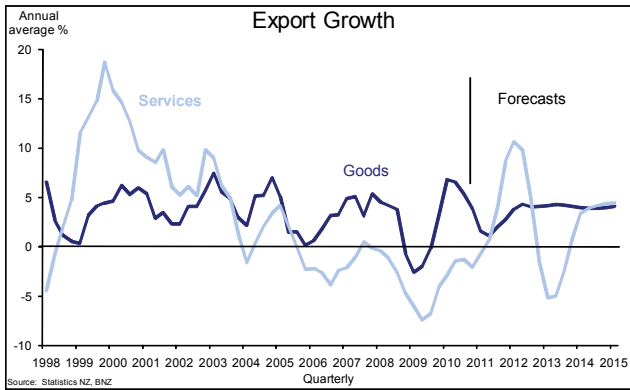


Similarly, the current weakness against the AUD is likely to be sustained for a while longer yet. The real threat on this cross revolves around the strength of the Chinese economy and, in turn, commodity prices. In the event that Chinese attempts to slow growth prove overly aggressive the NZD would likely appreciate rapidly against the AUD. Even without this, we think the NZD will slowly push higher against the AUD as soon as the New Zealand tightening cycle begins.

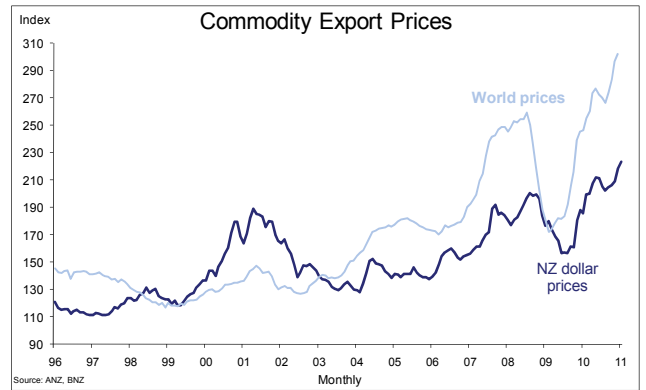
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Growth Drivers

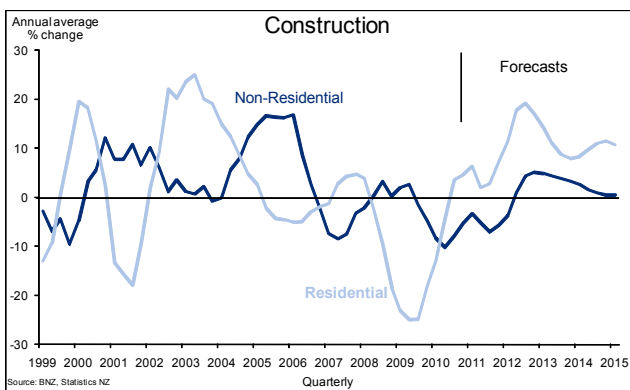
The Rugby World Cup



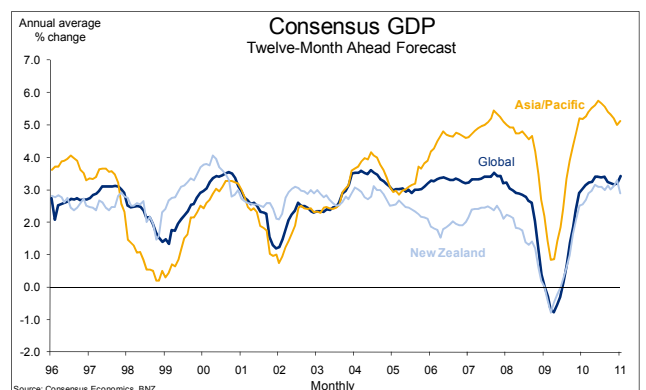
Staggering Commodity Prices



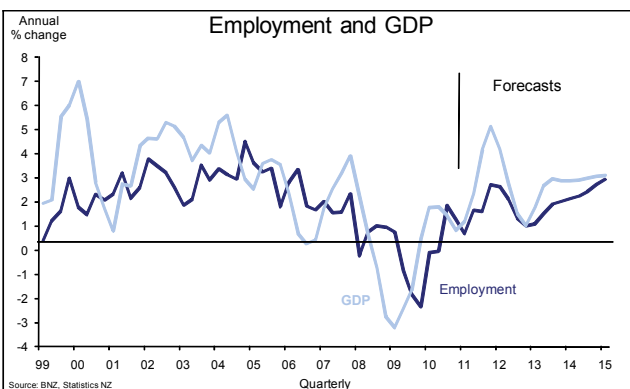
Canterbury Rebuild



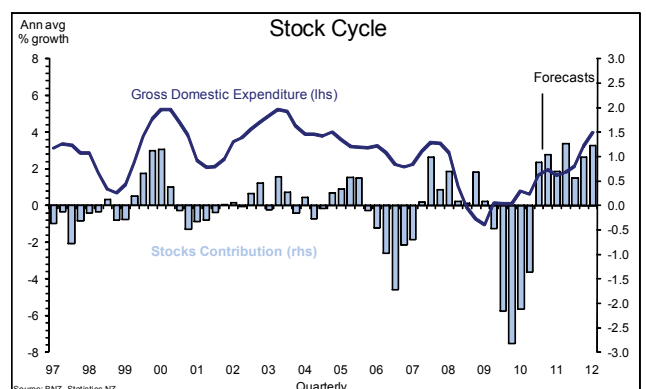
Solid Global Growth



An Improving Labour Market



The Inventory Cycle



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