

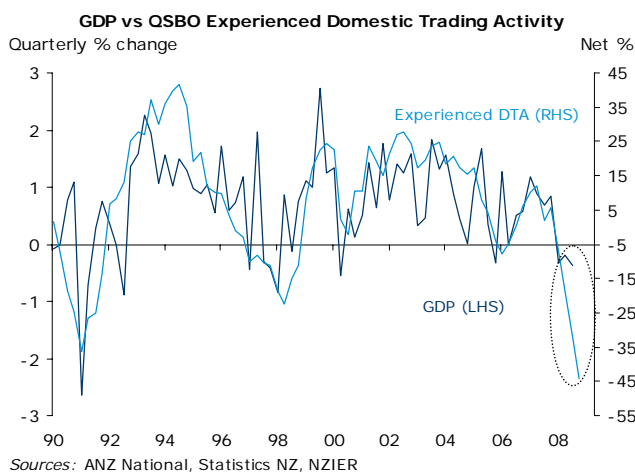
### Quarterly Survey of Business Opinion: December 2008 quarter

#### Key points

- > Today's survey results were literally dreadful across the board and shows the economy is far from finding a base.
- > The labour market is turning sharply and this looks to be setting off strong non-linear type consequences for the general economy.
- > The RBNZ clearly has more work to do and we now expect them to cut the OCR by 100bps at their meeting at the end of the month.

#### Assessment

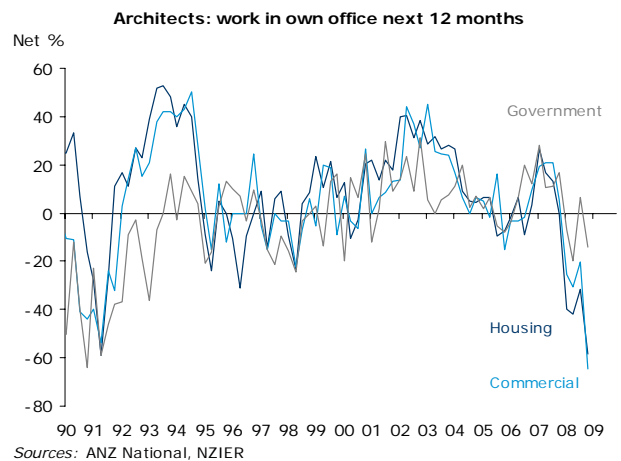
**Today's QSBO does not make pleasant reading.** In terms of the key indicators, headline confidence collapsed with a net 64 percent expecting worse times ahead. In terms of the key trading activity gauges, a net 44 percent of firms reported a decrease in their own activity in the December quarter, the highest number since the survey began in 1970. There is a strong likelihood that Q4 GDP could again be negative (and by a large amount) extending the recession to four quarters. However, the outlook for the March quarter appears just as troublesome. A net 43 percent of firms expect their own activity to decrease in the next three months, again the lowest on record. We can't find any period in NZ's historic experience when a recession has extended five quarters.



**While a weak survey was to be expected, the extent of the weakness in today's survey shows the recession intensifying as opposed to an economy starting to find a trough.**

