

The Bank of New Zealand - Business NZ Performance of Services Index is a monthly survey of the services sector providing an early indicator of activity levels. A PSI reading above 50 points indicates services activity is expanding; below 50 indicates it is contracting.

psi

Service sector expansion continues to ease in January

Bank of New Zealand - Business NZ PSI for January 2008

- The January Bank of New Zealand - Business NZ Performance of Service Index (PSI) started the year on a soft note with a value of 51.9, down 2.0 points from December. As was the case in the previous month, the January result was the lowest recorded for the survey since it began in April 2007. Over that time, values have ranged between 51.9-62.6, with an average value of 57.5.
- All five diffusion indices that make up the PSI continued to exhibit expansion, although two of the key indicators produced their lowest result. *New orders/business* (55.6) again led the way, but produced its second consecutive sub-60 result. *Activity/sales* (50.2) were close to no change, while *employment* (51.8) and *deliveries* (51.1) produced similar results.
- Activity by region was again lower for all, with the *Otago/Southland* region (40.9) continuing to exhibit a sharp decline in activity, which was also evident in December. This was mainly due to very low activity and new order results. The *Canterbury/Westland* region (55.6) again led the January values, while both North Island regions showed moderate growth.
- Most service sectors continued to show expansion for the start of 2008, with *accommodation, cafes & restaurants* and *health & community services* (both 56.1) sharing the top spot for activity. The only decline was for *wholesale trade* (49.1), although the value for January was an improvement on December, and probably indicative of seasonal factors.
- The downwards movement on the rate of expansion continues to closely mirror the fall of positive comments received, which fell from 50.2% in December to 43.5% in January. Compared with the same time last year, activity for those with negative comments for January remained stable at 3.3*, while those enjoying positive activity on balance experienced another rise at 2.4. Overall, the national result for activity compared with 2007 stood at 2.9, compared with 2.8 in December.

National Indexes	Oct 2007	Nov 2007	Dec 2007	Jan 2008
Business NZ PSI	58.4	62.6	53.9	51.9
Activity/Sales	58.7	65.9	53.7	50.2
Employment	52.2	57.6	51.1	51.8
New Orders/Business	66.0	67.2	59.2	55.6
Stocks/Inventories	56.7	63.6	53.4	48.5
Supplier Deliveries	57.0	57.3	50.3	51.1

Regional Indexes	Oct 2007	Nov 2007	Dec 2007	Jan 2008
Business NZ PSI	58.4	62.6	53.9	51.9
Northern	60.4	64.1	55.2	52.7
Central	54.7	61.9	52.4	51.8
Cant/Westland	59.6	59.6	56.3	55.6
Otago/Southland	55.3	62.0	44.7	40.9

HIGHLIGHTS

- Activity level for the service sector stood at 51.9 in January, down 2.0 points from the December result.*
- New orders/business (55.6) was again the leading index, although it posted its second consecutive sub-60 value.*
- Contraction in activity continued in the Otago/Southland region.*
- The proportion of positive comments fell to well under half (43.5%) in January.*
- Next Bank of New Zealand - Business NZ PSI: 17 March 2008*

SPONSOR STATEMENT

Bank of New Zealand Ltd is delighted to be associated with the Performance of Services Index (PSI) and Business NZ. This association brings together the significant experience of leading business advocacy body Business NZ, and business finance specialist BNZ. We look forward to continuing our association with Business NZ and associated regional organisations, and to playing our part in the ongoing development of the New Zealand services sector.

Bank of New Zealand (www.bnz.co.nz)

PARTICIPANTS

Business NZ gratefully acknowledges the participation of the following associations in contributing to the PSI:

Employers & Manufacturers Association (Northern)
 Employers & Manufacturers Association (Central)
 Canterbury Employers' Chamber of Commerce
 Otago Southland Employers Association
 Hospitality Association of New Zealand
 New Zealand Retailers Association
 Tourism Industry Association New Zealand

* Respondents are asked for a score from 1-5, where 1= large rise and 5= large fall.

NZ Interest Rates: Why So High And When The Fall?

