

PERFORMANCE OF MANUFACTURING INDEX



BusinessNZ 

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 up 1.3 points from 45.7 to sit at 47.0 for September.

Four of the five main indices continued to show contraction, with the sub-indices of employment exhibiting new lows.

Regional activity contrasted in the North and South Islands.

The wood & paper product sector showed a significant rebound, while other sectors continued lackluster results.

The global manufacturing scene continued to worsen, with levels not seen since 2001.

Next Business NZ PMI:

November 13 2008

SPONSOR STATEMENT

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)

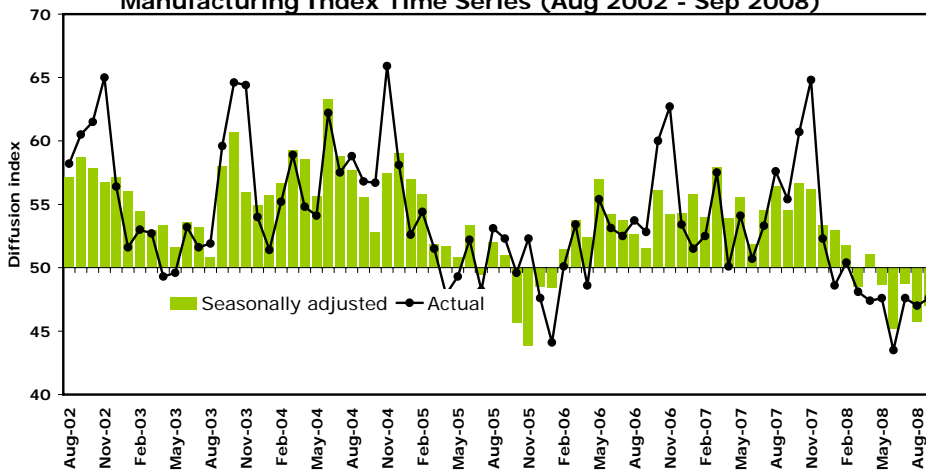
Manufacturing activity remains in contraction in September

Bank of New Zealand - Business NZ PMI for September 2008

- The Bank of New Zealand - Business NZ seasonally adjusted PMI for September (47.0) remained in contraction, with the sector posting a sub-50 result for the fifth consecutive month. This now equates with the longest period of contraction for the sector since the survey began.
- Four of the five seasonally adjusted main diffusion indices recorded their lowest values for a September month to date. *Production* (45.5) improved slightly on August, while *new orders* (48.8) returned to similar levels experienced in July. However, *employment* (44.7) recorded its lowest result for the second month in a row, indicating further cuts in staffing levels in the sector. *Finished stocks* (50.2) was generally unchanged during September, while *deliveries of raw materials* (48.8) experienced some contraction.
- Unadjusted activity for September showed a distinct contrast between the two islands. For the North Island, the Northern region (45.9) remained in contraction for the ninth consecutive month, while the Central region (46.2) remained at similar levels to August. In the South Island, both regions showed recovery for September, with the Canterbury/Westland region (51.6) rebounding from the August result and Otago/Southland (53.9) showing expansion for the first time since May.
- Results for the various manufacturing industries generally showed contraction for most. The *wood & paper product* sector (55.3) experienced a significant rebound in September, with its first expansionary result since November 2007. This was followed by the *food, beverage & tobacco* (50.5), which has shown some level of expansion for three of the last four months. In contrast, the *textile, clothing, footwear & leather* sector (41.4) continued to slip lower, while the *petroleum, coal, chemical & associated product* sector (43.3) and *metal product* sector (44.4) also showed lackluster results.
- In comparison with manufacturing activity offshore, the JPMorgan Global PMI for September (44.2) showed worldwide manufacturing contracting at its fastest rate since 2001. The Australian PMI (47.2) remained similar to previous months, while the USA PMI (43.5) took a sharp turn downwards.
- On a positive note, the proportion of negative comments made by respondents continued to fall back, sitting at 64.3% in September, compared with 68.3% in August and 70.6% in July. Those with negative comments outlined uncertainty, lack of orders and a general slowdown in other parts of the economy that affects manufacturing directly. Positive comments tended to focus on the drop of the New Zealand dollar, as well as the recent dairy pay-out.

