

PERFORMANCE OF SERVICES INDEX



BusinessNZ 

Service sector faces tough times leading into Christmas

Bank of New Zealand - Business NZ PSI for November 2008

- The Bank of New Zealand - Business NZ Performance of Service Index (PSI) remained in contraction for the eighth consecutive month, with the November result (47.3) the third lowest result since the survey began in 2007. The November result was 1.4 points down from October, and a significant 15.3 points down from the same month in 2007.
- Four of the five diffusion indices that make up the PSI exhibited contraction during November. *Activity/sales* (45.7) fell from October, although *employment* (49.5) picked up to be close to the level of no change. *New orders/business* (45.9) slumped to its lowest ever result, which will undoubtedly create further pressure on future activity/sales for many businesses. *Stocks/inventories* (51.1) experienced another minor drop but still in expansion, while *deliveries* (46.6) reverted back to a result similar to that recorded in September.
- Activity by region was mixed for November, with a combination of both expansion and contraction. The *Northern* region (44.8) recorded its second worst result, while the *Central* region (50.4) also experienced a drop in activity, albeit still in expansion for five consecutive months. In the South Island, the *Canterbury/Westland* region (55.3) continued to build on its October result, while the *Otago/Southland* region (47.6) recovered from three consecutive sub-40 results to post its highest activity result since March 2008.
- Results for the various service sectors were also mixed during November. The *health & community services* (54.6) and *accommodation, cafes & restaurants* (52.2) sectors were in positive territory, while the *transport & storage* sector (50.0) was again unchanged for November. *Property & business services* (44.5) experienced a sizeable fall in activity, along with *wholesale trade* (44.3), and *retail trade* (43.4).
- Like October, three of the four firms by employment size experienced contraction during November. Medium-large firms (51-100 workers) (39.9) were the worst affected, while large firms (101+ workers) (44.8) also experienced a fall in activity from October. Micro firms (1-10 workers) (47.6) continued to gradually slip from the previous month, although small-medium firms (11-50 workers) (50.0) continued to perform the best of all firms by size with activity that was unchanged from October.
- Interestingly, although overall activity fell, the proportion of negative comments from respondents during November fell to 59.2%, compared with 62.4% for both October and September. There continued to be a difference comparing activity with the same time last year for positive and negative comments, although this gap closed in November. Activity for those with negative comments (3.8*) was the same as October, while for positive comments there was a considerable worsening of results, moving from 2.3 in October to 2.8 in November.

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.

HIGHLIGHTS

- The overall level of activity for the service sector remained in contraction for the eighth consecutive month.**
- Activity/sales (45.7) fell in November, while new orders/business (45.9) slumped to its lowest ever result.**
- The Canterbury/Westland region led regional activity, while Otago/Southland showed some improvement.**
- Despite the overall fall in activity, the proportion of negative comments from respondents dipped to 59.2%**

Next Bank of New Zealand - Business NZ PSI: January 26 2009

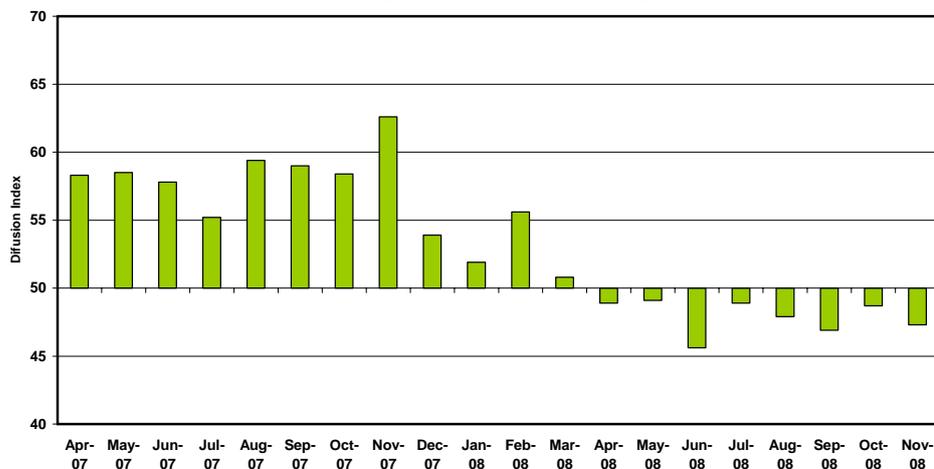
SPONSOR STATEMENT

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)

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

Bank of New Zealand - Business NZ Performance of Services Index Time Series (April 2007 - November 2008)



