Bank of New Zealand

BusinessNZ

BANK OF NEW ZEALAND – BUSINESS NZ PERFORMANCE OF MANUFACTURING INDEX

The Bank of New Zealand - Business NZ 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.

pmi

Further slide in manufacturing growth

Bank of New Zealand - Business NZ PMI for February 2008

- The Bank of New Zealand - Business NZ seasonally adjusted PMI for February (52.2) continued to show softening in the sector, with the fourth consecutive drop in the level of expansion. Comparing all February values, the 2008 result was the second lowest, behind the 2006 result (51.7).

- For the first time in eight months, not all the main diffusion indices recorded expansion. This was due to *employment* (48.3) contracting for the first time since June 2007. *New orders* (54.1) led the way for February, and remained largely unchanged from the previous month, despite being its lowest result since March 2006. *Production* (51.6) was almost exactly at January levels, while *finished stocks* (53.9) and *deliveries* (52.7) both fell from January.

- Unadjusted activity for February showed that it was the South Island leading the expansion. The *Canterbury/Westland* region (57.0) rose in expansion for February, and led the way for the month. The *Otago/Southland* region (52.4) experienced its third consecutive drop in expansion, mainly due to a fall off in production and employment. Both North Island regions continued to exhibit a decline, although not as pronounced as January. Both the *Northern* and *Central* regions stood at 48.9 and it was the third consecutive fall in activity for the latter.

- Unadjusted results for the various manufacturing industries were a combination of contraction and expansion. The petroleum*, coal, chemical & associated product* sector (60.3) bounced back from the January decline to lead the way in February. This was followed by the *metal product* sector (54.7), which showed expansion after two months of decline. The *food, beverage & tobacco* sector (49.1) continued to slip in activity, while the *machinery & equipment* sector (45.6) also showed a significant fall in activity compared with the latter half of 2007.

- The latest JPMorgan Global PMI for Manufacturing that the New Zealand PMI contributes to showed further softening in global manufacturing with overall results falling to 51.1, the lowest result since July 2003. This was mainly due to lower production and new order results. Closer to New Zealand, Australia's manufacturing activity remained subdued in February, although showing slight expansion.

- The proportion of negative comments made by respondents continued to increase, with 63.7% highlighting negative influences for February (up from just over 60% in January). The majority of negative comments were again associated with the high New Zealand dollar (around 25% of all negative comments), while other firms noted the sluggish start to the year.

HIGHLIGHTS

Seasonally-adjusted PMI down 1.0 point from January to sit at 52.2 for February.

Four of the five main indices continued to show expansion, with employment showing a minor contraction.

Regional activity was positive in the South island, but continued to be negative in the North Island.

The proportion of negative comments increased again in February.

The global PMI shows further loss of momentum with weak production and new order results.

Next Bank of New Zealand - Business NZ PMI: 10 April 2008

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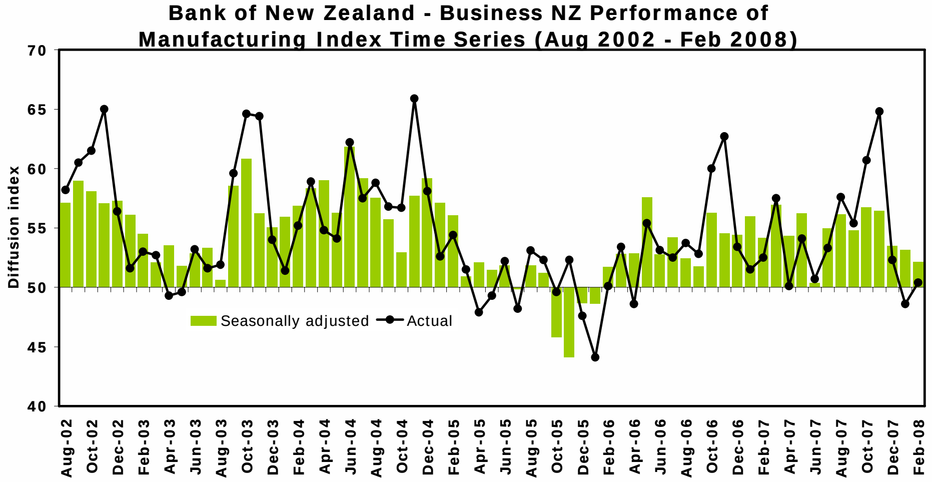
pmi



