BNZ-BusinessNZ PSI

BNZ-BusinessNZ 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. The main PMI and sub-index results are seasonally adjusted.

psi

Service sector starts on positive note for 2013

BNZ - BusinessNZ PSI for January 2013

- The seasonally adjusted BNZ - BusinessNZ Performance of Service Index (PSI) for January stood at 52.6. This was up 1.1 points from December and the first month-on-month increase since October 2012. Compared with previous January results, the 2012 value was lower than 2012, but higher than 2011.

- Only two of the five main sub-indices were in expansion during January. However, these involved the lead sub-indices of *new orders/business* (57.6) and *activity/sales* (53.5), which were both up from December. In contrast, *employment* (49.9) slipped back after a slight pick-up in December, while *stocks/inventories* (49.9) produced an identical result following last months' decline in activity. *Supplier deliveries* (48.1) recovered somewhat from December, although still in contraction.

- It was the tale of two Islands when examining activity by region. In the North Island, the *Northern* region (50.9) continued to slip from the previous month, but remained in positive territory. The *Central* region (54.4) led the way for January, recovering from a decline in activity during the previous month. In the South Island, the *Canterbury/Westland* region (49.8) continued to show increased momentum (although still in technical contraction), while the *Otago/Southland* region (42.0) fell back sharply after three consecutive months in expansion.

- Service sector results were a mix of expansion and contraction during January. *Property & business services* (50.4) fell back from December to its lowest value since September 2012, while similarly *wholesale trade* (50.1) fell back to its lowest result since April 2012. In contrast, *health & community services* (59.0) recovered from two consecutive months in expansion to produce its highest result since March 2012.

Inside BNZ Commentary this Month (page 4)

BNZ Head of Research Stephen Toplis looks at the changing global environment over recent months and what this means for New Zealand — particularly the risks associated with its nearest neighbours.

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HIGHLIGHTS - PSI

- ***Service sector shows pick up in expansion.***
- ***While only two of the five major sub-indices were in expansion, this involved the key sub-indices of activity/sales and new orders/sales.***
- ***Regional activity positive in the North Island.***

HIGHLIGHTS – PERFORMANCE OF COMPOSITE INDEX (PCI)

- ***Options for measuring PCI activity both showed a pick-up in expansion.***
- ***Global PCI for January similar to New Zealand's result.***

Next BNZ - BusinessNZ PSI/PCI: 18 March 2013

SPONSOR STATEMENT

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

BNZ (www.research.bnz.co.nz)

BNZ-BusinessNZ PSI

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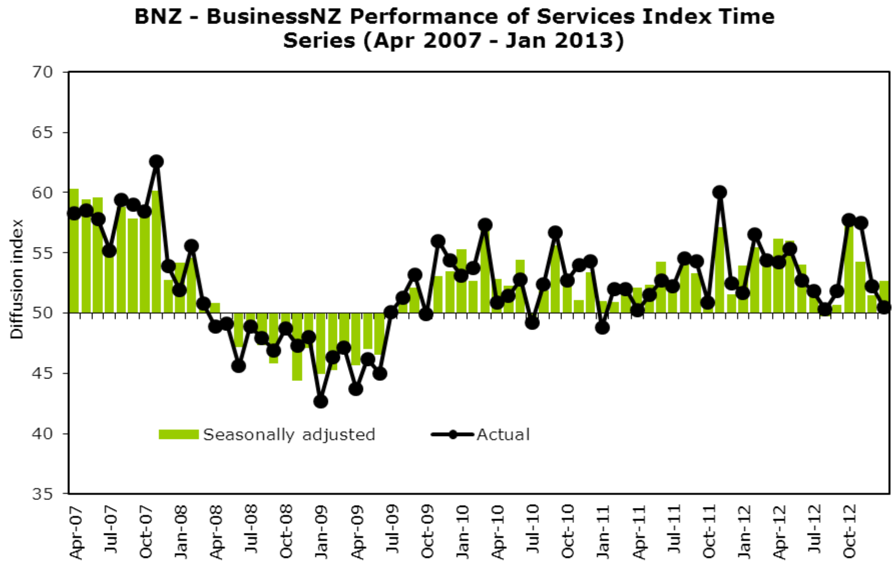