- NZ interest rate highs reflect inflation extremes
- Reduction thus depends on price pressures easing
- We expect this to be happening from late-2008
- But NZ rates also reflect higher risk compensation
- Against backdrop of lingering global credit crunch

We are often asked; "Why are New Zealand interest rates so high?" It is an understandable concern – one certainly expressed in today's Bank of New Zealand-Business NZ Performance of Services Index survey.

The short answer is that interest rates are high in order to fight the inflationary pressures that have built up in the economy over recent years. Thus, it's only once we get on top of inflation that yields will be able to ease.

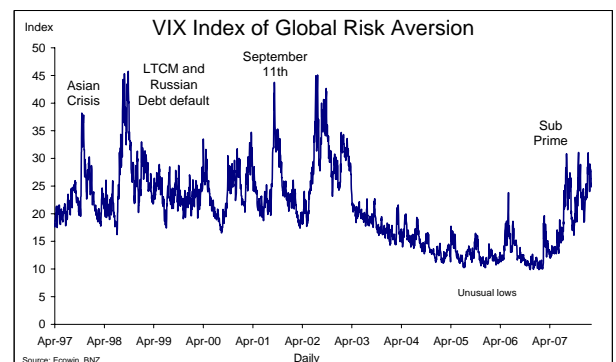
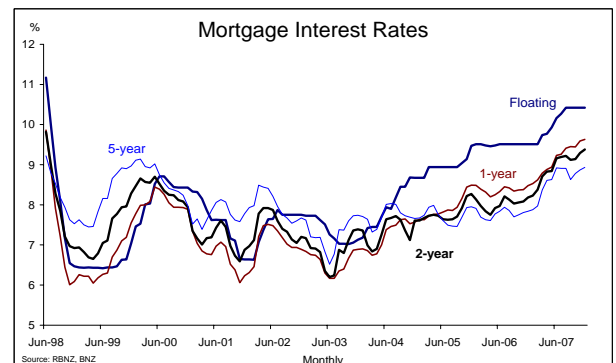
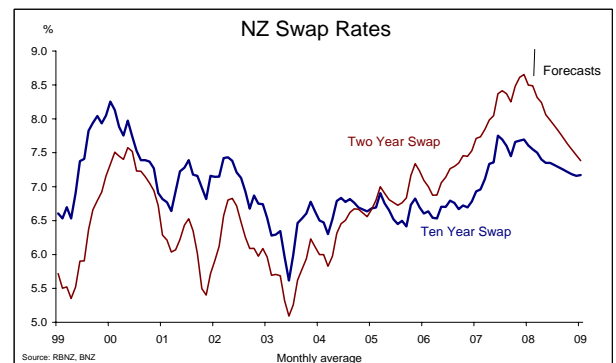
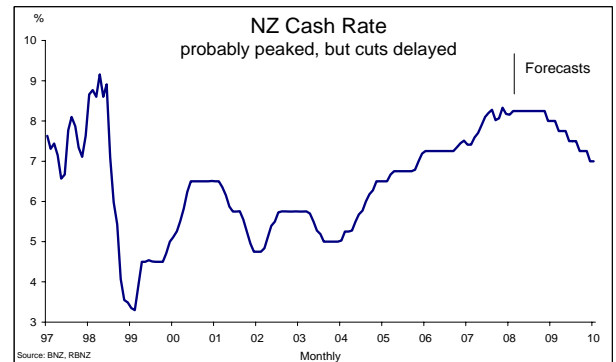
Thankfully, we do envisage price pressures dissipating, gradually, over the coming year. To be clear, this presumes annual economic growth moderates to just 1.4% over calendar 2008. With this, the Reserve Bank should be able to reduce its Official Cash Rate (OCR), allowing other market interest rates react to this prospect. In respect of degree, we note a normal OCR is viewed around 5.75%, compared to the present 8.25%. In terms of timing, we're thinking of late-2008 as the starting point for relief, rather than anything near term.

The delay will effectively be even longer for many of those who have recently struck fixed-rate debt, particularly mortgages. But postponed relief is also something for those contemplating fresh amounts of longer-term borrowing to think about.

The other issue for NZ interest rate markets is the higher implicit risk premium that has already crept back into yields since mid-to-late 2007. This has occurred not only in the likes of short-term rates but also in commercial paper and credit markets. Associated "spreads" are unlikely to return to the unusual lows of prior years.

