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BNZ-BusinessNZ PMI

BNZ-BusinessNZ PMI is a monthly survey of the manufacturing sector providing an early indicator of activity levels. A PMI reading above 50 points indicates manufacturing activity is expanding; below 50 indicates it is contracting. The main PMI and sub-index results are seasonally adjusted.

pmi

Marching onwards

BNZ - BusinessNZ PMI for March 2014

- The BNZ-BusinessNZ seasonally adjusted PMI for March stood at 58.4, which was 1.9 points higher than the previous month, and the highest result since July 2013. For the first quarter of 2014 the PMI averaged 57.1, while the sector has now been in expansion for 19 consecutive months.

- For the first time since October 2013, all five seasonally adjusted main diffusion indices were in expansion for the current month. Both *production* and *new orders* (60.5) displayed the same level of expansion, while *employment* (56.3) rose 1.6 points to record its highest level since November 2007. *Deliveries of raw materials* (57.1) edged slightly downwards from February, while *finished stocks* (51.1) went back into expansion after four consecutive months in contraction.

- All four regions were again in expansion during March, with levels very similar across the country. In the North Island, the *Northern* region (59.2) rose 6.3 points, while the *Central* region (57.6) was almost identical to February's result. In the South Island, the *Canterbury/Westland* region (59.9) picked up 6.2 points from February, while the *Otago-Southland* region (59.8) dipped 1.9 points.

- Manufacturing by industry sub-groups were almost all in expansion during February. *Machinery & equipment manufacturing* (64.4) picked up strongly from February, while *petroleum, coal, chemical & associated product manufacturing* (62.5) also produced a post-60 result. *Metal product manufacturing* (62.1) experienced strong activity levels, while *food, beverage & tobacco manufacturing* (59.9) saw a slight reduction in expansion.

- The proportion of positive comments for March (61.3%) was up on the results for February (58.8%) and January (59.2%). Globally, the JPMorgan Global Manufacturing PMI (52.4) fell back slightly from February, as weather related distortions hit both the US and Japan surveys in recent months.

Inside BNZ Commentary this Month (page 3)

While the manufacturing sector is buoyant, BNZ Head of Research Stephen Toplis, looks at the implications for businesses when the economy and financial markets are at such an inflection point. He discusses the potential for significant movements in interest rates and exchange rates, and the need for businesses to focus on risk management.

The BNZ - BusinessNZ Performance of Manufacturing Index is a monthly survey of the manufacturing sector providing an early indicator of activity levels. A PMI reading above 50 points indicates manufacturing activity is expanding; below 50 indicates it is contracting. The main PMI and sub-index results are seasonally adjusted.

HIGHLIGHTS

Seasonally-adjusted PMI marches onwards with a very healthy result for March.

All five main indices were in expansion, with production and new orders jointly leading the way.

Unadjusted regional activity was expansionary in all four regions.

Next BNZ - BusinessNZ PMI:
15 May 2014

SPONSOR STATEMENT

BNZ is delighted to be associated with the Performance of Manufacturing Index (PMI) 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 manufacturing sector.

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

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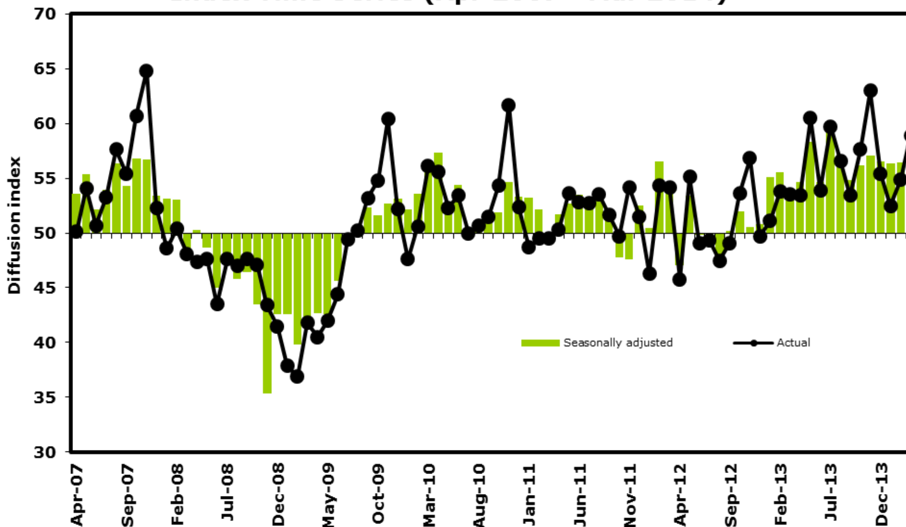
pmi



