

PERFORMANCE OF MANUFACTURING INDEX



Manufacturing activity sinks to new low in October

Bank of New Zealand - Business NZ PMI for October 2008

- The Bank of New Zealand - Business NZ seasonally adjusted PMI for October (43.5) fell 3.2 points from September, reaching the lowest recorded value since the survey began in 2002. This also marked the sixth consecutive month of contraction for New Zealand's manufacturing sector, which is now the longest period of contraction recorded.
- All five seasonally adjusted main diffusion indices were in contraction and all recorded their lowest values for an October month. *Production* (43.4) fell back to a level similar to June of this year, while *employment* (42.5) experienced its ninth straight level of contraction, with most of these months producing a lower value than the previous one. *New orders* (42.6) dived from September's result, while *finished stocks* (48.0) produced its lowest value since November 2003. *Deliveries of raw materials* (44.7) also continued to remain in contraction, although not as significant as the June result.
- Unadjusted activity for October showed much of the weakness to be evident at the top of the country. For the North Island, the Northern region (43.7) is yet to produce an expansionary result for 2008, while the Central region (47.0) has remained in a band of 45-47 for the last five months. Both South Island regions continued to show expansion in October, with the Canterbury/Westland region (54.3) building on its September result. Lastly, the Otago/Southland region (54.2) produced a similar result to the Canterbury/Westland region.
- Results for the various manufacturing industries generally showed contraction. The *petroleum, coal, chemical & associated product* sector (39.3) continued to remain in significant contraction, while the *metal product* sector (44.0) showed further deterioration in activity from September. On a relatively positive note, the *machinery & equipment* sector (49.4) improved slightly from September, and has yet to show some of the deep contraction figures other sub-sectors have shown.
- The New Zealand results for October mirror the global picture of manufacturing, which shows steep declines. The JPMorgan Global PMI for October (41.0) showed worldwide manufacturing suffering its sharpest contraction since the composite survey began in 1998. Both the Australian PMI (40.4) and USA PMI (38.9) experienced further sharp falls in activity, generally led by falls in new orders, employment and activity.
- The further fall in activity mirrored the growing proportion of negative comments made by respondents during October (sitting at 67.0%), compared with 64.3% in September, but not as high as the 68.3% recorded in August. Those with negative comments outlined a general fall in orders from offshore, along with the general negative sentiments prevalent amongst most businesses.

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.

HIGHLIGHTS

Seasonally-adjusted PMI down 3.2 points from 46.7 to sit at 43.5 for October.

All five main indices showed ongoing contraction, with two of the sub-indices exhibiting new lows.

Regional activity continues to show contraction in the top half of the North Island.

The petroleum, coal, chemical & associated product sector remained in significant contraction.

The global manufacturing scene worsened, with the sharpest level of contraction for more than 10 years.

Next PMI: December 11 2008

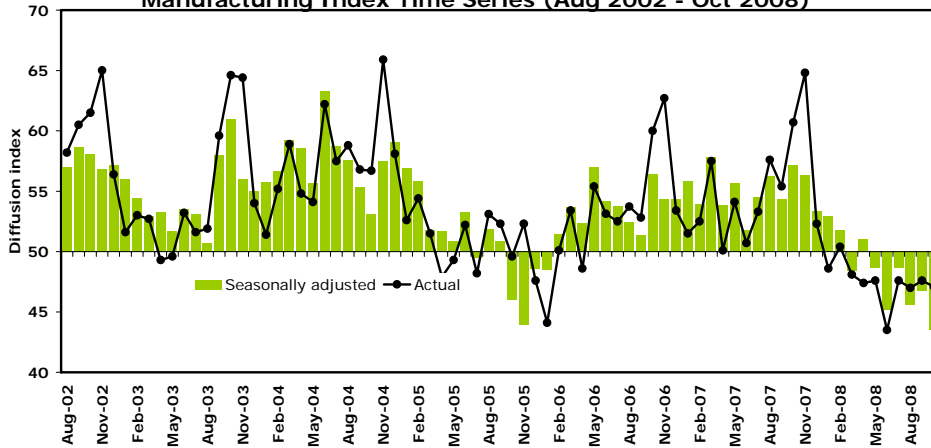
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Bank of New Zealand is delighted to be associated with the Performance of Manufacturing Index (PMI) and Business NZ. This association brings together the significant experience of leading business advocacy body Business NZ and business finance specialist 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 manufacturing sector.

