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Business NZ

BNZ CAPITAL-BUSINESS NZ PSI

BNZ Capital-Business NZ PSI 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. BNZ Capital is a division of the Bank of New Zealand

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# Service sector activity picks up heading into Christmas

## BNZ Capital - Business NZ PSI for November 2009

- The BNZ Capital - Business NZ Performance of Service Index (PSI) for November increased 6.1 points from October to stand at 56.0. This was the highest level of overall activity recorded since November 2007.
- The current month was the first time since February 2008 that all sub-indices were in expansion mode. The two major contributors to the increase in overall activity came from a 10.3 point lift in *activity/sales* (58.7) and an 8.5 point lift in *new orders/business* (61.1). *Employment* (51.2) continued to edge up higher, while *stocks/inventories* (50.6) and *deliveries* (54.3) recorded their highest values since November 2008 and November 2007 respectively.
- Activity was positive for all four main regions during November, with the *Otago/Southland* region (59.4) leading the way with its highest result since February 2008. This was closely followed by the *Central* region (59.3), which had broken free of a tight band of results during the previous three months. The *Canterbury/Westland* region (56.0) continued to build on previous results, while the *Northern* region (54.8) returned to similar expansion levels experienced in September.
- Results for the various service sectors were almost all in expansion during November. *Transport & storage* (61.4) again led the way with ongoing improvements on previous results. *Health & community services* (59.4) recorded its highest value since August 2007, while *wholesale trade* (53.7) recovered somewhat after the drop in October. *Retail trade* (49.6) dipped below the no change mark of 50 after two months of expansion, while *property & business services* (52.9) did the opposite after two months of declines.
- All firms by employment size showed expansion during November – the first time since December 2007. Micro sized firms (1-10 workers) (51.9) showed small expansion after three months of contraction, while small-medium sized firms (11-50 workers) (57.3) reverted back to a level similar to September. Medium-large sized firms (51-100) (65.1) recorded its highest value since the survey began, while large sized firms (101+ workers) (55.9) was slightly down on its October value.
- The rise in overall activity levels was mirrored by the proportion of positive comments from respondents rising to 54.5% in November, compared with 49.8% in October, 53.2% in September, 50.5% in August and 48.1% in July.

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***HIGHLIGHTS***

- ***Service sector activity for November at highest level since November 2007.***
- ***Activity/sales and new orders/business help strengthen expansion levels.***
- ***Regional activity shows expansion across all parts of the country – first time since February 2008.***

***Next BNZ Capital - Business NZ PSI: 25 January 2010***

***SPONSOR STATEMENT***

*BNZ Capital 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. BNZ Capital is a division of Bank of New Zealand Ltd.*

BNZ Capital (www.bnzcapital.co.nz)

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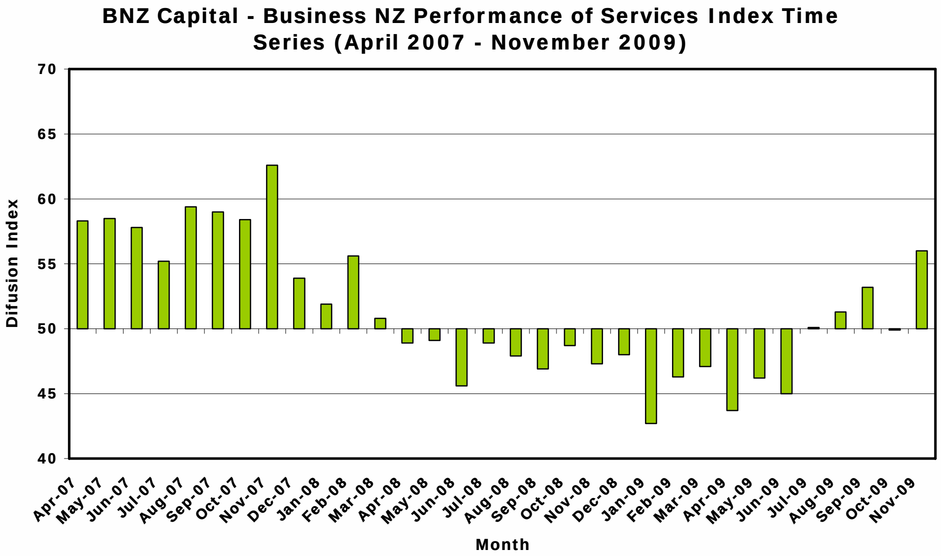


