



Economics

Tasting our porridge

The good news just keeps getting better. Confidence continues to improve. While a net 14 percent of businesses still expect business conditions to deteriorate over the coming year, confidence has been on an improving trend for close to a year, and has now hit a two-year high. Optimists accounted for 15 percent of replies to our survey and pessimists 29 percent.

Confidence improved in every sector bar agriculture. The construction sector is now the most confident with a net 10 percent expecting better conditions over the year ahead – the highest reading in four years.

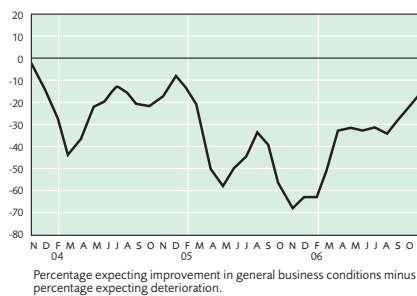
Firms' expectations of their own activity has followed a similar trend, surging to levels not seen since early 2005. Firms' own activity expectations have risen from +18 to +24 – which is indicative of 2.5 percent growth over the coming 12 months. Domestically aligned sectors are leading the charge with notable improvements in activity expectations within the retail and construction sectors. Profit and investment intentions have followed a similar trend although employment intentions are largely unchanged on the previous month. Pricing intentions and inflation expectations continue to nudge marginally lower.

A plethora of good news appears to have perked up confidence. The retail sector is humming courtesy of lower petrol prices putting discretionary income back into people's pockets. While the unemployment rate nudged back up in the September quarter, at 3.8 percent it remains exceptionally low, and job vacancies remain plentiful. The housing

market continues to surge, credit growth is strong, migration gains are solid, and the construction sector must be wetting its lips at prospects for World Cup related activity. There is scant evidence of the run-up in the currency significantly impacting on the export sector. Export intentions are unchanged on the previous month and manufacturers' confidence improved.

Rebuilding economic momentum at a time capacity constraints are intense, and inflation pressure receding? It's the stuff of a goldilocks economy. Little wonder the New Zealand equity market is performing so well. While we are encouraged by the readings from our survey in terms of the economic nuances going forward and signs that goldilocks is tasting our porridge, she is far from sleeping in our bed.

Business Confidence Index



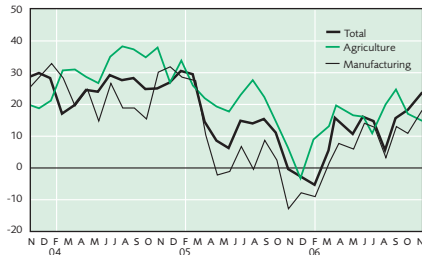
Productivity performance is woeful. Employment growth has been outstripping economic growth for more than a year. Doing things smarter is the key to the goldilocks economy and this remains the missing ingredient linking the soft landing, rebuilding momentum and easing inflation trend being depicted in the survey. Pricing intentions remain elevated, despite easing now for four months, and the major uncertainty at

present is how much of this is petrol induced and to what degree an inflationary under-current remains. Every journey begins with a small step but the Reserve Bank needs to see a continuation of these small steps to be comforted that the inflationary genie is back in the bottle. A turn in the currency or oil prices and inflation pressure could quickly rocket back up. Disconcertingly, the only sector to show a rise in inflation expectations this month was the construction sector – the big domestic inflationary nemesis the Reserve Bank is trying to contain.

New Zealand is far from out of the woods. Growth remains heavily dominated within the domestic and spending aligned sectors as opposed to the earnings based industries. New Zealand's monstrous current account deficit will only worsen given a spending dominated mix to growth. With each passing day we see the New Zealand dollar slowly tick up. With NZ.Inc looking on a firm footing going by the partial and confidence indicators, in the absence of a major global development, there seems little prospect for a lower currency in the near-term. The share price of our little company may remain elevated. In fact continued grinds up may be the order of the day until Christmas if previous December trends are followed.

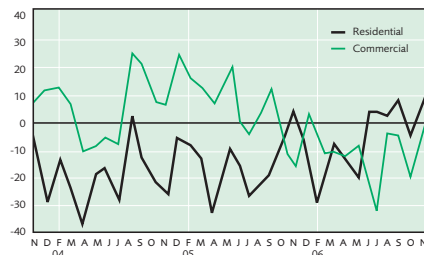
Yet the higher the currency goes, the more economic prospects are dented with the external division feeling the brunt. This may well be the unfortunate avenue that eventually pushes the economy towards the sustained slow-down the Reserve Bank is seeking.

