

BUSINESS MATTERS



Kiwibank Business Banking wants to help Kiwi businesses succeed. We've teamed up with Business and Economic Research Limited (BERL Economics) to bring you this economic update.

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Europe remains in crisis management mode

- little good news to report
- future of Euro still in the balance
- political influences just as important as economic

Unfortunately the global economy provided little good news over the past month, as all eyes and ears are transfixed on the Euro area. For months now, the business and financial sectors of countries have been held hostage by debt and financial worries in Europe. With these concerns, growth prospects and recovery of export-reliant countries like New Zealand are also uncertain.

In terms of the New Zealand economy, it seems to be very much a story of 'watch and wait'. Undoubtedly, the economic conditions in New Zealand are nowhere near as bad as those in parts of Europe, the UK and the US.

Unemployment rates in many Euro countries well above 9%, provide a sobering reminder that New Zealand has up until now weathered the storm of the past couple of years relatively well. In particular, export revenues continue to grow. However, the slump in the building sector, a frustratingly slow pace in re-building the Christchurch, and a projected deterioration in the nation's external deficit are causes for concern.

On the global front, managing the debt crisis in the Euro area needs to go beyond its current approach of raising capital to secure success. A process for an orderly write-down of assets is also required.

How the Euro will function in the future is on everybody's watch list. Strengthening the structures surrounding the Euro is essential to anchor market expectations and dispel the prevailing uncertainty. In addition, a strengthening of the fiscal and economic governance of the monetary union is required.

Countries will need share risks, but how risks will be shared is a matter that leaders in the Euro area have to tackle.

NZ deficit 'under control' in short term

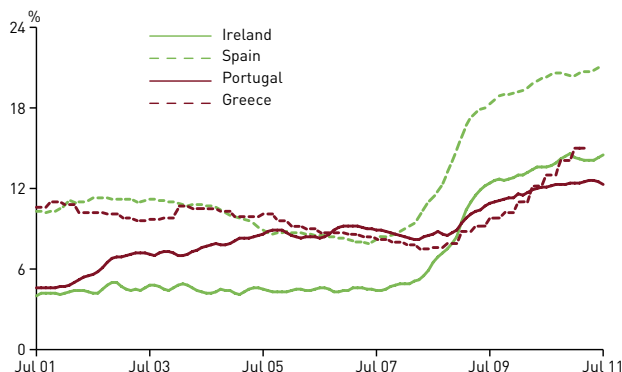
- credit rating agencies signal concern at NZ's foreign debt and external deficit
- but, external balance OK in short term
- longer-term trend remains worrying

Two credit ratings agencies, Fitch Ratings and Standard & Poor's, downgraded New Zealand's foreign currency credit rating in September.

The downgrade was primarily due to the country's net external debt and deteriorating external position. New Zealand's net debt position reached \$140 billion (equivalent to 70% of annual GDP) as of 30 June 2011.

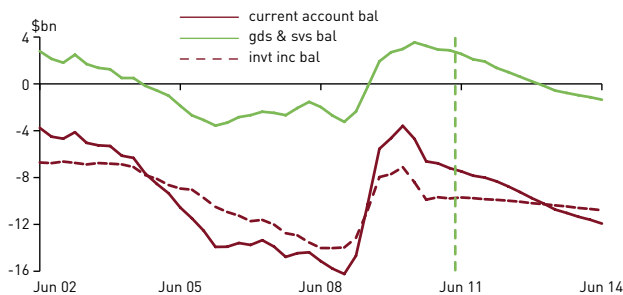
Unemployment rate
% of labour force

Eurostat



BoP balances Annualised totals

Statistics NZ



Furthermore, the annual current account deficit deteriorated by a further \$2 billion over the last year, to be \$7.5 billion in the year to June.

This deterioration comprised an improvement in the goods balance, but a significant worsening in the services balance. The latter resulted from a decline in tourism receipts as the sector struggled with sluggish visitor numbers and an unhelpful NZ\$ exchange rate.

Further, the deficit was amplified by a growing net investment income outflow, as foreign-owned companies repatriate profits and interest on previous borrowings accumulate.

Most forecasting agencies expect this deficit to worsen, as the demand for construction materials required for rebuilding Christchurch begins to surge. This factor, along with a weakening of the export performance as uncertainty in the world market continues, underlies the concerns expressed by the credit rating agencies.