February time series tables

National Indexes	Feb 2003	Feb 2004	Feb 2005	Feb 2006	Feb 2007	Feb 2008
BNZ - Business NZ PMI (s.a)	54.5	56.8	56.0	51.7	54.2	52.2
Production (s.a)	55.7	57.5	57.2	52.9	53.3	51.6
Employment (s.a)	55.8	49.9	52.8	48.6	52.9	48.3
New Orders (s.a)	53.4	61.2	58.8	53.2	56.5	54.1
Finished Stocks (s.a)	55.3	54.4	50.9	50.1	52.2	53.9
Deliveries (s.a)	52.1	57.5	55.8	52.0	54.1	52.7

Regional Indexes	Feb 2003	Feb 2004	Feb 2005	Feb 2006	Feb 2007	Feb 2008
BNZ - Business NZ PMI (s.a)	54.5	56.8	56.0	51.7	54.2	52.2
Northern	51.2	54.1	53.8	46.8	52.3	48.9
Central	54.2	58.1	51.0	49.1	53.0	48.9
Canterbury/Westland	50.5	57.1	63.1	59.4	51.4	57.0
Otago/Southland	60.4	47.1	51.0	48.9	53.9	52.4

(s.a denotes seasonally adjusted)

The Bank of New Zealand - Business NZ PMI contains data obtained through Business NZ's regional organisations:

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

Central (Employers and Manufacturers Association - 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.

Rate Cut to Offer Little Relief

- Growth comes unstuck
- Overnight cash rate to fall
- But the supply of credit is being slaughtered
- So lending rates may still rise
- And credit rationing rears its ugly head

The worm has most definitely turned. The New Zealand economy is well entrenched in the early stages of a marked softening in growth. In fact a recession cannot be ruled out. This being the case, it is now highly likely that we have seen the peak in the official cash rate for this cycle.

For all intents and purposes this was acknowledged in the Reserve Bank's March Monetary Policy Statement where the Bank intimated that it had moved from a tightening bias to a neutral stance thanks to a string of economic data which indicated "potentially severe downside risks to activity".

According to the central bank, this will probably open the way for the cash rate to be lowered late in 2009. However, we already see some of those downside risks playing out in terms of: the rapid correction in the housing sector; continued deterioration in global growth expectations; the flow on impacts of the global credit crisis; and the costs of the summer drought. This being so, we believe it is plausible the Reserve Bank will end up cutting interest rates before the end of this year and, conceivably, by a substantial margin.

But if you think this will be good news for your business, think again! In the first instance, the very fact that the RBNZ will start to cut interest rates will be reflective of an economy under some duress. This will likely have a much bigger impact on earnings than the ensuing interest rate relief. Even more importantly, we can't stress enough that, in the current environment, a cut in the cash rate may not flow through into lending rates in the manner that would normally be expected. In fact, it is quite conceivable that lending rates, for both households and businesses alike, continue to climb, even in the face of a falling cash rate.

To cut to the chase, financial intermediaries, such as banks, simply pay for funds from investors, add on a margin and then on-lend the cash. Typically, the overnight cash rate is a significant determinant in establishing the level at which lenders can borrow. But we are in strange times. The crux of the international credit crisis is that folk are no longer willing to provide funds to lenders because those lenders have, by a variety of means, frittered away their money on a multitude of complex deals that have since come to grief. While Australasian banks have avoided the worst of the chaos they are still vulnerable to the reduction in the supply of cash available on a world wide basis. Consequently, lenders have been in heavy competition for the available supply of funds and are paying through the nose for it, with margins over traditional funding rates soaring. This is the very same pressure faced by businesses that have gone direct to the market for cash as evidenced by the current blow out in corporate paper spreads.

As this global "crisis" deepens the pressures on funding costs will continue to intensify. The extent of these cost increases is so great that lenders will have no option but to pass them on. And they are doing just that. Symptomatic of this, mortgage lending rates continue to rise despite the cash rate holding steady. Conceivably they will rise further even if the cash rate falls.

For business borrowers there is yet another problem to face and that is lenders are demanding to be compensated for the increased risk of lending. As we enter a period of softer economic growth, the likelihood of business failure increases. More folk than normal will simply fail to repay debts owed to lenders. Consequently, this will also put upward pressure on interest rates as lenders attempt to offset these potential losses. At the same time, lenders will also tend to credit ration. The lenders themselves are struggling to get funding so they will tend to be much more choosey about who they distribute the increasingly limited supply of cash to. This, in itself, may prove problematic for struggling businesses.

Putting all this together, then, we offer a strong warning that businesses should focus heavily on managing their debt and debt servicing obligations and that, while some relief may be forthcoming in terms of a falling official cash rate, it would be premature to assume that the benefits of this will be felt at the coal face any time soon.