January PSI time series tables

National Indexes	Jan 2008	Jan 2009	Jan 2010	Jan 2011	Jan 2012	Jan 2013
BNZ - BusinessNZ PSI (s.a.)	54.2	44.9	55.3	51.0	53.9	52.6
Activity/Sales (s.a.)	55.1	42.0	58.3	50.7	53.6	53.5
Employment (s.a.)	51.8	43.5	52.8	47.9	54.1	49.9
New Orders/Business (s.a.)	59.3	48.9	59.6	54.6	58.5	57.6
Stocks/Inventories (s.a.)	48.5	45.7	50.2	50.5	45.7	49.9
Supplier Deliveries (s.a.)	51.9	45.0	51.1	50.5	50.9	48.1

Regional Indexes	Jan 2008	Jan 2009	Jan 2010	Jan 2011	Jan 2012	Jan 2013
BNZ - BusinessNZ PSI (s.a.)	54.2	44.9	55.3	51.0	53.9	52.6
Northern	52.7	39.3	52.4	50.0	49.7	50.9
Central	51.8	53.9	54.3	49.3	47.7	54.4
Canterbury/Westland	55.6	48.3	51.7	44.7	64.5	49.8
Otago/Southland	40.9	40.4	59.0	46.3	63.2	42.0

(s.a. denotes seasonally adjusted)

PARTICIPANTS

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

Employers & Manufacturers Association (Northern)

Business Central

Canterbury Employers' Chamber of Commerce

Otago Southland Employers Association

Hospitality New Zealand

BNZ-BusinessNZ PSI

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Pick-up for both measures

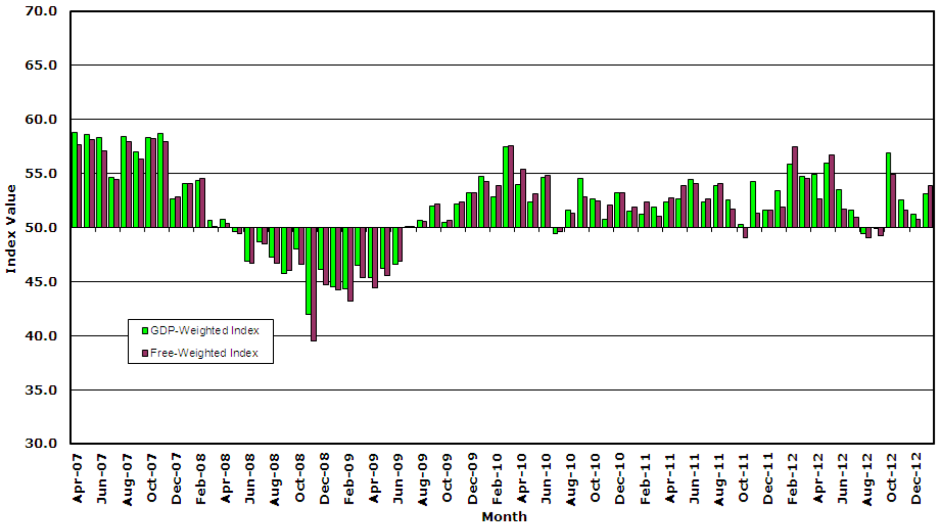
BNZ - BusinessNZ Performance of Composite Index (PCI) for January 2013

- The seasonally adjusted BNZ - BusinessNZ Performance of Composite Index or PCI (which combines the PMI and PSI) for January saw both options for measuring the PCI in expansion after a continued slip at the end of 2012.

- The GDP-Weighted Index (53.1) increased 1.9 points from December, while the Free-Weighted Index (53.9) rose 3.1 points over the same period. This was the highest result for both measures since October 2012, and the second highest since the middle of 2012.

- The JPMorgan Global Combined Index for January (53.3) was very similar to New Zealand's result, with both the manufacturing and service sectors seeing output rises.

BNZ - BusinessNZ PCI Seasonally Adjusted Time Series (April 2007 - Jan 2013)



Performance of Composite Index January time series table

Combined National Indexes	Jan 2008	Jan 2009	Jan 2010	Jan 2011	Jan 2012	Jan 2013
GDP-Weighted Index (s.a.)	54.1	44.5	54.8	51.5	53.4	53.1
Free-Weighted Index (s.a.)	54.1	44.2	54.2	51.9	51.9	53.9

About the Performance of Composite Index

The BNZ - BusinessNZ Performance of Composite Index (PCI) takes into account results from both the Performance of Manufacturing Index (PMI) and the Performance of Services Index (PSI).

Combined results are shown in two ways:

GDP-Weighted Index: Apportions the weight of the manufacturing and services index within the economy to produce an overall result.

Free-Weighted Index: Combines data from both indexes to produce an overall result.

Both time series for the PCI are then seasonally adjusted.