PSI time series tables

National Indexes	Nov 2007	Jul 2008	Aug 2008	Sep 2008	Oct 2008	Nov 2008
Bank of New Zealand - Business NZ PSI	62.6	48.9	47.9	46.9	48.7	47.3
Activity/Sales	65.9	47.9	41.2	43.9	46.8	45.7
Employment	57.6	47.5	48.1	45.8	47.1	49.5
New Orders/Business	67.2	52.7	50.2	49.4	50.0	45.9
Stocks/Inventories	63.6	46.7	53.2	53.0	52.0	51.1
Supplier Deliveries	57.3	48.2	51.3	45.6	50.2	46.6

Regional Indexes	Nov 2007	Jul 2008	Aug 2008	Sep 2008	Oct 2008	Nov 2008
Bank of New Zealand - Business NZ PSI	62.6	48.9	47.9	46.9	48.7	47.3
Northern	64.1	48.2	47.3	46.5	48.4	44.8
Central	61.9	54.9	55.4	52.7	55.4	50.4
Canterbury/Westland	59.6	51.1	47.7	50.9	52.3	55.3
Otago/Southland	62.0	40.4	39.3	37.0	37.7	47.6

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

In Defence of Corporate NZ

- Margins under pressure
- As input price inflation outpaces selling price growth
- Generally, though, inflation is abating rapidly
- Despite declining interest rates
- Market competition is working as it should

RBNZ Governor, Alan Bollard, has put a few noses out of joint with his wide ranging attack on business pricing behaviour. His intent, allegedly, was to reinforce the need for all players in the economy do their bit to help keep inflation in check. While we have some difficulty with the specifics of his commentary, we certainly share the sentiment. Notwithstanding this, we think that the Governor needs to better recognise three economic imperatives:

- Aggregate inflation will fall to zero, below the RBNZ's target band, if prices across the board remain as they are. Falling prices create deflation, not disinflation;
- A reduction in interest rates does not help contain inflation. Interest rates are not included in the CPI. To the contrary, the Reserve Bank's own models show that falling interest rates generally support demand which, in turn, helps push inflation higher;
- In times of significant stress, corporates are often forced to increase margins to improve overall profitability in the face of falling unit sales. Whether they can get away with it is a moot point but in some cases this will be the difference between survival and bankruptcy.

It is this last point that we would like to focus most on. In our experience, corporate New Zealand is, in aggregate, getting well and truly beaten up by a combination of reduced demand and margin pressure. This is why profits are under so much duress. Symptomatic of this, the aggregate price that producers are selling their goods may have risen 8.6% in the year to September, which seems an awful lot, but the costs of their inputs rose 13.6% over the same period. That's a big margin haircut.

This is backed up by the latest NZIER Quarterly Survey of Business Opinion in which substantially more businesses reported that their costs were rising faster than their selling prices.

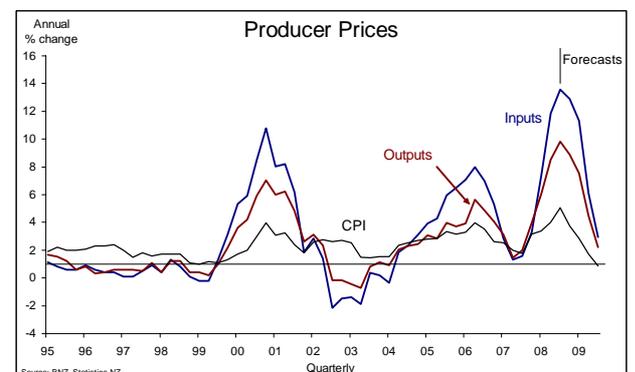
There are many reasons for this but we suspect that much of the blame can be put down to:

- rising labour costs, both in a nominal wage sense and through shifts in Government regulation;
- massive increases in rent;
- higher electricity and gas charges;
- pressure on the costs and availability of finance;
- the falling NZD pushing up the cost of imported product; and
- problems with lags.

The last of these is particularly problematic for. There is no doubt that the spot price of some inputs is falling but contracted prices, including rents and fixed price debt, take a little longer to move.

By and large, we believe New Zealand businesses operate in a highly competitive environment and that prices and margins will respond to this. Indeed, we think they already are and will do so further in the months ahead. That's why we are forecasting the CPI to drop 0.1% in Q4 and a further 0.2% in Q1, 2009 taking annual inflation down to just 0.8% by September 2009.

Where lack of competition is allowing price gouging, there are mechanisms available to address this and they should be adopted. For everyone else, the competitive process will produce an environment where the price and volume of sales is determined by the market, as it should.



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