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



September time series tables

National Indexes	Sep 2002	Sep 2003	Sep 2004	Sep 2005	Sep 2006	Sep 2007	Sep 2008
Bank of New Zealand - Business NZ PMI (s.a)	58.7	58.0	55.5	51.0	51.5	54.6	47.0
Production (s.a)	60.4	60.0	56.6	51.4	50.8	54.4	45.5
Employment (s.a)	52.2	53.1	52.8	49.1	49.0	51.0	44.7
New Orders (s.a)	63.1	61.0	58.3	53.9	55.3	56.7	48.8
Finished Stocks (s.a)	52.5	54.1	52.8	49.2	51.0	56.1	50.2
Deliveries (s.a)	59.5	57.4	54.1	51.1	53.1	57.2	48.8

National Indexes	Sep 2002	Sep 2003	Sep 2004	Sep 2005	Sep 2006	Sep 2007	Sep 2008
Bank of New Zealand - Business NZ PMI (s.a)	58.7	58.0	55.5	51.0	51.5	54.6	47.0
Northern	58.1	62.1	58.5	52.1	52.2	51.8	45.9
Central	60.3	57.0	54.3	53.1	50.0	51.7	46.2
Canterbury/Westland	63.6	65.2	54.9	46.7	54.2	62.6	51.6
Otago/Southland	67.0	52.1	62.3	59.8	60.6	66.9	53.9

(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.

Global Gloom Tenders NZ Opportunities, Not Just Pain

- Impending global recession a big downer
- But salvation will be there for the savvy
- As the NZ dollar keeps softening
- Global inflation and commodity prices fall
- And shipping costs subside

The world economy is giving up the ghost of its inflationary past, and subsiding into a recessionary phase. The scrambled financial and fiscal packages, while significant, can only soften the blow.

Yet it's not all wail and woe. The global correction will tender many opportunities, not just pain, for the NZ economy. Indeed, we are seeing some of these quite clearly already. The currency is falling. Commodity markets are cooling, raw materials included. Global inflation pressures are lessening and discounts might well emerge. Freight costs are coming off.

The trick for local firms is to take advantage of, and position around, these trends as best they can, as global demand continues to cool down.

On balance, of course, the worsening global outlook has to be bad news for a local economy already well in the grip of recession. Even with a strong starting point, New Zealand has never been able to sidestep the worst of a wilting world. And why should it ever – being, as it is, still a small, open, largely commodity-trading economy.

Sure, some of New Zealand's markets will hold up better than others. Exporters will do well to think this through. However, now's not the time to be presuming emerging markets will take up the slack of a rich world's comeuppance. Funny how the phrase "de-coupling"

is not heard much anymore. And even if the emerging markets can avoid the nastiest of the recession facing the developed economies (including Australia), what prices will they now be paying for the goods and services they consume. All the while, the petro-dollar states will remain busy gauging their revenue declines.

Yes, the most recent government-sponsored rescue efforts have finally given some hope the worst might be passed – but only in the sense of avoiding a complete catastrophe. We're still left with a severely battered and bruised international financial system – now part-nationalised in many respects – that will be a shadow of its former self, and one not without ongoing risks of more problems flaring up.