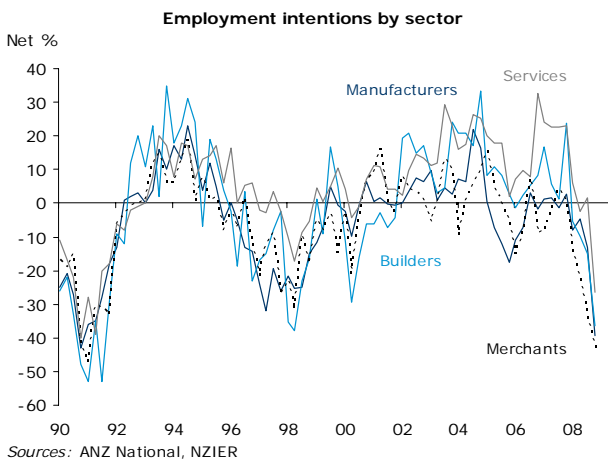
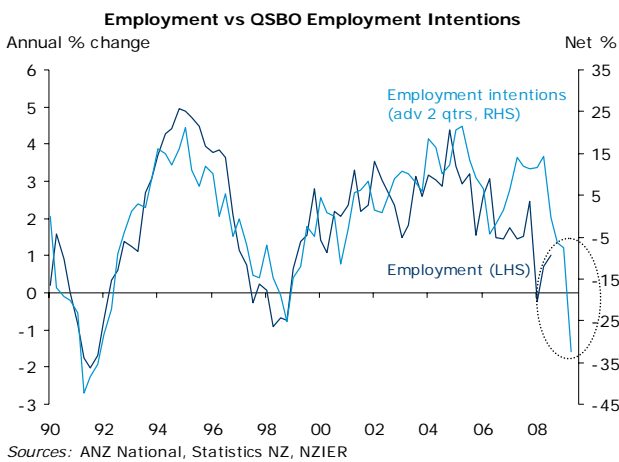
**This slowdown is broad-based.** While most sectors of the economy are facing difficulties and this weakness was picked up in today's survey, it is

of little surprise that retailers appear the most pessimistic. General business confidence for retailers fell from -10 to -70 percent. When profitability expectations hit a 26-year low for this sector (in the face of weak demand and aggressive price discounting), it is little wonder we are getting moves of this magnitude in confidence. Likewise the outlook for construction remains poor. Of note in the survey was the sharp decline in reported commercial building work sentiment from architects, which suggests that this previous leg of support to the economy is unfolding rapidly.



	Headline business confidence		Domestic trading activity – next 3 mths		CUBO	Avg selling price – next 3 mths
	actual	s.a.	actual	s.a.		
Q4 2006	3	-9	15	13	0.9171	28
Q1 2007	-15	-8	16	18	0.9182	40
Q2 2007	-37	-26	9	14	0.9156	35
Q3 2007	-27	-32	15	11	0.9134	34
Q4 2007	-26	-39	14	12	0.9204	35
Q1 2008	-64	-58	-10	-8	0.9262	45
Q2 2008	-64	-52	-23	-18	0.9237	49
Q3 2008	-19	-25	-8	-13	0.9079	28
<b>Q4 2008</b>	<b>-64</b>	<b>-77</b>	<b>-41</b>	<b>-43</b>	<b>0.8878</b>	<b>-3</b>

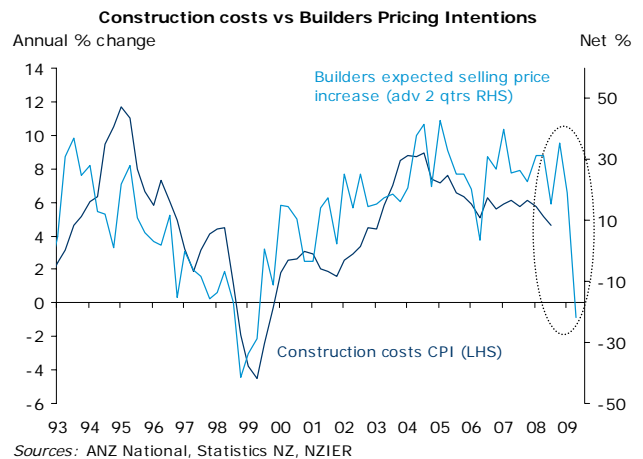
**The labour market is turning aggressively.** In the September quarter, a net 7 percent of firms intended to reduce staff levels (a net 21 percent reported that they actually did). However, going forward, a third of all businesses now expect fewer staff – the highest since June 1991. It all portends of some sharp upwards movement in the unemployment rate. The weakness in employment intentions is across the board for all sectors, although retailers again look like they are set to be the most aggressive. For those firms that are still looking for staff, they now report it much easier. A net 20 percent of firms report that skilled staff are easier to find, while the comparable figure for unskilled staff has risen to a net 43 percent. These are the highest results in 17 years, and suggest that the strong wage increases experienced over recent years is at an end.