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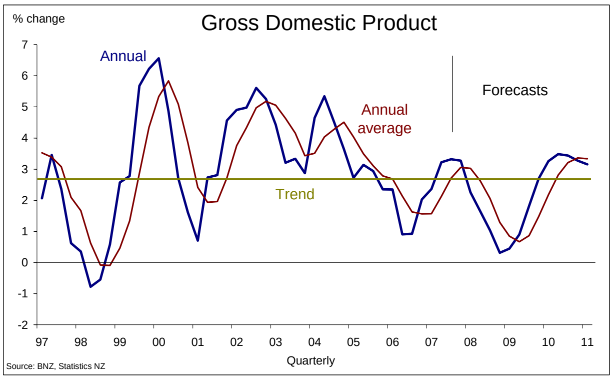
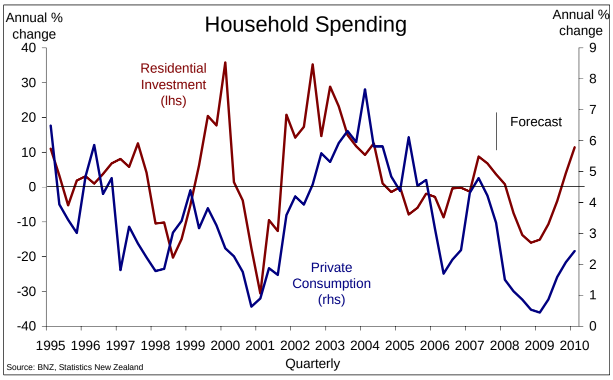
Mixed Messages

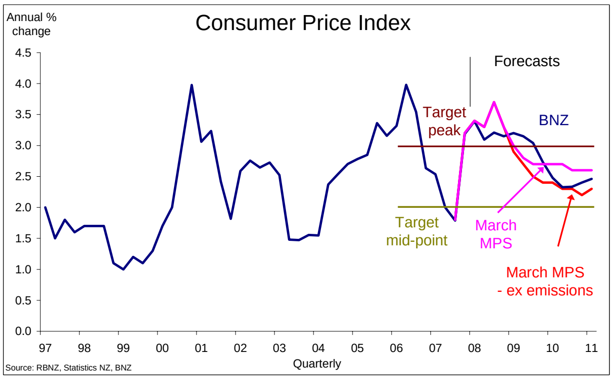
Growth Has Come Unstuck



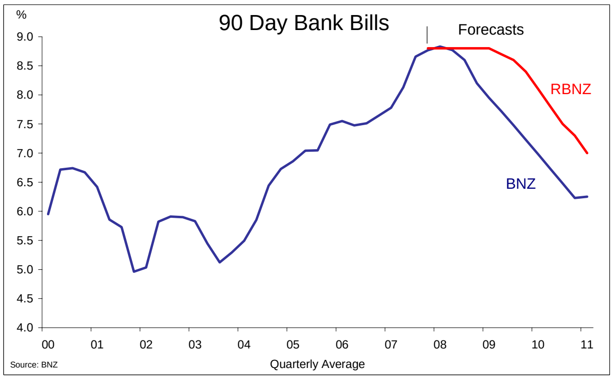
Led By Household Spending



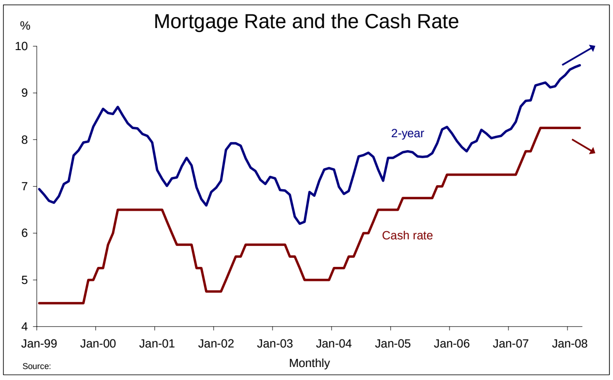
Inflationary Pressures Will Moderate



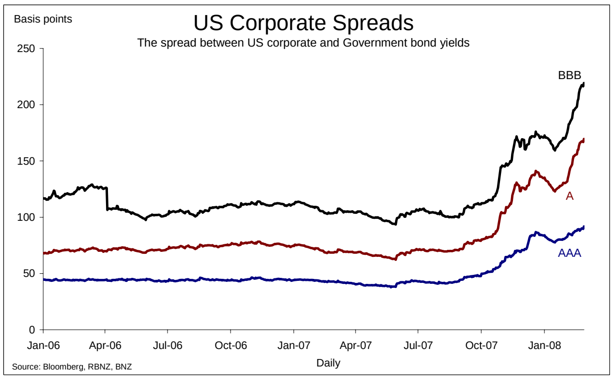
RBNZ Will Respond Eventually



But Lending Rates May Not Fall



As the Cost of Funds Rises



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