Activity Outlook Index



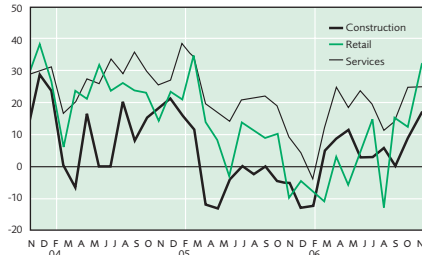
Percentage expecting increase minus percentage expecting decrease.

Construction Intentions



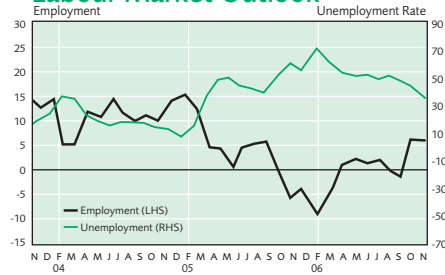
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Activity Outlook Index



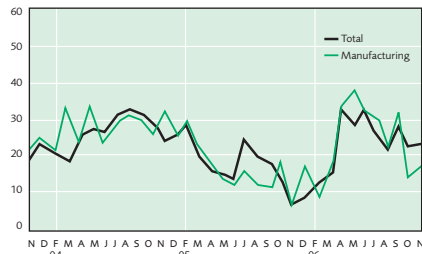
Percentage expecting increase minus percentage expecting decrease.

Labour Market Outlook



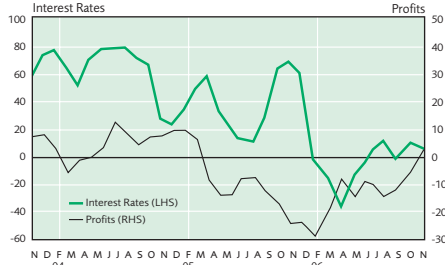
Percentage expecting increase minus percentage expecting decrease.

Export Sales Volume



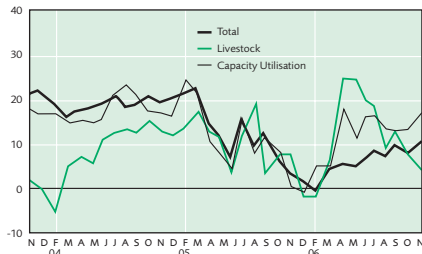
Percentage expecting increase minus percentage expecting decrease.

Financial Outlook



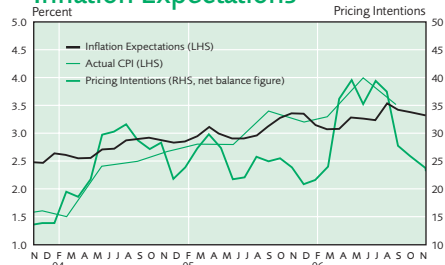
Percentage expecting increase minus percentage expecting decrease.

Investment Intentions



Percentage expecting increase minus percentage expecting decrease.

Inflation Expectations



Inflation Expectations = Expected CPI inflation rate in 12 months time.
Pricing Intentions = Percentage expecting increase minus percentage expecting decrease.

Survey Results	Total	Previous Month	Retail	Mfg	Agric	Constrn	Services
November 2006							
Business Confidence	-14.0	-21.7	-5.7	-11.5	-47.2	10.0	-11.2
Activity Outlook	23.7	18.0	31.8	18.0	15.1	16.7	24.1
Exports	23.3	23.0	...	17.0	...	...	...
Investment	11.3	8.1	12.6	13.5	-5.5	13.3	15.8
Livestock	5.2	7.8	...	...	5.2	...	...
Capacity Utilisation	17.6	13.8	22.6	19.0	7.3	0.0	21.4
Residential Construction	10.0	-5.0	...	...	...	10.0	...
Commercial Construction	0.0	-20.0	...	...	...	0.0	...
Employment	6.1	6.3	5.7	-2.2	-1.4	0.0	13.7
Unemployment Rate	36.3	42.9	36.4	30.3	47.9	20.0	35.7
Profits	4.0	-5.6	4.5	9.0	-16.7	10.0	5.5
Interest Rates	5.4	10.0	9.2	8.0	15.3	10.3	-1.0
Pricing Intentions	23.1	25.7	31.8	25.8	0.0	26.7	25.6
Inflation Expectations	3.31	3.38	3.24	3.29	3.44	3.27	3.30

The historical results are available on The National Bank's internet site: www.nationalbank.co.nz/economics/outlook/default.htm



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