

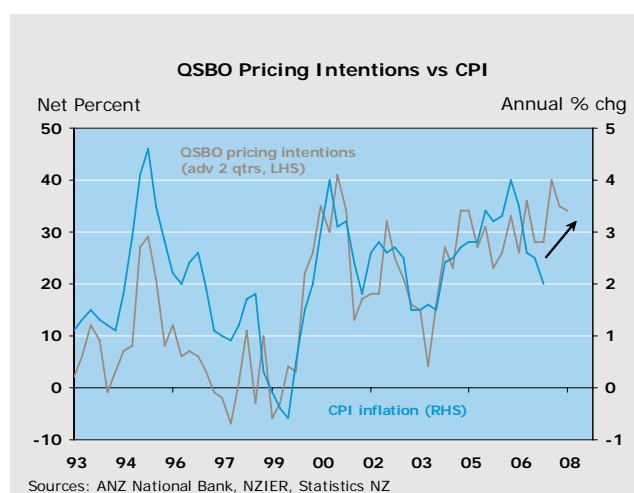
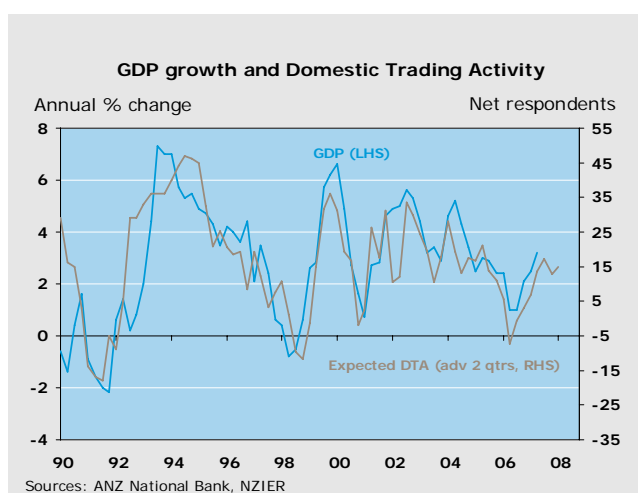
NZIER QUARTERLY SURVEY OF BUSINESS OPINION SEPTEMBER QUARTER 2007

Key points

- Activity indicators remain robust and consistent with annual GDP growth of around 2-2½ percent.
- Resource and capacity indicators, although easing marginally in the quarter, remain elevated, and provide limited comfort for the Reserve Bank.
- On balance, the economy looks to have found a good base, with capacity, and hence inflation pressures, remaining elevated. While today's results don't provide any reason for panic, neither do they give the Reserve Bank any reason to relax.

The headlines

| | Q3 2006 | Q4 2006 | Q1 2007 | Q2 2007 | Q3 2007 | Decade Average |
|---|-------------------|-----------------|------------------|-------------------|---------------------------------|-------------------|
| Business Confidence | -19 (-22 s.a.) | 3 (-8 s.a.) | -15 (-9 s.a.) | -37 (-30 s.a.) | -27 (-30 s.a.) | -12 (-12 s.a.) |
| Domestic trading activity – past 3 months | -1 (0 s.a.) | 11 (6 s.a.) | 11 (10 s.a.) | 8 (13 s.a.) | 0 (2 s.a.) | 8 (8 s.a.) |
| Domestic trading activity – next 3 months | 10 (7 s.a.) | 15 (14 s.a.) | 16 (17 s.a.) | 9 (13 s.a.) | 15 (12 s.a.) | 14 (14 s.a.) |
| Capacity Utilisation (CUBO) | 0.9230 | 0.9171 | 0.9182 | 0.9156 | 0.9134 | 0.9040 |
| Average selling price – next 3 months | 28 | 28 | 40 | 35 | 34 | 22 |
| Costs – past 3 months | 54 | 40 | 49 | 46 | 46 | 28 |
| Costs – next 3 months | 43 | 42 | 50 | 48 | 44 | 27 |
| Difficulty finding labour – skilled | -21 | -29 | -41 | -42 | -41 | -32 |
| Difficulty finding labour – unskilled | -7 | -11 | -21 | -26 | -19 | -9 |
| Investment intentions – Buildings | -8 | 0 | 2 | -5 | -6 | -9 |
| Investment intentions – Plant & Machinery | 2 | 13 | 7 | 3 | 3 | 7 |
| Employment intentions | 6 | 14 | 12 | 11 | 12 | 3 |



Headline business confidence improved slightly in the September quarter, with a net 27 percent of respondents expecting the general business situation to deteriorate in the next six months. This is up from a net 37 percent expecting a deterioration in the June quarter. In seasonally adjusted terms, business confidence was broadly unchanged at -30 (-29 in the June quarter).