With growing global concern over sovereign debts and highly volatile financial markets, our net debt position leaves us vulnerable to further shocks from abroad.

NZ economy close to standstill

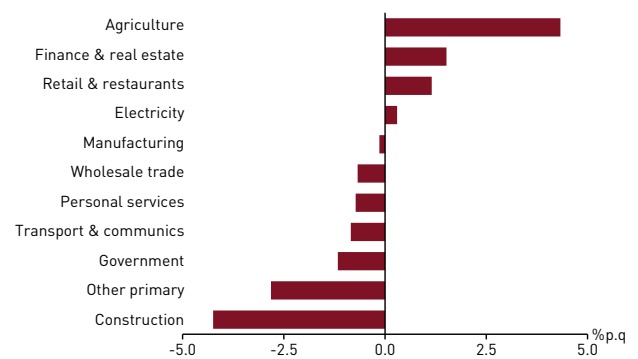
- little growth in GDP over June quarter
- significant decline in construction activity
- primary sector leading the way

The economy is slowing sharply as the June quarter GDP figures confirm that recovery remains patchy across different sectors. The almost standstill growth in the June 2011 quarter (up 0.1% over March quarter) was due to falls in construction (down 4.3%) activity despite strength in some services and agriculture industries.

In the year to the June quarter, the largest movements were a 9% rise in agriculture activity, followed by a 5.7% rise in manufacturing, while the largest falls were a 10.3% fall in fishing, forestry and mining, and a 10% fall in construction activity. Although annual figures (up 1.5% for the year ended June 2011) show economic activity expanded, the domestic economy remains fragile.

GDP production sector growth June 2011 % change on March 2011

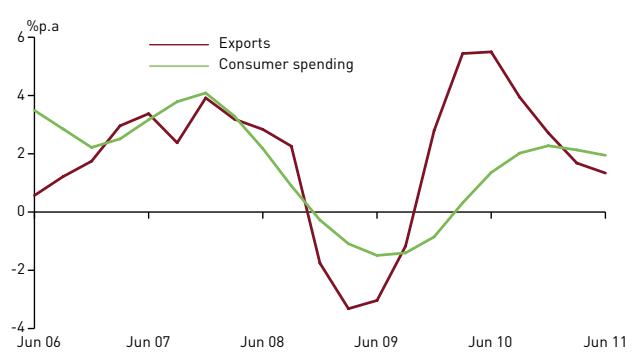
Statistics NZ



Latest figures on spending also suggest that domestic spending remains subdued, with household consumption (up 0.3%) barely growing over the previous quarter. Import spending was also less encouraging (up 1.7%). Contributing to the weak domestic performance were falls in business investment (down 0.4%) and government spending (down 0.1%).

Exports and consumer spending Annual average growth

Statistics NZ



The weak economic growth justifies the Reserve Bank of New Zealand's (RBNZ) decision to keep its Official Cash Rate (OCR) on hold until early next year. The RBNZ cited global economic and financial risks for keeping the OCR at 2.5%. With the global front remaining shaky, we anticipate an increase in the OCR is unlikely in the short term. The relatively high NZ\$ and weaker export markets are additional reasons that will delay the timing of any rise in the OCR.

While risks remain, the economic outlook for the near term remains relatively optimistic, especially in comparison to other developed economies. In particular, we expect to see GDP figures reflect better growth with the boost to spending from Rugby World Cup visitors.

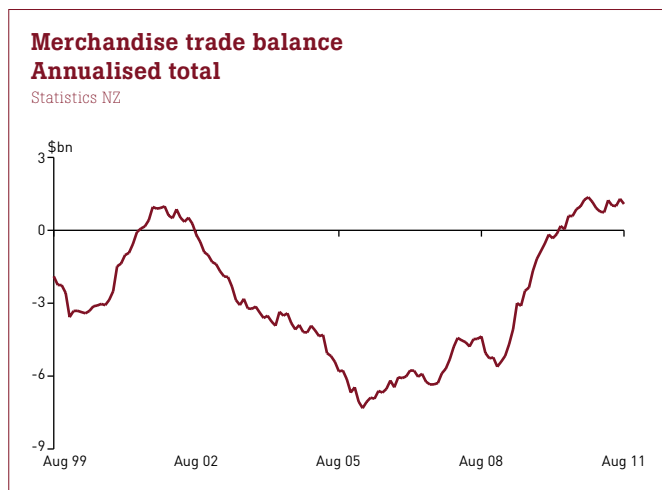
Of course, a more solid expansion in economic activity awaits a significant recovery in the manufacturing and construction sectors, along with job opportunities within them. Although the economy will be boosted by reconstruction activities in Christchurch, there is significant uncertainty as to its timing.