## PSI time series tables

| National Indexes | Nov 2007 | Nov 2008 | Aug 2009 | Sep 2009 | Oct 2009 | Nov 2009 |
|---|---|---|---|---|---|---|
| BNZ Capital - Business NZ PSI | 62.6 | 47.3 | 51.3 | 53.2 | 49.9 | 56.0 |
| Activity/Sales | 65.9 | 45.7 | 50.5 | 58.0 | 48.4 | 58.7 |
| Employment | 57.6 | 49.5 | 49.3 | 48.0 | 50.4 | 51.2 |
| New Orders/Business | 67.2 | 45.9 | 57.6 | 58.6 | 52.6 | 61.1 |
| Stocks/Inventories | 63.6 | 51.1 | 48.0 | 46.9 | 47.0 | 50.6 |
| Supplier Deliveries | 57.3 | 46.6 | 47.9 | 49.3 | 49.1 | 54.3 |

| Regional Indexes | Nov 2007 | Nov 2008 | Aug 2009 | Sep 2009 | Oct 2009 | Nov 2009 |
|---|---|---|---|---|---|---|
| BNZ Capital - Business NZ PSI | 62.6 | 47.3 | 51.3 | 53.2 | 49.9 | 56.0 |
| Northern | 64.1 | 44.8 | 50.2 | 55.8 | 48.9 | 54.8 |
| Central | 61.9 | 50.4 | 51.6 | 50.4 | 51.6 | 59.3 |
| Canterbury/Westland | 59.6 | 55.3 | 53.9 | 51.5 | 54.5 | 56.0 |
| Otago/Southland | 62.0 | 47.6 | 58.0 | 45.6 | 47.5 | 59.4 |


***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

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14 December 2009

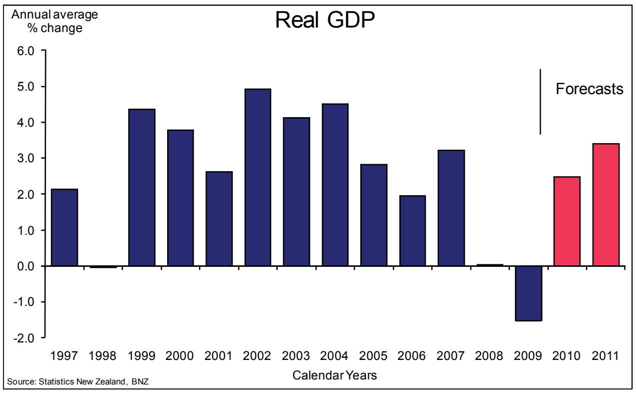
# Conservative Optimism Demanded

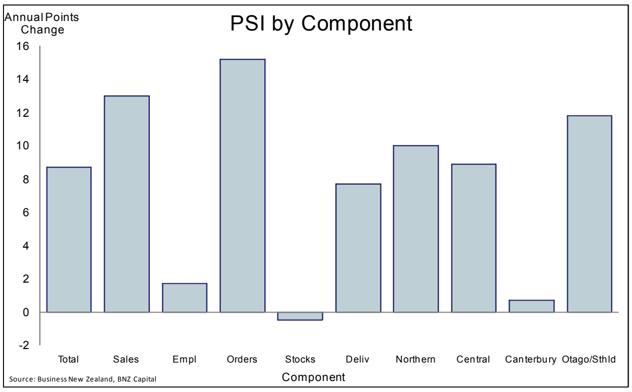
- Service sector right to be optimistic
- We forecast GDP growth of 2.5% for calendar 2010
- But watch for the monetary response
- Interest rates headed higher
- Currency could prove too high for some

The November PSI suggests that, despite the trials and tribulations of the current environment, the service sector, in aggregate, has become unequivocally upbeat about the future. Sure the November figures seem prone to a seasonal rush of blood but this can't overrule the fact that the sector is significantly more optimistic than it was one year ago. Moreover, the increase in the total index is being led by substantial improvements in expectations for activity and new orders.

The resurgence in the PSI is consistent with other domestic leading indicators (including the sister series the PMI) and significantly improved hope for global economic activity. They are also consistent with our own expectation that the economy grows 2.5% in calendar 2010 and 3.4% in 2011.

While this is all good news, and we don't want to pour cold water on Christmas cheer, we warn that the prospect of better times comes with a potentially very nasty sting in the tail. That sting comes by way of rising interest rates. The prospect of this was clearly laid out in last week's December Monetary Policy Statement in which the Reserve Bank cautioned that the time for higher interest rates is fast approaching. Just three months ago the RBNZ had said there would be no rate hikes until December 2010 at the earliest. Now it is intimating June is the most likely starting point with April, or even March, well within the realm of possibilities.