March time series tables

National Indexes	Mar 2009	Mar 2010	Mar 2011	Mar 2012	Mar 2013	Mar 2014
BNZ - BusinessNZ PMI (s.a.)	41.8	56.3	49.3	53.9	53.0	58.4
Production (s.a.)	38.9	59.2	48.7	55.9	52.9	60.5
Employment (s.a.)	39.8	49.7	51.7	50.9	51.0	56.3
New Orders (s.a.)	42.6	57.6	48.9	56.3	54.6	60.5
Finished Stocks (s.a.)	46.9	53.7	48.8	49.7	50.7	51.1
Deliveries (s.a.)	40.9	56.3	46.5	51.5	52.7	57.1

National Indexes	Mar 2009	Mar 2010	Mar 2011	Mar 2012	Mar 2013	Mar 2014
BNZ - BusinessNZ PMI (s.a.)	41.8	56.3	49.3	53.9	53.0	58.4
Northern	41.3	57.8	52.4	51.6	50.7	59.2
Central	45.2	49.0	53.1	62.1	60.9	57.6
Canterbury/Westland	41.0	58.6	42.0	50.4	59.1	59.9
Otago/Southland	37.6	57.5	44.3	48.8	46.8	59.8

(s.a. denotes seasonally adjusted)

The BNZ - BusinessNZ PMI contains data obtained through BusinessNZ's regional organisations:

Northern (Employers and Manufacturers Association - Northern): Northland, Auckland, Waikato, Bay of Plenty

Central (Business Central): Gisborne, Hawke's Bay, Taranaki, Manawatu, Wanganui, Wellington, Nelson, Tasman

Canterbury/Westland (Canterbury Employers Chamber of Commerce): Canterbury, Marlborough, West Coast

Otago/Southland (Otago Southland Employers Association): Otago, Southland.

10 April 2014

Focus on Risk Management!

- Times are good
- However, the economy and financial markets are at an inflection point
- Monetary conditions will tighten
- But the form of that tightening is far from clear
- NZD and commodity prices will be key determinants

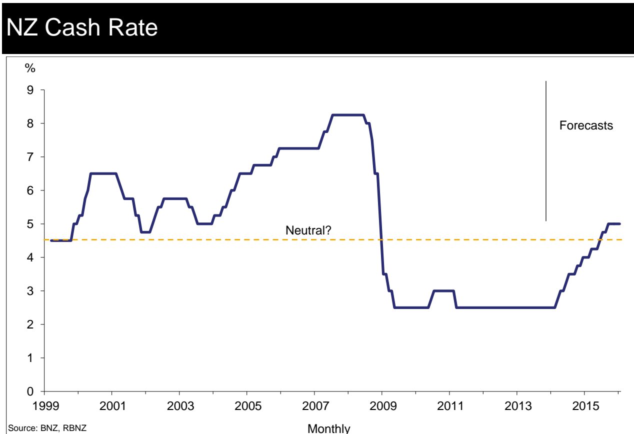
The manufacturing sector is in a buoyant mood with the total PMI, production and employment indicators all near ten year highs. This despite an elevated NZD and an uncertain global environment. What this reveals is that local manufacturers are making the most of: strong domestic demand; increased primary sector output; our increasing exposure to the faster growing economies of Asia; and gains in competitiveness, enforced on the sector by a trying external environment.

There is every reason to assume that such momentum can be sustained for a while yet but we caution that the operating environment may change significantly for many. Those in the industry should be making plans now to ensure flexibility should such change occur.

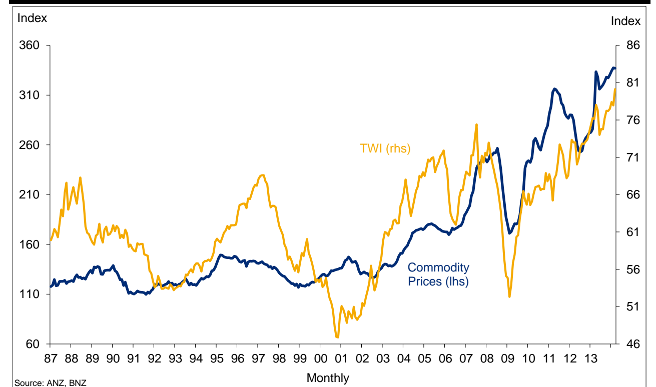
The biggest immediate adjustments are likely to come via monetary policy settings. While change is most definitely in the wind, the nature of that change is far less certain.

What we can say, with some certainty, is that the Reserve Bank will raise its overnight cash rate significantly over the next year or two as interest rate settings move from being extremely stimulatory, (and consistent with an economy in deep recession) to levels more appropriate for an economy growing at, or probably above, trend. The cash rate is seen as being at neutral at around 4.5% - a far cry from the 2.75% currently being experienced.