Global uncertainty still prevalent

- **export revenue continues to surge**
- **import payments rise faster in line with oil prices**
- **volatile markets and uncertainty set to continue**

The August trade deficit (\$641 million) was larger than expected, taking the annual trade balance to a surplus of \$1.1 billion.

Export receipts, although dipping slightly in August, remain robust. But, the rise in import payments (particularly in the energy sector) was greater than expected.



Exports for the year remain more than 12% up on the previous year, after hitting a low in 2009. The increase in exports, which amounted to \$313 million, was largely due to meat and dairy exports. The rise in imports, which amounted to \$523 million, was due to petrol, mechanical machinery and railway vehicles. Imports have been flat since March 2011, having risen from a low in September 2009.

Despite robust export receipts, uncertainty over the global outlook continues to cast shadows over New Zealand's export performance. Weaker trading partner growth and growing concerns over the European debt crisis are likely to slow demand for some exports. Nonetheless, we continue to expect some of our core commodity exports such as logs and dairy to continue to hold up well (although easing slightly).

Given global fragilities, the risk to New Zealand's export sector remains acute. The lack of certainty as to the continuation of support programmes in the euro area continues to have repercussions globally. Growth prospects for a country like New Zealand, which relies significantly on exports to those markets, suffer from the uncertainty and the consequent volatility in global finance and exchange rate markets.

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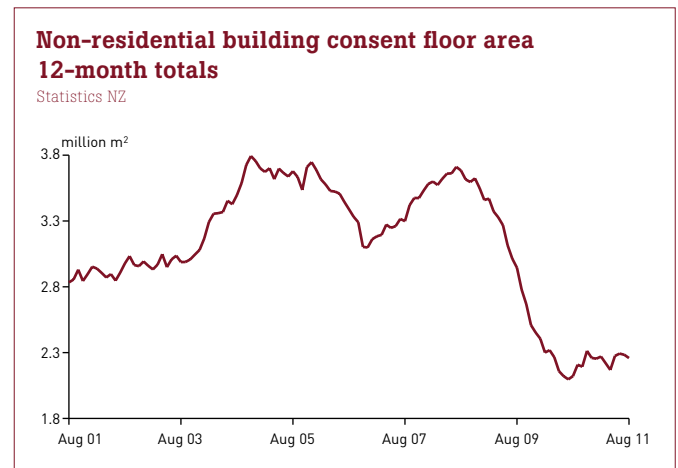
Construction industry looking sad

Non-residential building construction is continuing its slow downward slide.

Throughout 2011, the 12-month running total for consents issued each month has sat at between 13,400 and 13,000. However, in August 2011 non-residential building consents slipped even further to sit at 12,800 consents being issued.

The last time the 12 month running total for non-residential building consents was this low was August 1993, and this was when we were clawing back from the depths of recession. In the early 1990s the 12-month running total for non-residential building consents was around 9,000.

At the same time that consents are down the size of the buildings we are constructing, as measured by square metres of floor area, has also declined. In the 12 months to August 2011, just under 2.3 million square metres of non-residential buildings were approved for construction, well below the levels of the past decade.



Similarly, residential building activity also remains in the doldrums. Consents issued in the three months to August 2011 were down 27% in Wellington and 26% in Canterbury compared to this time last year. Consents in regions such as Nelson, Marlborough, the Hawke's Bay and Taranaki were also down over 31%.

Looking at the 12-month totals, compared with the previous year, the North Island was down 12% and the South Island was down 18%.

With such little activity currently underway, construction skills and businesses are likely to be lost to other industries or abroad. Consequently, the capacity of the industry to meet the future needs of a full-scale Canterbury re-build effort is questionable.

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