18 February 2013

Looking Ahead

- Global environment improves
- Domestic growth looking good
- Led by construction and durables spending
- Interest rates lower for longer
- But currency headed higher

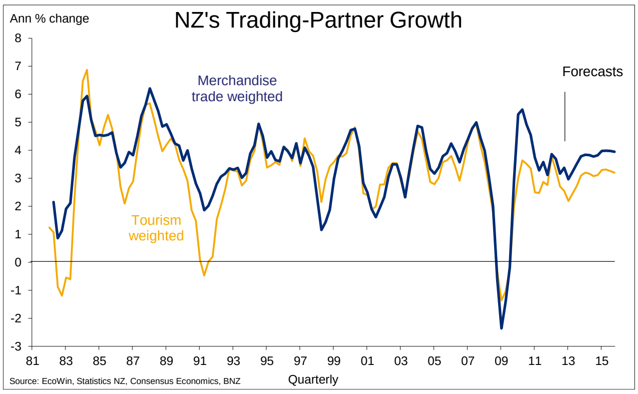
Pessimism about the future of the world has diminished significantly over the last six months. It would be a far cry to suggest optimism has returned but concerns about the possibility of a global recession have dissipated resulting in substantially lower risk premia for financial assets supporting both lower interest rates and a strong share market performance.

Be that as it may, there remain significant threats to the health of the global economy and, in turn, New Zealand's well-being. From New Zealand's perspective, the strength of its nearer neighbours, rather than the ructions in the US and Europe remain of greatest interest. In this regard, there are mounting fears about the state of the Australian economy. While the consensus view remains that the economy will stay as one of the fastest growth areas in the developed world, there are increasing risks to this view.

In short, Australia has been dependent on the strength of its export sector, as domestic demand has come under increasingly negative pressure. But a combination of substantial increases in its cost structure, a very high Australian dollar and a lower-cost-supply response elsewhere in this world has proved to be a significant obstacle to the economy's progress. How this unfolds will not only be key to Australia's success but also the strength of the New Zealand economy to the extent that our exporters, particularly manufacturers, are exposed to the Australian economy.

In part, Australia's strength will, in turn, depend on China's performance. At this stage there appears significant cause for optimism that the Chinese authorities have engineered a relatively soft landing for the economy. China still faces issues associated with: excess local authority debt, an over-supply of manufacturing output, low returns on investment and, increasingly, demographic constraints. Nonetheless, these constraints do not look as if they will be particularly binding in the near future.

Underlining China's importance, China overtook the United States last year to become the world's biggest trading nation (when measured by the total dollar value of the exports and imports of goods).



The "fiscal cliff" will continue to dominate the news flow out of the United States but this isn't really the big issue for them. The much bigger issue is how the United States will cope with its growing fiscal imbalances as the unfunded liabilities of the nation become realized over time. This is likely to act as a major impediment to economic expansion for the foreseeable future.

The Federal Reserve is doing its best to offset all of the negative imposts on the economy, from all sources, by vowing to maintain its current super-accommodative monetary policy stance until such time as the unemployment rate falls to 6.5% (currently 7.9%). How the US unwinds this stance, when, and what damage it has caused in the interim will have a major impact on the global economy. In the first instance there is the pain inflicted on other nations by the effective manipulation of the USD by the authorities, then there is the medium term risk of heightened inflation (with a nearer-term risk of heightened commodity prices) and, later on, the global fall-out as bond yields back up very quickly when the easing unwinds.

The machinations of Europe will remain of interest. What happens there is less about economic theory than political. This being the case, the "solution" is likely to be protracted, volatile and will condemn the region to sub-par growth for a very long time. And, this, only if they succeed.

Against this backdrop, the New Zealand economic outlook continues to look relatively promising. Indeed, we have recently raised our expectations for growth over the next two to three years.

This largely reflects the following:

- The Christchurch rebuild looks to be a larger process than we had initially anticipated;

- But construction activity elsewhere also looks to be much more robust than first thought as surging house prices create a supply response;
- There is also evidence that non-residential investment may prove stronger than first estimated;
- The combination of the above and the strong New Zealand dollar is likely to result in increased investment in plant and machinery;
- The strengthening housing market will also support modest private consumption growth as will the continuation of very low interest rates.

