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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

psi

Spring boost for service sector activity

BNZ Capital - Business NZ PSI for September 2009

- The BNZ Capital - Business NZ Performance of Service Index (PSI) for September increased 1.9 points from August to stand at 53.2. This was the highest overall result since February 2008, and 6.3 points higher than the September 2008 result.

- Like August, only two of the five diffusion indices that make up the PSI exhibited expansion, but involved the two key indicators of *activity/sales* (58.0) and *new orders/business* (58.6) that increased 7.5 points and 1.0 point respectively. The former was the highest result since November 2007. *Employment* (48.0) slipped back slightly from the August result, and remains in contraction now for 19 months. *Stocks/inventories* (46.9) also slipped back from the previous month, while *deliveries* (49.3) continued to show upwards movement to reach its highest result since March 2009 (albeit still in decline).

- Activity was positive for three of the four main regions during September, with the *Northern* region (55.8) recording its highest result since November 2007, as well as the strongest regional result for the current month. The *Central* region (50.4) fell back slightly from August, although still exhibited slight expansion. The *Canterbury/Westland* region (51.5) also experienced a dip in expansion after consecutive values above 53.0, while the *Otago/Southland* region (45.6) dropped back to levels experienced in June/July after a brief recovery in August.

- Results for the various service sectors were mostly positive for September, with *wholesale trade* (60.8) showing significant improvement from August and leading the way for September. This was followed by *health & community services* (56.8) and *retail trade* (54.8). *Accommodation, cafes & restaurants* (40.9) fell back from August, as did *property & business services* (47.9).

- Two of the four firms by employment size showed expansion during September, with small-medium sized firms (11-50 workers) (58.2) continuing to build on results over previous months. Medium-large sized firms (51-100 workers) (52.1) experienced a dip from August but still in expansion, while large sized firms (101+ workers) (46.7) went into decline for the current month. Micro sized firms (1-10 workers) (49.9) was largely unchanged for September.

- The improvement in overall activity levels was again mirrored by the proportion of negative comments from respondents dropping to 46.8% in September, compared with 49.5% in August, 51.9% in July and 58.8% in June.

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<u>HIGHLIGHTS</u>

- ***Service sector activity at highest level since February 2008.***
- ***Production and new orders/business key indicators for continued expansion.***
- ***Regional and sector activity mixed, with Northern region at highest level since November 2007.***

Next BNZ Capital - Business NZ PSI: 16 November 2009

<u>SPONSOR STATEMENT</u>

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)

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

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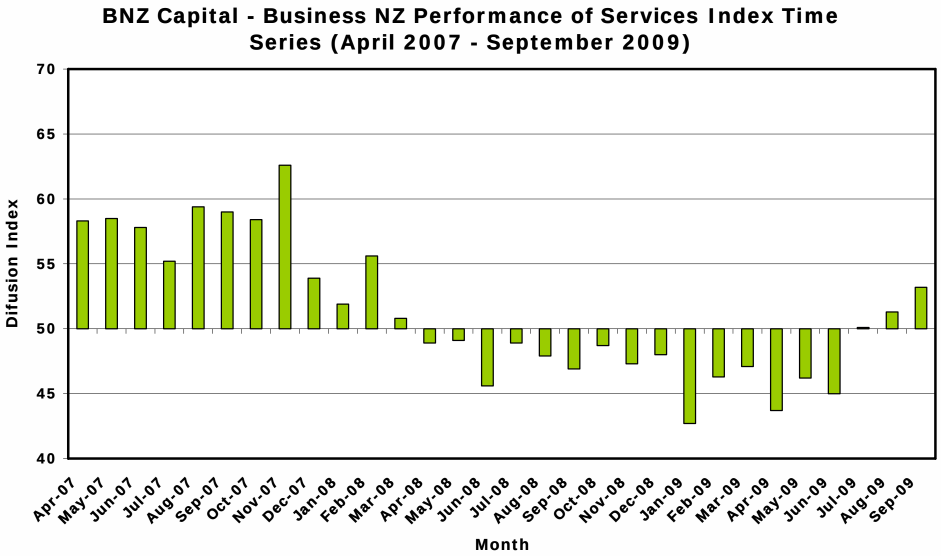


PSI time series tables

National Indexes	Sep 2007	Sep 2008	June 2009	July 2009	Aug 2009	Sep 2009
BNZ Capital - Business NZ PSI	59.0	46.9	45.0	50.1	51.3	53.2
Activity/Sales	60.7	43.9	43.9	51.7	50.5	58.0
Employment	53.1	45.8	43.6	47.9	49.3	48.0
New Orders/Business	65.4	49.4	50.8	56.5	57.6	58.6
Stocks/Inventories	57.1	53.0	41.0	42.1	48.0	46.9
Supplier Deliveries	56.8	45.6	42.2	46.0	47.9	49.3