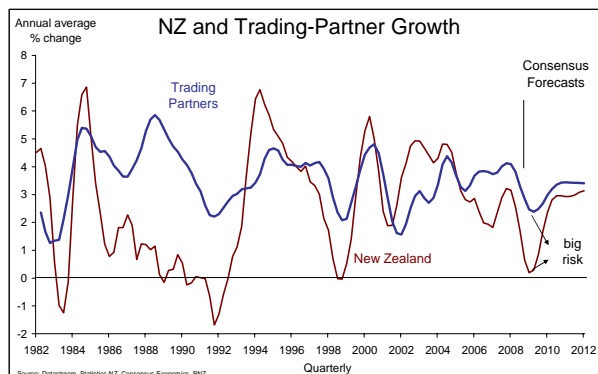
Will Alt-A, for instance, soon "same-page" Sub-prime in the dictionary of dastardly financial malfeasance? And how well will corporate balance sheets withstand the intense scrutiny hitherto reserved for banks and financial institutions in the US, Europe and elsewhere?

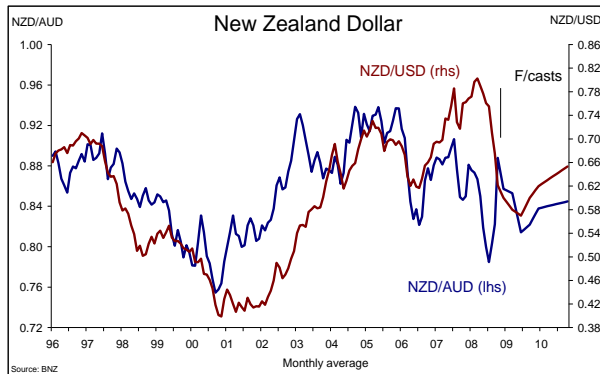
With all of this, we can imagine the global credit channels will be extremely conservative, at best, and outright sticky and problematic in greater probability. This will hamper New Zealand's ability to maintain as much foreign funding as it's become reliant on over recent years, let alone at a reasonable price.

Around these problematic credit and economic forces from abroad, however, there'll be some important silver linings for New Zealand.

Take the exchange rate. The trade-weighted index has fallen more abruptly over recent weeks, largely in reaction to the international distress. At around 61.0, the TWI is approximately 5% lower than it was just a couple of weeks ago. And it's 15% weaker than a year ago – to the point of now being in line with the long-term fair-value level we estimate for it. Excuses of an overvalued NZ dollar have thus worn thin.

To be sure, NZD/AUD has actually lifted to about 0.8900, so above the 0.8600 level we judge as average. But this has occurred on the back of a severely smashed Australian dollar (down to 0.7100, from 0.9800 three months ago). NZD/USD has slumped to a middling 0.6200, from 0.6800 a few weeks ago and 0.7700 a few months prior. The even bigger mover and shaker has





been NZD/JPY, which has tanked to 63.00, from 73.00 in late September, to be 22% lower than it was in late July. The NZD has slipped in a more minor fashion against EUR and GBP, which have each struggled alone.

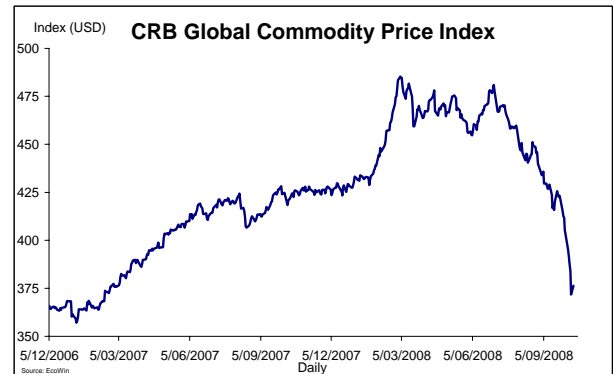
To be clear, we believe the exchange rate falls to date are not an over-reaction to global fears. Indeed, we believe the NZ dollar has further to moderate, based on the worsening economic fundamentals we see – both here and abroad. Having been bearish on the currency for a long while, we now believe 0.5700 is in sight for NZD/USD by mid-2009, with NZD/AUD back down to 0.8150 by then. We see NZD/JPY sagging to 58.00. This is under-value territory. It will help cushion the NZ economy.

