BANK OF NEW ZEALAND — BUSINESS NZ

PERFORMANCE OF SERVICES INDEX

Bank of New Zealand

Business NZ

Service sector activity improves

Bank of New Zealand - Business NZ PSI for July 2008

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.

- The Bank of New Zealand - Business NZ Performance of Service Index (PSI) showed a slight recovery in July to stand at 48.9, which was 3.3 points higher than June and a return to the same level experienced in April. Despite the improvement, the sector was still in contraction and was also 6.3 points down from July 2007.
- Four of the five diffusion indices that make up the PSI continued to exhibit decline, which has now occurred for four consecutive months. The improvement in the overall PSI result for July was mainly due to a recovery in *activity/sales* (47.9), *employment* (47.5) and *supplier deliveries* (48.2). *Stocks/inventories* (46.7) have remained very stable since April, with the difference between the highest and lowest value over the four month period only being 0.5 points. *New orders/business* (52.7) continues to lead the sub-indices, although the July result was the second lowest since the survey began.
- Activity by region showed a split between expansion and contraction. For the two North Island regions there was a recovery from the June results, as the *Northern* region (48.2) increased 4.3 points from June, although still in contraction. The *Central* region (54.9) went back into expansion mode to record its highest level of activity since March (largely due to a boost in sales/activity). In the South Island, the *Canterbury/Westland* region (51.1) has remained steady in terms of activity, with the July result exactly matching that of June. Lastly, the *Otago/Southland* region (40.4) improved from the significant contraction experienced in June, although this was still the second lowest recorded value for that region.
- The various service sectors continued to almost all be in contraction mode during July. *Health & community services* (50.8) fell back from stronger gains in expansion over recent months, while *wholesale trade* (50.0) improved from June to show no change in activity. *Retail trade* (46.1) continued to remain lackluster, although reversed a trend of four consecutive worsening results in activity to return to the level of the May result.
- By size of firm, micro firms (1-10 workers) at 51.3, faired the best over July, while firms of larger size typically struggled, with large firms (101+ workers) (44.1) exhibiting their lowest level of expansion since the survey began. This was mainly due to a significant drop in orders/new business, along with a run down of stocks/inventories.
- Although there was a slight lift in overall activity for July, the proportion of negative comments from respondents only fell from 65.8% in June to 64% in July. Compared with the same time last year, activity for those with positive comments (2.1*) improved, while negative comments (3.5) for July remained the same as June.

<u>*HIGHLIGHTS*</u>

- ***The overall level of activity for the service sector improved slightly in July, although still showing contraction.***
- ***Activity/sales (47.9), employment (47.5) and supplier deliveries (48.2) recovered somewhat from June.***
- ***The Central region led regional activity for July, with a result similar to July 2007.***
- ***The proportion of negative comments from respondents fell back slightly to 64%.***

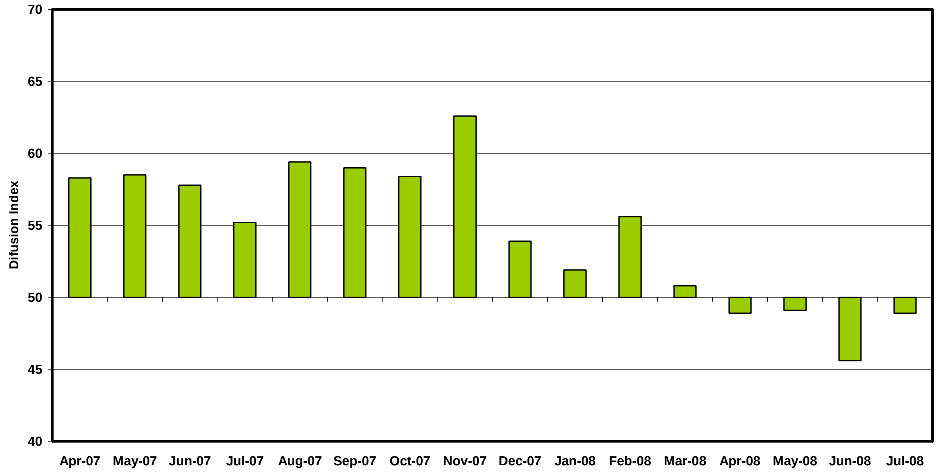
Next Bank of New Zealand - Business NZ PSI: September 15 2008

<u>*SPONSOR STATEMENT*</u>

Bank of New Zealand 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 its 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.



PSI time series tables

National Indexes	Jul 2007	Mar 2008	Apr 2008	May 2008	Jun 2008	Jul 2008
Bank of New Zealand - Business NZ PSI	55.2	50.8	48.9	49.1	45.6	48.9
Activity/Sales	56.4	51.8	48.3	49.0	44.9	47.9
Employment	51.7	48.9	44.7	46.8	41.8	47.5
New Orders/Business	61.8	52.9	55.3	54.8	51.4	52.7
Stocks/Inventories	49.4	49.0	46.9	47.1	46.6	46.7
Supplier Deliveries	52.4	50.3	47.8	44.8	42.7	48.2

Regional Indexes	Jul 2007	Mar 2008	Apr 2008	May 2008	Jun 2008	Jul 2008
Bank of New Zealand - Business NZ PSI	55.2	50.8	48.9	49.1	45.6	48.9
Northern	57.6	49.7	49.8	50.8	43.9	48.2
Central	55.3	57.1	53.8	50.5	47.9	54.9
Canterbury/Westland	49.1	47.7	48.1	50.6	51.1	51.1
Otago/Southland	55.9	52.9	42.8	41.6	36.1	40.4