**This poses strong non-linear type risks for the economy.** Economists tend to rely on linear type models and relationships, which by definition means they tend to understate both the booms and the busts. At present we see significant non-linear type dynamics unfolding in relation to credit, housing and unemployment, with the risk that they set off substantial second round effects for the domestic economy, and act as a significant counter to the aggressive easing in financial conditions seen to date.

**Considerable slack is appearing within the economy.** Not only are labour resources freeing up, but general capacity pressures within the economy are easing rapidly. The CUBO fell from 90.8 percent to 88.8 percent in the December quarter and is at its lowest level since June 1999. This sharp fall was led mostly by manufacturers (particularly exporters) – a sure sign that the global downturn is hitting hard.

**This is having a big impact on inflationary pressures.** If there is any good “news” in today’s survey, it is that pricing intentions turned negative – indicating that more firms are looking to cut their prices in the face of falling demand rather than raise them. A net 3 percent of firms intend to reduce their selling prices in the next three months, the first time this has turned negative since December 1998. This suggests we are set for a sharp drop in CPI inflation over the year ahead, and possibly not just due to lower petrol prices. Indeed, we could finally be seeing the start of an easing in domestic inflation pressures which the RBNZ so desperately wants to see. In fact, construction prices (a key bugbear of the RBNZ) could fall sharply over the first half of this year if builders pricing intentions are anything to go by.



**Implications**

If there is one clear observation from today’s survey, it is that the RBNZ has more work to do. The rapid loosening in financial conditions seen over H2 2008 has done literally nothing to stabilise prospects. While there are certainly lags between policy and the economy, such aggressive action could have still been expected to manifest in some semblance of stabilisation in forward indicators. The fact it has not is testament to the powerful forces influencing the economy, and also the starting position with the reciprocal wealth effect now taking hold as asset prices correct and de-leveraging continues. We expect the RBNZ to cut the OCR by 100bps at their next *OCR Review* on 29 January, and the terminal rate to go sub 3.5 percent.

	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Decade Average
Business Confidence - actual	-27	-26	-64	-64	-19	<b>-64</b>	-17
- s.a.	-32	-39	-58	-52	-25	<b>-77</b>	-18
Experienced domestic trading activity – actual	0	10	-7	-22	-34	<b>-39</b>	7
- s.a.	2	6	-7	-19	-32	<b>-44</b>	7
Expected domestic trading activity – actual	15	14	-10	-23	-8	<b>-41</b>	11
- s.a.	11	12	-8	-18	-13	<b>-43</b>	11
Capacity Utilisation (CUBO)	0.9134	0.9204	0.9262	0.9237	0.9079	<b>0.8878</b>	0.9061
Average selling price – past 3 months	33	28	42	47	36	<b>9</b>	17
Average selling price – next 3 months	34	35	45	49	28	<b>-3</b>	23
Costs – past 3 months	46	45	59	68	59	<b>42</b>	32
Costs – next 3 months	44	49	62	71	52	<b>27</b>	31
Difficulty finding labour – skilled	-41	-46	-36	-19	-5	<b>20</b>	-32
Difficulty finding labour – unskilled	-19	-33	-22	6	16	<b>43</b>	-9
Investment intentions – Buildings	-6	-8	-18	-18	-20	<b>-42</b>	-10
Investment intentions – Plant & Machinery	3	-3	-15	-17	-16	<b>-39</b>	0
Employment intentions – past 3 months	5	4	4	-3	-11	<b>-21</b>	0
Employment intentions – next 3 months	12	14	0	-6	-7	<b>-32</b>	3

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The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

### *Qualifications, experience and professional standing*

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#### **Relevant professional body**

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

#### **Professional indemnity insurance**

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The insurer is ANZcover Insurance Pty Limited.

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- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;

- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

#### **Fees**

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

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When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

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- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
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- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

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If you wish to pay investment money to the Bank you can do this in several ways such as by:

- Providing cash;
- Providing a cheque payable to the relevant product or service provider and crossed 'not transferable'; or
- Making an automatic payment or payment through another electronic delivery mechanism operated by the Bank.

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third

parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

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