Part of this relates to the global credit crunch, which looks likely to linger, at least to some extent, for a while yet. But the higher risk premium in NZ rates more fundamentally echoes the general reassessment of risk that has rippled through all international markets, from previously "bullet proof" attitudes. New Zealand is no exception to this, especially with the economy needing to rid its own recent (inflationary) excesses.

craig_ebert@bnz.co.nz



Contact Details

Bank of New Zealand Research



Stephen Toplis
Head of Research
+(64 4) 474 6905

Craig Ebert
Senior Markets Economist
+(64 4) 474 6799

Mark Walton
Markets Economist
+(64 4) 474 6923

Danica Hampton
Currency Strategist
+(64 4) 472 4767

Main Offices

Wellington
1 Willis Street
PO Box 2392
Wellington
New Zealand
Phone: +(64 4) 474 6145
FI: 0800 283 269
Fax: +(64 4) 474 6266

Auckland
125 Queen Street
PO Box 2139
Auckland
New Zealand
Phone: +(64 9) 976 5762
Toll Free: 0800 081 167

Christchurch
129 Hereford Street
PO Box 1461
Christchurch
New Zealand
Phone: +(64 3) 353 2219
Toll Free: 0800 854 854

NAB/nabCapital Research



Peter Jolly
Head of Research
+(61 2) 9295 1199

Alan Oster
Group Chief Economist
+(61 3) 8641 3464

Rob Henderson
Chief Economist, Markets
+(61 2) 9237 1836

John Kyriakopoulos
Currency Strategist
+(61 2) 9237 1903

Contact Phone Numbers

Wellington
Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

Sydney
Foreign Exchange +800 9295 1100
Fixed Income/Derivatives +(61 2) 9295 1166

London
Foreign Exchange +800 333 00 333
Fixed Income/Derivatives +(44 20) 7796 4761

New York
Foreign Exchange +1800 125 602
Fixed Income/Derivatives +1877 377 5480

Hong Kong
Foreign Exchange +(85 2) 2526 5891
Fixed Income/Derivatives +(85 2) 2526 5891

24 HOUR FOREIGN EXCHANGE SERVICE

Phone Toll Free 0800 739 707 6am to 10pm NZT – Wellington Office
10pm to 6am NZT – London Office – Olivia Core

ANALYST DISCLAIMER: The person or persons named as the author(s) of this report hereby certify that the views expressed in the research report accurately reflect their personal views about the subject securities and issuers and other subject matters discussed. No part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Markets Division which is part of the Institutional Markets & Services division of National Australia Bank Limited, a member of the National Australia Bank Group (the 'National'). The views of the author(s) do not necessarily reflect the views of the National and are subject to change without notice. The National may receive fees for banking services provided to an issuer of securities mentioned in this report. The National, its affiliates and their respective officers, and employees, including persons involved in the preparation or issuance of this report (subject to the policies of the National), may also from time to time maintain a long or short position in, or purchase or sell a position in, hold or act as advisors, brokers or commercial bankers in relation to the securities (or related securities and financial instruments), of companies mentioned in this report. The National or its affiliates may engage in these transactions in a manner that is inconsistent with or contrary to any recommendations made in this report.

NEW ZEALAND DISCLAIMER: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither the Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

U.S. DISCLAIMER: This information has been prepared by National Australia Bank or one of its affiliates or subsidiaries (collectively, "NAB"). If it is distributed in the United States, such distribution is by National Australia Capital Markets, LLC (NACM) which accepts responsibility for its contents. Any U.S. person receiving this information wishes further information or desires to effect transactions in the securities described herein should call or write to NACM, 200 Park Avenue, New York, NY 10166 (or call (877) 377-5480). The information contained herein has been obtained from, and any opinions herein are based upon sources believed to be reliable and no guarantees, representations or warranties are made as to its accuracy, completeness or suitability for any purpose. Any opinions or estimates expressed in this information is our current opinion as of the date of this report and is subject to change without notice. The principals of NACM or NAB and/or its affiliates may have a long or short position or may transact in the securities referred to herein or hold or transact derivative instruments, including options, warrants or rights with securities, or may act as a market maker in the securities discussed herein and may sell such securities to or buy from customers on a principal basis. This material is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action. It is intended for the information of clients only and is not for publication in the press or elsewhere.