The improvement in confidence was across all sectors. Across the business sectors surveyed, the building sector recorded the largest improvement in confidence, having deteriorated sharply in the June survey.

From a regional perspective, confidence improved across those firms whose operations were geographically restricted, while firms operating across the entire country recorded a decline in confidence.

A net 12 percent of firms (seasonally adjusted) expect their own trading activity to improve in the next three months, compared with a net 13 percent in June. The number of firms reporting an increase in their own trading activity in the past three months fell from a net 8 percent of firms reporting an increase in June, to a net 0 percent in September (from 13 to 2 in seasonally adjusted terms).

Capacity utilisation and difficulty finding staff eased in the quarter but remain elevated. The capacity utilisation measure fell to 91.3 in the September quarter, continuing to ease from the recent peak of 91.8 recorded in the March quarter survey. The number of firms reporting difficulty in finding skilled staff eased slightly, with a net 41 percent of respondents finding it more difficult compared to a net 42 percent in June. The number of firms reporting difficulty in finding unskilled staff also eased with a net 19 percent reporting difficulty, compared with a net 26 percent in June. While these are down on their June quarter readings, they remain historically elevated.

Pricing intentions and cost pressures have eased slightly but remain elevated. The number of firms intending to increase their prices in the next three months eased slightly to a net 34 percent of respondents, following a net 35 percent intending to raise their prices in the June quarter. However, average selling prices in the September quarter left to the highest reading since 2000, a potential harbinger of a stronger Q3 CPI result next week. Cost pressures were largely unchanged, with a net 46 percent of firms stating costs had increased in the past three months (the same as recorded in the June survey) and a net 44 percent of firms expecting costs to increase in the next three months (down from 48 percent previously). These indicators remain elevated, and well above their decade averages, and will provide little comfort to the Reserve Bank.

Pressure on profitability has eased, although there is little change in firms' investment plans or employment intentions. A net 19 percent of respondents reported a decline in profitability in the past three months (down from 21 percent in June), while a net 6 percent of respondents expect profitability to fall in the next three months (down from 14 percent in June). The net balance of firms intending to invest more in buildings over the next 12 months is largely unchanged at -6 (from -5 in the June quarter). For plant and machinery investment, intentions are unchanged with a net 3 percent expecting an increase in both September and June. Employment intentions are static, with a net 12 percent of firms intending to increase their staffing levels over the next three months, from a net 11 percent in June. The latter suggests limited easing in pressure emanating from the labour market.

Assessment and implications

The economy appears to have found a good base. Respondents continue to be more optimistic about their own trading activity than the economy as a whole. The domestic trading activity indicator, which has a good lead relationship with GDP, remains robust and consistent with annual GDP growth around 2½ percent, which is broadly where we see available resource capacity at present. The survey does not explicitly sample the rural sector directly, which in some pockets is booming courtesy of strong commodity prices, so the overall figures may understate momentum to a degree.

We note that the majority of responses were received just after the MPS. In practice this means the survey will have missed both the run-up in the NZ dollar (a negative going forward), and equally signs of stabilisation across credit markets around the globe (a positive). However, even abstracting from such contrasting forces, the survey suggests a solid level of support.

Capacity and inflationary pressure gauges remain elevated. Firms continue to report high levels of capacity utilisation (though lower compared to the previous quarter). In terms of the composition, non-exporting manufacturing capacity utilisation rose to the highest level in more than a decade, a sign of significant domestic inflation pressure. Conversely, capacity utilisation across exporters and builders eased. Improvements in difficulty in finding both skilled and unskilled staff, cost expectations and pricing intentions all look relatively marginal. Employment intentions remain robust. All remain well above historical averages, and consistent with a sticky and persistent inflation theme.

We see nothing in the survey to panic the Reserve Bank, nor little in the detail that will provide much comfort. Four successive hikes have only marginally dented growth prospects (a sign of resilience for the economy, but also likely some disappointment for the Reserve Bank). Looking forward, the economy is expected to track broadly in line with its available speed limit implying continued pressure on resources and inflation. For now it remains a familiar story of watch, worry and wait, and see how the data unfolds. On this front, next week's CPI figures will be key.

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