Regional Indexes	Sep 2007	Sep 2008	June 2009	July 2009	Aug 2009	Sep 2009
BNZ Capital - Business NZ PSI	59.0	46.9	45.0	50.1	51.3	53.2
Northern	58.7	46.5	44.4	51.2	50.2	55.8
Central	56.5	52.7	45.8	45.8	51.6	50.4
Canterbury/Westland	61.2	50.9	47.5	53.1	53.9	51.5
Otago/Southland	61.9	37.0	44.8	43.7	58.0	45.6

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

19 October 2009

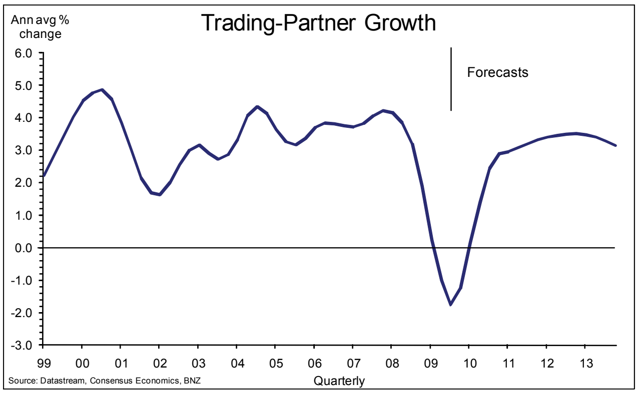
Overview

Domestic and international growth continues to push higher – so much so that the economy will be expanding at an above-trend pace by the end of next year. However, with the unemployment rate expected to rise further, the New Zealand dollar appreciating, and plenty of spare capacity still available, inflation will remain well contained. Consequently, we think it unlikely the central bank will begin raising interest rates until mid 2010. The current strength of the NZD is causing some angst for many and we think it will remain problematic until the economic cycle peaks.

Key Indicators	December Years					
	Actual			Forecasts		
	2006	2007	2008	2009	2010	2011
GDP production (an avg %)	1.9	3.2	0.0	-1.6	2.3	3.3
Consumers Price Index (ann %)	2.6	3.2	3.4	1.8	0.7	2.1
Unemployment Rate (end qtr %)	3.8	3.5	4.7	7.0	7.4	6.3
Current Account (% of GDP)	-8.6	-8.1	-8.9	-3.6	-5.7	-6.0
Fiscal Balance (% GDP June Yr)	4.5	3.5	3.1	-1.6	-4.4	-5.1
NZD/USD (Dec mth avge)	0.69	0.77	0.56	0.74	0.75	0.67
Overnight Cash Rate (Dec mth end %)	7.25	8.25	5.00	2.50	3.75	5.75
10 Year Govt Bond (Dec mth avge %)	5.77	6.40	4.88	5.50	6.00	6.80

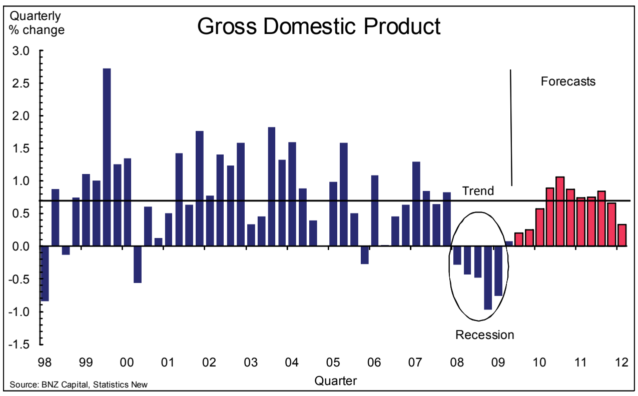
International

Expectations for global growth continue to be revised higher. From New Zealand's perspective the weighted average growth rate of our trading partners is expected to rise to 2.9% in calendar 2010 from -1.3% in 2009. 2011 looks better still at 3.3%. Nonetheless, severe risks to the global outlook remain. These include: the process by which the Federal Reserve removes quantitative easing in the United States; the removal of fiscal and monetary stimulus world-wide; the apparent "excess exuberance" driving Chinese production; ongoing banking sector issues; the necessary realignment of emerging market currencies, and the process by which that realignment will occur.