NZ Cash Rate



World Price of NZ Commodities and the TWI

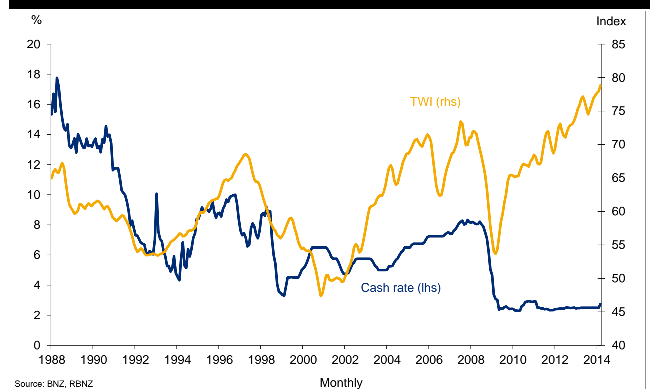


This suggests borrowers need to do some serious risk management around their debt. This is not to say that all and sundry should rush out and fix their borrowing rates, as fixed rates are already pricing in a significant increase in the cash rate. But understanding interest rate risk at this juncture is a must.

Ultimately, the extent of future rate increases will be highly dependent on the combination of the movements in the New Zealand dollar and commodity prices. And we stress that it is the combination that matters, not just one or the other.

If we just look at the path of the NZD in isolation then, all other things being equal, if the currency pushes above the track the Reserve Bank assumed for it when it produced its March Monetary Policy Statement, interest rate increases will be less than would otherwise be the case. In contrast, if it falls faster than assumed then interest rates will push higher. All of this happens because of

Cash and the TWI



the impact that the exchange rate has on inflation both directly (via changes in import and export prices) and, indirectly, through its impact on activity levels in the economy.

But if, for example, the NZD is rising because commodity prices are rising then the downward pressure on prices created by the currency's strength would be offset by the inflationary impact of higher commodity prices and the increased spending power of local producers. That's why the currency has been so strong yet the RBNZ still feels the need to hike further.

With all this in mind, we thought it worthy of bringing to your attention the fact that there are two very conceivable monetary conditions scenarios in the wings that are (a) not priced in by the markets and (b) could have a significant impact on the earnings of manufacturers.

As things stand, the Reserve Bank is assuming the cash rate rises steadily to around 5.25% by March 2017 and that the NZD gradually falls back to a Trade Weighted Index of 75.3 (from a current level of 80.5) over the same period. This is the nirvana scenario, and we all know that nirvana and reality are rarely the same thing.

There are two very plausible alternatives to this scenario that should be contemplated by all. Firstly, it should be recognized that New Zealand commodity prices (in aggregate) appear to have peaked. In particular, the GDT (GlobalDairyTrade) auctions have already revealed a 20% drop in prices over the last twelve months. These prices only impact a very small proportion of current dairy sales as much of our production is sold forward at a fixed price. But, eventually, average prices will reflect the marginal prices revealed in the auctions. We not only believe that this will be the case but we are also anticipating significant further declines from current levels.

And this is where things could, potentially, get very interesting. If investors in the New Zealand dollar fail to recognize the future impact of falling commodity prices on the currency but, instead, focus on all the relatively positive things about New Zealand, then the NZD could go from strength to strength. Against a backdrop of falling commodity prices this could mean only one thing – a lower interest rate track.

If this happens then:

- There is less need for protection against rising interest rates;
- Exporters will need to contend with more pressure on returns (and/or hedge against it);
- Importers will be dancing in the streets;
- The New Zealand economy will become increasingly imbalanced as domestic demand is supported by low interest rates while exporters suffer; and
- The housing market will get even more overvalued.

But an equally plausible alternative should also be contemplated.

It may well be that international investors, who already see the NZD as overvalued, react quickly to further news on commodity price declines and the rush to sell it such that it drops precipitously, in a very short period of time, forcing the Reserve Bank into raising interest rates much more aggressively than currently believed possible.

Under this scenario:

- Importers need to be very highly hedged to protect against cost increases;
- Exporters should be totally unhedged;
- Holders of debt should be fixing aggressively; and
- Homeowners should be prepared for house price falls.

We too, have adopted a fairly nirvana-like central scenario for our forecasts. But when an economy is at a point of inflection, as ours currently is, then we cannot stress enough that a focus on risk management is very important. It is imperative, at this juncture, that businesses contemplate the potential impacts of a variety of alternative scenarios in order to, at least, be aware of the risks to their operations and, when possible and appropriate, mitigate them. Any business can make money when times are good and there is no volatility. The real winners, however, are those that effectively manage change in a manner that allows them to maximize risk-adjusted returns across the economic cycle.

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