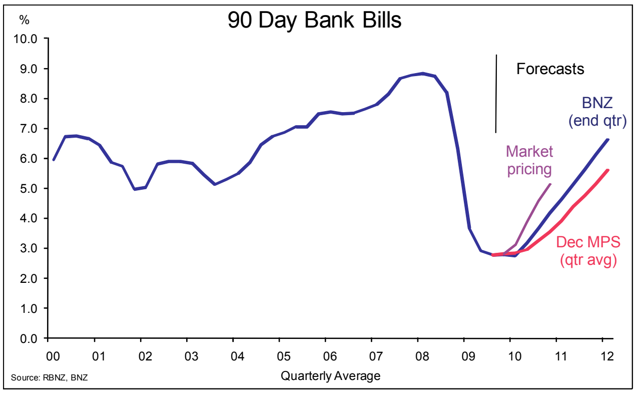


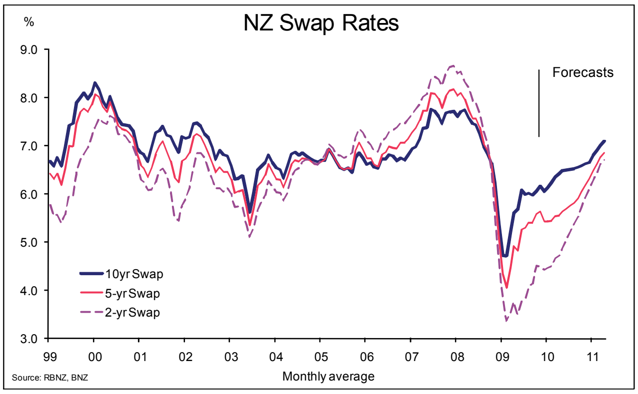



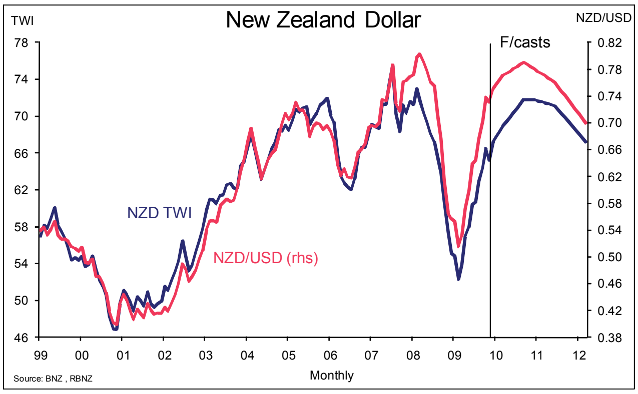

While financial market players get very excited by the exact timing of any such move, the key message for businesses is that interest rates ARE going up. It's a "when" not an "if". Moreover, the increases will eventually be significant as monetary conditions return to "normal". The very steep upwardly sloping nature of the curve means that financial markets have already priced a significant amount of this in so longer term rates should rise by a lot less than floating, if all pans out as expected. Nonetheless, the directional pressure is clear.

This being so, businesses need to very careful as to how they manage and plan for their future debt servicing requirements and, as has been the case for some time now, the more leveraged the business the greater the potential costs and risks.

The other side to this, of course, is that rising interest rates are designed to slow consumer spending and, in turn, make business investment hurdles higher. Consequently, not only do businesses have to cope with the direct costs of rising debt but also weaker-than-would-otherwise-be-the-case demand.






As if all this wasn't bad enough a strengthening economy coupled with rising interest rates tends to be associated with a stronger currency. The New Zealand dollar's upward response to last week's monetary policy statement is symptomatic of this.

In aggregate, then, monetary conditions will be tightening and, in turn, constraining economic activity.

To cap things off, a cash-constrained Government will also be turning off its fiscal stimulus further restricting the economy's growth path.

In our opinion, these developments are not to be feared. In fact, to an extent, they are to be welcomed with open arms. After all, interest rates and the currency will only be forced higher if the economy is on the improve. Another recession, in contrast, would see both fall but would hardly be considered as the optimal outcome.

We think businesses in the New Zealand service sector, as evidenced in today's findings, are right to be cautiously optimistic about the year ahead. But in this environment, the policy risks will be high. Accordingly, to increase the chances that you are one of the folk in the winners (rather than the losers) basket it will be imperative that corporate debt positioning be conservative and that there is recognition in business planning that, while the medium term outlook for the NZD is increasingly negative, it could yet cause grief on the upside for some.

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