Growth

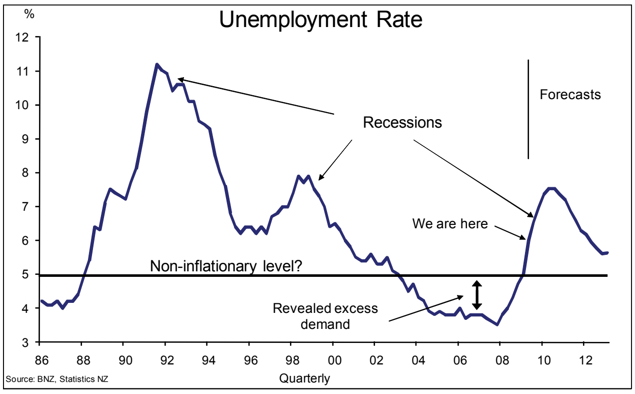
New Zealand came out of technical recession in the second quarter of this year. More importantly, all of the economy's key leading indicators are pointing to a much stronger year ahead. We estimate that GDP contracted 1.6% over calendar 2009. A 2.3% expansion is forecast for 2010 rising to 3.3% in 2011. While there is little doubt a sharp acceleration in activity is in the immediate offing, there remain significant uncertainties as to the sustainability of the expansion given the imbalances that remain including the poor household savings ratio, mounting international debt and the deteriorating fiscal position. Moreover, the current pace of the currency's appreciation will have significant negative medium term effects on the expansion.



National Australia Bank

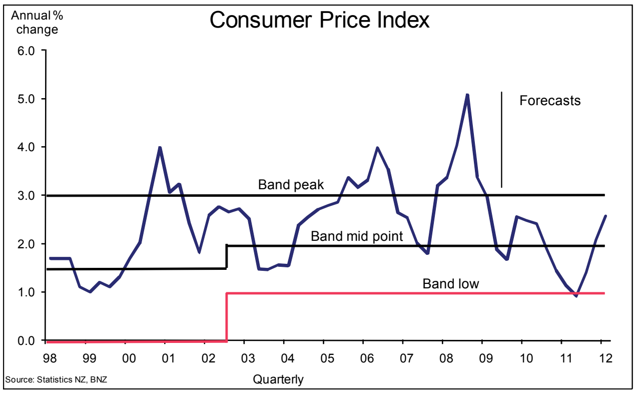
Labour Market

The unemployment rate is rising sharply. As at the end of June total job losses had climbed to 40,000 and had resulted in the unemployment rate climbing to 6.0% from a low of 3.5% back in the December quarter of 2007. We believe substantial further weakening in the labour market is likely with the unemployment rate set to peak at 7.5% mid next year. While this is a poor outlook, it is notable that unemployment is likely to peak at a lower level than in the last two major downturns. Unsurprisingly, with plenty of spare labour capacity developing, wage growth is well contained.



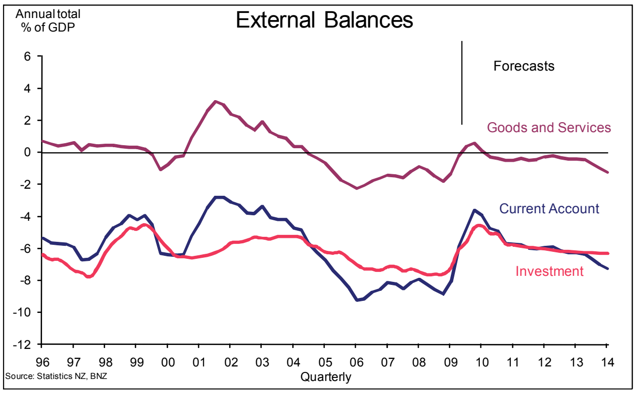
Inflation

There is no inflation problem in New Zealand, now or for the foreseeable future. In fact there is much more risk that CPI inflation will fall below the central bank's target band than there is of an upside surprise. Indeed, we are forecasting annual inflation to fall to a low of 0.9% in the year to June 2011. In the first instance, the driving disinflationary force is the rapidly appreciating New Zealand dollar but this is also being assisted by the fact that the economy is operating well below capacity and will stay that way for some time. We are forecasting annual CPI inflation of 2.6% for the year ended December 2009, 1.4% for 2010 and 2.1% in 2011.