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

Performance of Services Index

18 August 2008

Retail Highlights Service Sector Squeeze

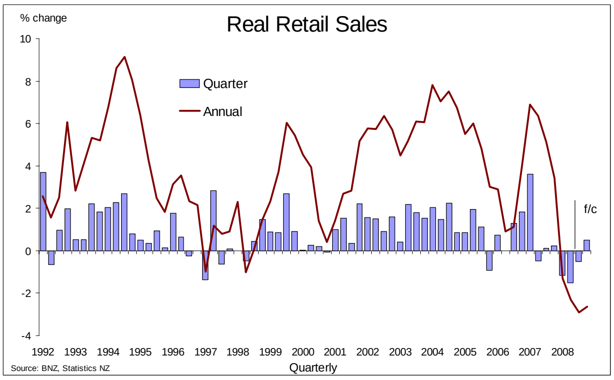
- Retail recession confirmed
- Tough conditions for service sector
- Squeeze to persist for some months
- 2009 relief on horizon

The squeeze being felt by the service sector was illustrated in spades by last Friday's retail sales figures. June quarter real retail sales dropped for the second consecutive quarter, down 1.5%, following Q1's 1.2% fall.

Though this wasn't hugely surprising – anecdote and monthly figures have both warned of a retail recession for some time now – it would be a mistake to be too blasé about the results. To put the declines in context, the last time we saw consecutive falls of such magnitude in the retailing sector was during the 1991 recession.

Nor does the fact that today's figure's weren't as bad as they might have been appreciably change our outlook for the wider economy. As such we remain inclined toward the view that GDP will contract again in Q2 (thus cementing a technical recession).

Most importantly, the Reserve Bank is unlikely to have been swayed appreciably in either direction by the latest retail news. The June/Q2 data likely did little more than confirm what the Bank (and everybody else) already strongly suspected regarding the retail sector. And it seems broadly consistent with the June MPS forecasts of real household consumption. This leaves the RBNZ on track to ease 25bp at its mid-September MPS (we do not subscribe to the view that a 50bp cut is on the cards).



Indeed, the Bank's (and our) attention now swings to the likely evolution of spending from Q3 onwards. From our view point, trading conditions look set to remain tough for a while yet. After all, consider the following:

- the labour market looks set to soften by much more than it has over the first half of this year already, thus posing significant risk to household incomes during the second half of this year;
- declines in housing wealth, a key driver of negative retail growth, have shown little, if any, signs of easing;
- prices of many staple goods, including those of food and utilities, continue to increase at rates in excess of nominal wage growth;
- mortgage rates remain high, even with the many OCR cuts priced into wholesale rates;
- a weakening New Zealand currency will see the cost of imported consumer goods lift.

Not that it's all one-way traffic. The recent softening in petrol prices will help lessen the pressure on household's disposable income, freeing up cash able to be spent elsewhere.

On balance, though, Q3 looks set to be another tough one for the service sector. Of retailers, in particular, we wouldn't be surprised to see real sales contract again. In this regard, look out for July's first nominal spending indicators in the form of the electronic card transactions and credit card billings, both due this Thursday. After recent monthly falls, it wouldn't surprise to see these spending indicators creep back into positive territory. A failure to do so, however – as seems the risk – would simply underscore the extent of retail angst and/or reflect lower prices being heavily discounted by retailers in order to shift stock.

The good news, for those retailers able to ride out the current storm, is that the positives will eventually start to outweigh the negatives. In particular, the start of 2009 could see the stars begin to align in favour of retailers, with the combined impact of fiscal stimulus (including the 1 October personal tax cuts), lower staples inflation, lower mortgage rates and booming agricultural incomes set to play key roles in reviving the retail sector.

mark_walton@bnz.co.nz

Contact Details

Bank of New Zealand Research

Stephen Toplis	Craig Ebert	Mark Walton	Danica Hampton
Head of Research	Senior Markets Economist	Markets Economist	Currency Strategist
+(64 4) 474 6905	+(64 4) 474 6799	+(64 4) 474 6923	+(64 4) 472 4767

Main Offices

Wellington	Auckland	Christchurch
1 Willis Street	125 Queen Street	129 Hereford Street
PO Box 2392	PO Box 2139	PO Box 1461
Wellington	Auckland	Christchurch
New Zealand	New Zealand	New Zealand
Phone: +(64 4) 474 6145	Phone: +(64 9) 976 5762	Phone: +(64 3) 353 2219
FI: 0800 283 269	Toll Free: 0800 081 167	Toll Free: 0800 854 854
Fax: +(64 4) 474 6266		

NAB/nabCapital Research

Peter Jolly	Alan Oster	Rob Henderson	John Kyriakopoulos
Head of Research	Group Chief Economist	Chief Economist, Markets	Currency Strategist
+(61 2) 9295 1199	+(61 3) 8641 3464	+(61 2) 9237 1836	+(61 2) 9237 1903

Contact Phone Numbers

Wellington		**New York**	
Foreign Exchange	+800 642 222	Foreign Exchange	+1800 125 602
Fixed Income/Derivatives	+800 283 269	Fixed Income/Derivatives	+1877 377 5480
Sydney		**Hong Kong**	
Foreign Exchange	+800 9295 1100	Foreign Exchange	+(85 2) 2526 5891
Fixed Income/Derivatives	+(61 2) 9295 1166	Fixed Income/Derivatives	+(85 2) 2526 5891
London			
Foreign Exchange	+800 333 00 333		
Fixed Income/Derivatives	+(44 20) 7796 4761		

24 HOUR FOREIGN EXCHANGE SERVICE	
Phone Toll Free	6am to 10pm NZT – Wellington Office
0800 739 707	10pm to 6am NZT – London Office – Olivia Core