Bank of New Zealand (www.bnz.co.nz)

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Bank of New Zealand - Business NZ Performance of Manufacturing Index Time Series (Aug 2002 - Oct 2008)



October time series tables

National Indexes	Oct 2002	Oct 2003	Oct 2004	Oct 2005	Oct 2006	Oct 2007	Oct 2008
Bank of New Zealand - Business NZ PMI (s.a)	58.0	61.0	53.1	46.0	56.5	57.1	43.5
Production (s.a)	61.2	67.4	55.2	45.1	58.4	57.5	43.4
Employment (s.a)	53.8	52.5	50.0	45.8	50.9	53.6	42.5
New Orders (s.a)	63.1	68.0	57.3	47.6	61.1	59.1	42.6
Finished Stocks (s.a)	52.7	53.9	51.5	49.0	53.0	56.8	48.0
Deliveries (s.a)	57.6	58.0	51.0	46.1	56.9	59.9	44.7

National Indexes	Oct 2002	Oct 2003	Oct 2004	Oct 2005	Oct 2006	Oct 2007	Oct 2008
Bank of New Zealand - Business NZ PMI (s.a)	58.0	61.0	53.1	46.0	56.5	57.1	43.5
Northern	59.6	64.2	56.8	48.4	59.3	62.3	43.7
Central	62.3	64.2	57.7	48.8	57.8	56.6	47.0
Canterbury/Westland	65.3	75.0	56.0	52.7	64.7	60.0	54.3
Otago/Southland	62.5	59.7	54.8	54.9	62.4	65.7	54.2

(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.

NZ Manufacturers Not Alone in Suffering

- Manufacturing in globally co-ordinated contraction
- Emerging markets now going backwards
- Worse yet to come for activity, employment
- Global deflation a genuine prospect

It will likely come as little consolation to New Zealand manufacturers, but October's local PMI reading puts them in good (or should that be bad?) company.

The manufacturing activity index's global equivalent – a composite of over 20 national PMIs – hit 41.0 in October, the global index's lowest reading since the series was first compiled over a decade ago.

Looking at the detail of the global PMI reveals insights into the state of the manufacturing sector on a global scale – and, by and large, it's not pretty. All of the activity-based sub-indexes (i.e. output, new orders and employment) underlying the headline index worsened, in October, with further declines possible.

Manufacturing recession is entrenched and widespread

Not only did October see global conditions reach an all-time low, but the index has now printed below the 'breakeven' 50-mark for five consecutive months. Furthermore, the problems besieging the sector are truly global. Of the 20-odd countries that produce PMI indices, just India's printed above 50 in October. The remainder each have manufacturing sectors that are going backwards.

The notable implication of the above is that the manufacturing sectors of emerging economies are suffering just as much as their developed counterparts. It might surprise many to know, for instance, that China's PMI has been sub-50 for the past three months.

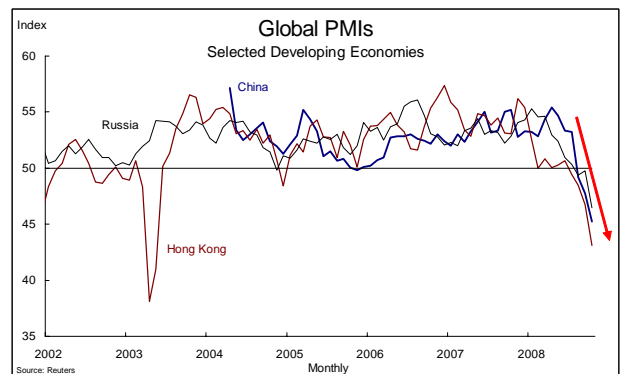
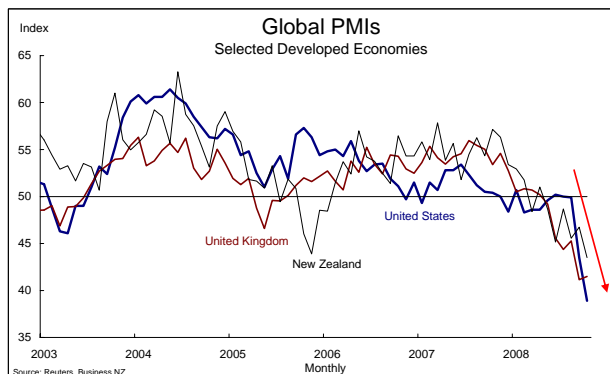
This is particularly worrisome since it is usually the degree of growth one talks about regarding China, given its natural expansion from population growth and urbanisation, making outright contraction all that more alarming. The protracted weakness in manufacturing in emerging economies provides the basis for two further observations. First, the notion that emerging market economies had become decoupled from the developed powerhouses such as the US and the euro-zone can surely be discarded.