NZ firms should be thinking about more than just currency trends, however. Consider, too, falling international inflation. As we wrote in our recent piece "Wither Inflation", "...fundamental relief to international inflation will come, naturally enough, from the slowing global economy. This will alleviate the resource constraints that had built up on the upswing. This will go a long way to bringing core inflation pressure – in terms of consumer prices and wages – back down to earth."

This process might even play out so far as to offer juicy discounts on official ticket prices, especially as inventories of unsold product accumulate around the world, as often happens in the early phase of any abrupt economic slowdown.

NZD Forecasts					
NZD/EUR	NZD/JPY	NZD/GBP	NZD/USD	NZD/AUD	TWI
0.4553	63.26	0.3565	0.6214	0.8880	61.2
0.4412	60.00	0.3448	0.6000	0.8571	58.9
0.4462	58.00	0.3392	0.5800	0.8529	57.9
0.4453	58.71	0.3393	0.5700	0.8143	57.3
0.4688	63.00	0.3593	0.6000	0.8219	60.1
0.4769	66.34	0.3690	0.6200	0.8378	61.9
0.4773	68.67	0.3706	0.6300	0.8400	62.7
0.4776	70.40	0.3721	0.6400	0.8421	63.4
0.4851	72.15	0.3757	0.6500	0.8442	64.4
0.4925	73.92	0.3771	0.6600	0.8462	65.3

Forecasts as at 15 October 2008

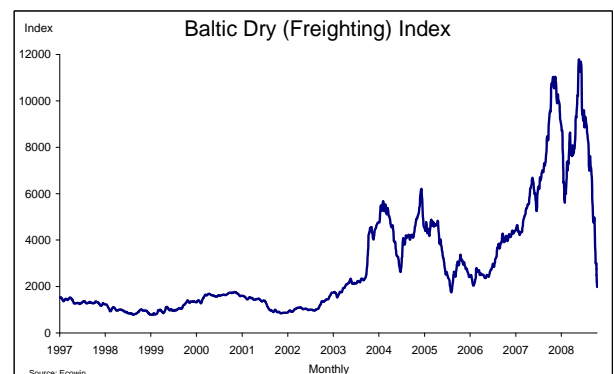


Related to this, the other global adjustment NZ firms will do well to position around is in respect to falling commodity prices. They have, by and large, slumped 15% over the last couple of weeks to be around two-thirds of the peak they struck in early July. Yes, some have fallen much more than others. However, the drop in commodity prices has been as much in metals, and foods, and other primary products, as it has been in the more high-profile slump in international oil prices.

While this will keep New Zealand's exporters on edge, it also promises to give more general relief to the local economy by way of raw material costs and the like.

We've already witnessed clear reprieve in fuel costs. World oil prices have fallen substantially more than the NZ dollar has, allowing local petrol companies to drop their pump prices. Chances are we'll see further drops. It's another one of the silver linings directly related to the global woes.

Another is the way international freighting costs have slumped, more generally. As an indication of this, the Baltic Dry Index – the price of shipping goods in great bulk – has plunged to around 1,800. A month ago it was 7,000. At its peak, back in June, it was near 12,000. Even if the half of the collapse reflects what's going on in container shipping rates, it represents a massive drop in the costs of international trade.



We can guess that prices for air freighting might also be getting sharper before too much longer, if not already.

Of course, falling freighting prices won't be an immediate benefit to NZ exporters and importers who are tied into contracts. But they do tell us substantial relief is in the pipeline, just sooner for some than others. This seems a combination of tumbling fuel prices and pressure coming off global freighting capacity. A haggle would seem well worth the effort.

Sure, none of this will rescue the NZ economy from what looks set to be a major slowdown in the global economy. But they do offer opportunities for local firms to extract some relief, or at least minimise the pain, amid what might otherwise be an untenable period for those frozen in the headlights of an international recession.

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