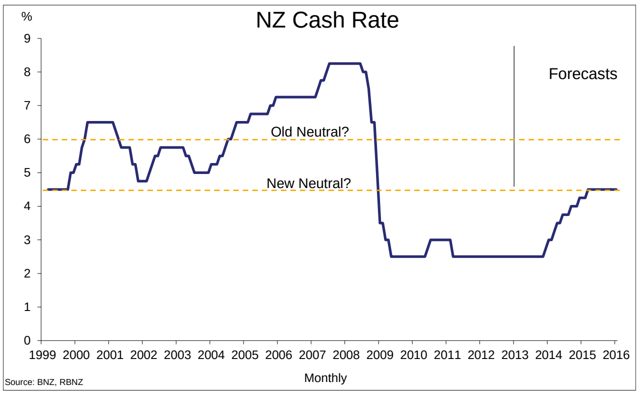
In addition, there is less reason to fear a global growth implosion and confidence levels amongst both consumers and businesses are at levels consistent with a robust expansion.

Putting all this together, we now forecast GDP growth of 2.5% for calendar 2013, 3.4% in 2014, and dropping to 2.0% in 2015. Growth in 2016 and 2017 will likely dip to around 1.5 to 2.0% but this simply reflects the fact that the acceleration in construction activity will be history.

Despite these relatively strong growth numbers, inflation stays broadly in check. This is thanks to the recent and expected strength in the currency, a weaker than anticipated labour market and a very low starting point for inflation, which not only helps in a statistical sense but also directly suppresses inflation via weakened inflation expectations. We expect annual inflation to be just 1.1% as at December 2013, rising to 2.2% by end 2014 and 2.9% end 2015. A gradual return to the RBNZ's mid-point is expected thereafter.

It is important to recognize that our inflation projections are predicated on the cash rate beginning to rise from late this year/early next and then rising steadily to reach a peak of around 4.5% by mid-2015. Were it not for the cash rate forecasts that we have, inflation would push through the top end of that band. The risks around this forecast should be seen as evenly balanced both in terms of timing and extent.

With interest rates in the ascendancy and New Zealand's relative economic performance positive, the NZD is likely to stay lofty (or loftier) for longer. On a TWI basis this

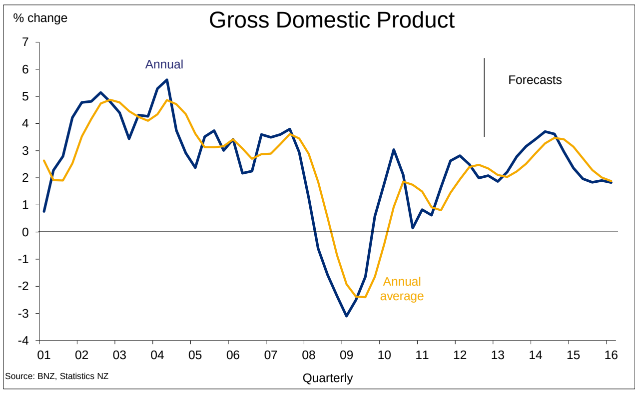


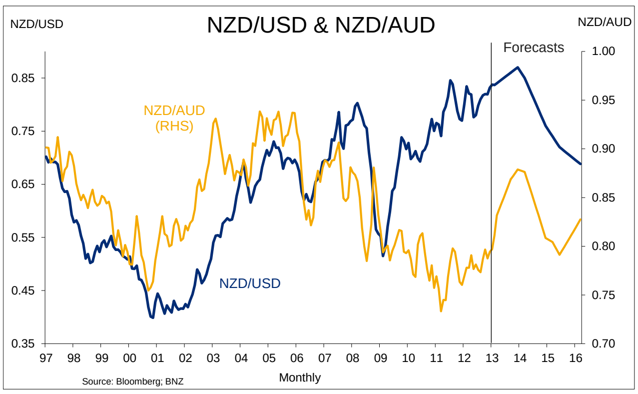
becomes even more likely given: the ongoing asset purchases by the Federal Reserve, the malaise of the Australian economy and Japan's determination to create inflation. Those looking for near term relief from the soaring NZD might have to think again. Only when the rest of the world looks more stable will this relief be forthcoming.

We are now forecasting a peak in the NZD/USD of around 87 cents late this year. The potential for the NZD to forge even higher than we are forecasting is probably the number one risk to both our growth forecast and our interest rate track. Further NZD strength could well undermine growth and result in a lower rate profile than we have projected.

What we can say with relative certainty is that given the combination of: the strong NZD, relatively weak global demand growth and the expected surge in domestic investment activity, it is highly likely that New Zealand's external accounts will deteriorate further and that the Government will get no nearer to achieving its stated objective of exports climbing to 40% of GDP.

Overall then, a solid start to the period ahead. New Zealand still looks a relatively good place to be when compared with most of the developed world. Risks to the economy's performance are abating but the outlook is far from certain and remains particularly vulnerable to the external environment, a potentially overheating housing market, and the accompanying strength in the NZD.





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