But the other issue (and probably of more relevance to commodity exporters such as Australia and New Zealand) is that 'emerging manufacturing' (for want of a better label) was a significant driver of the push up in global commodity prices that occurred through 2006 and 2007. As emerging manufacturing has reversed track, so too have commodity prices, and so long as manufacturing in the likes of China remains weak, demand in commodity markets will remain notably absent.

Way ahead looks fraught

One of the worst performing sub-indexes underlying October's headline global PMI result was that for forward (or new) orders. The global new orders sub-index plunged to 36.2 (from September's 41.4) – mirroring the fall in New Zealand new orders for October – to reach an all-time low. Again, India was the only country to exhibit any growth in its new orders. In stark contrast, new orders in the US fell to levels last seen in 1980.

As parlous as conditions in the global manufacturing sector currently are, the clear risks are that they could



yet worsen. At the very least, recovery is nowhere in sight, suggesting tough times ahead for New Zealand firms in the business of supplying intermediate inputs offshore.

Global manufacturing employment is on the wane

Manufacturing firms globally are showing an increasing willingness to rationalise their businesses, with falling staff numbers an obvious and predictable outcome. October's global employment index fell to 42.2, the third consecutive sub-50 reading.

Equally predictable is that manufacturing firms will continue to shed staff for some months to come. Manufacturers are clearly suffering from excess capacity, a situation that will continue to prevail as long as global demand is in the doldrums. Indeed, we could be well up the other side of a recovery in manufacturing activity before firms find it necessary to begin hiring staff again.

The PMI's employment readings are consistent with global unemployment rates, which are rising quickly, and this lift in the number of unemployed offshore could result in higher levels in inward permanent migration into New Zealand. As was the case in 2001, New Zealand could emerge as a relatively attractive place to reside, with fewer Kiwis departing, and/or more foreigners arriving as a result. The net result would, of course, place our own weakening labour market under further pressure but, on a positive front, would also provide some support to New Zealand's moribund housing market.

Global deflation in the offing?

For the first time since 2003, global manufacturing firms reported a fall in input costs. But it wasn't the sub-50 reading that stood out as much as the magnitude of the decline: October's 48.1 was a massive drop from the 59.9 seen in September.

Of course, such results reflect the extent of falls in commodity prices seen in the past six months, with oil and industrial metals leading the way. And the lag between what has happened in commodity markets and what manufacturers are now only just reporting likely reflects the degree and pace of pass-through from commodity markets to manufacturing end-users. As manufacturers benefit further they will likely continue to tell of falling input costs in coming months.

On their own, falling input costs flag the likelihood of global disinflation and the possibility of deflation. On top of this, though, manufacturers will also likely move to cut sales prices as quickly as they are able, as they strive to stimulate demand. It's just a matter of time before such price decreases are reflected in official national price indexes. Global deflation seems, to us, much more than a remote possibility.

New Zealand manufacturers will undoubtedly welcome lower input costs, particularly given sales prices are likely coming under the same downward pressure. The danger, however, is that deflation becomes entrenched, with key central banks (notably those of the US and Japan) sorely limited in the extent to which they can respond to the ensuing inevitable collapse in consumer spending.

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