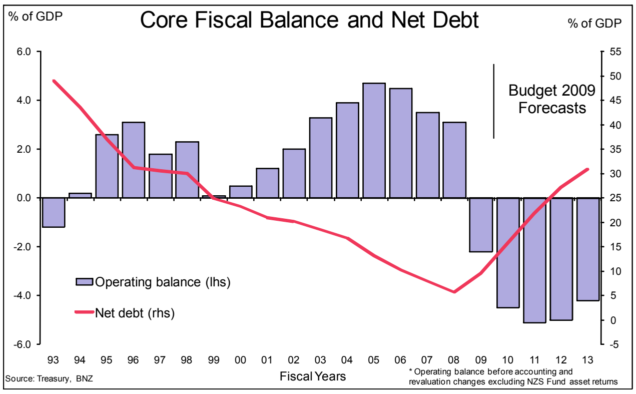
External Accounts

New Zealand's current account deficit is shrinking fast. In the December quarter of 2008 it peaked at 8.9% of GDP. It has since fallen to 5.9% and we believe it will be below 4.0% by year's end. The main driver of this is the sharp improvement in the international investment income deficit. A big chunk of this can be attributed to recent court rulings against the country's biggest banks, and in favour of the Inland Revenue Department, which is resulting in a $1bn-plus drop in direct investment income debits. Of course, this will have only a transitory impact on the accounts and is not reflective of an underlying reduction in New Zealand's imbalances. Nonetheless, it will be hard to argue that the NZD should be forced lower by growing current account deficits when the headline measure is going exactly the opposite way.



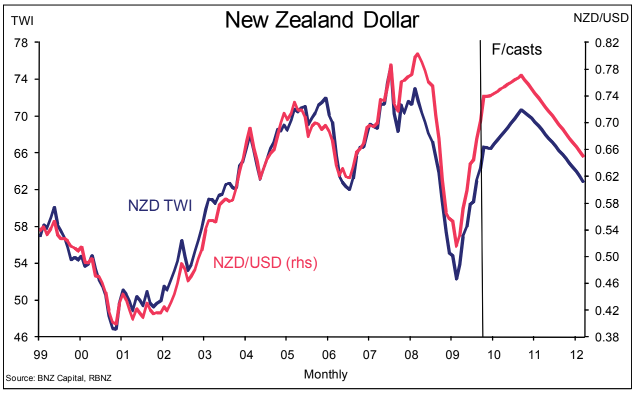
Fiscal Policy

The Government will be hoping that the stronger than expected growth outlook will translate into improved fiscal balances. So far, however, there is scant evidence of this. Whatever the case, the Government will have to soon shift its policy stance from accommodative to contractionary if it is to get its books in order. There are only three ways to do this: raise taxes, broaden the tax base and reduce spending. The first option has been ruled out. The second two are being heavily investigated. Watch in particular for recommendations from the VUW tax working group. Currently, capital gains taxes seem out of favour but the possibility of a land tax is very real.



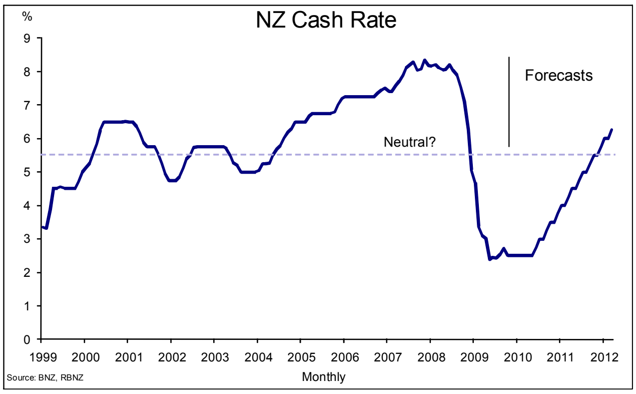
Exchange Rate

The New Zealand dollar is going from strength to strength aided by falling global risk aversion, commodity price increases and heightened optimism for both global and domestic growth. Adding further impetus is the growing belief that the RBNZ will be amongst the first central banks in the world to raise its cash rate, a view assisted by the fact that the RBA has already hiked by 25 basis points. Notwithstanding that the Kiwi remains very prone to a substantial corrective pull-back, we maintain our view that it is unlikely to display any substantive downward trend until the economic cycle peaks mid next year.



Interest Rates

The Reserve Bank has made things difficult for itself by sticking to its view that the first hike in the cash rate will not occur until the December quarter of 2010. We maintain our view that the Bank will be forced to move closer to mid-year. Formally, we are calling for the first tightening in June. Equally, however, we think market pricing for a January hike is premature given that: the New Zealand dollar is having a substantial disinflationary impact on the economy; retail interest rates are already being set as if the cash rate was much higher; bank lending growth to both businesses and households is very low; the RBNZ believes the recent resurgence in the housing market will be short-lived; the Bank already has strong GDP growth forecasts built into its projections; and the unemployment rate continues to rise.



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