Stand pat

NZIER *Quarterly Survey of Business Opinion,* March quarter 2017

4 April 2017

- Firms remained upbeat about their own prospects in the March quarter, indicative of a decent pace of growth through the first half of 2017.
- Pricing intentions rose for a second quarter, but we view these increases as consistent with a pick-up in inflation to moderate levels rather than a sustained over-shoot of the Reserve Bank's target. Notably, cost pressures have remained benign.

Key results – forward looking (seasonally adjusted)

	Dec-16	Mar-17
General business sentiment, next 6 mths	26	**16**
Trading activity, next 3 mths	25	**25**
Pricing intentions, next 3 mths	23	**28**
Cost expectations, next 3 mths	22	**27**
Profitability, next 3 mths	12	**7**
Employment intentions, next 3 mths	15	**11**
Building investment intentions, next 12 mths	10	**7**
Plant investment intentions, next 12 mths	17	**17**

Key results – backward looking (seasonally adjusted)

	Dec-16	Mar-17
Trading activity, past 3 mths	21	**21**
Pricing, past 3 mths	7	**15**
Costs, past 3 mths	21	**23**
Profitability, past 3 mths	-2	**0**
Employment, past 3 mths	10	**11**
Ease of finding skilled labour, past 3 mths	-36	**-41**
Ease of finding unskilled labour, past 3 mths	-19	**-23**
Capacity utilisation	92.7%	**93.6%**

The NZIER *Quarterly Survey of Business Opinion* for the March quarter showed that firms remain upbeat about their own prospects. In seasonally adjusted terms, a net 21% of firms reported stronger activity over the quarter and a net 25% of firms expect activity to improve further in the quarter ahead. These readings are unchanged from December and are well above the historic average.

Importantly, these measures of own activity provide a positive signal for near-term growth (given March quarter GDP isn't released until 15 June), and suggest that GDP growth bounced back in early 2017 after sluggish growth of only 0.4% in the December quarter. With growth in December largely held back by temporary declines in primary production (which wouldn't be expected to show up these survey results), we've pencilled in a 0.9% rise in March quarter GDP. This would see annual growth rise back near 3% - an only moderate pace against a backdrop of strong population growth.

Firms across sectors are reporting positive conditions for their own businesses – consistent with growth broadening across sectors and regions over the past year. This reflects a range of factors boosting activity including record levels of net immigration, rising tourist arrivals, and the improvement in dairy sector incomes.

That said, construction remains an important feature of the economic backdrop. But while construction firms remain the most optimistic, the positive impulse for growth is waning. Indeed, the number of firms reporting and expecting stronger activity eased this quarter. A slower pace of growth (or even a near-term decline) has been foreshadowed by a softening in dwelling consent issuance over the second half of last year – partly due to declining homebuilding in Canterbury, but also likely due to teething issues with the Auckland Unitary Plan and difficulty by firms in scaling up activity at the same rapid pace. Construction firms continue to report that it's extremely difficult to find staff, although this metric of tightness has flattened off over the past year. That seems to have come at the expense of the manufacturing sector, however, with manufacturing firms noting increasing difficulty in finding labour.

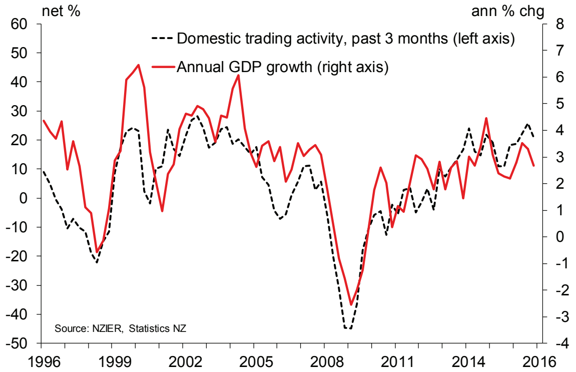
The consistent pace of growth is continuing to translate into solid demand for labour. A net 11% of firms increased headcount over the past quarter, with 11% expecting to increase headcount over the coming quarter. But although expected hiring remains solid, it has declined a bit in recent quarters. Difficulty in finding labour could be one factor holding back firms' hiring plans, with firms reporting that it's about the most difficult it's been since 2007. And it's not just pressure on labour that has been rising, the number of firms noting fixed capital as an impediment to increasing output has also been rising. This is encouraging firms to raise investment, with a net 17% of firms planning to increase plant and machinery investment.

But despite measures of capacity tightening, this doesn't appear to be translating into a notable increase in costs. Indeed, while the number of firms reporting and expecting an increase in costs increased to a net 23% and 26%, these readings are subdued relative to history. Record levels of net migration, including a high proportion of "work-ready" migrants, seems to be keeping a lid on wage inflation, while most businesses continue to benefit from low oil prices.

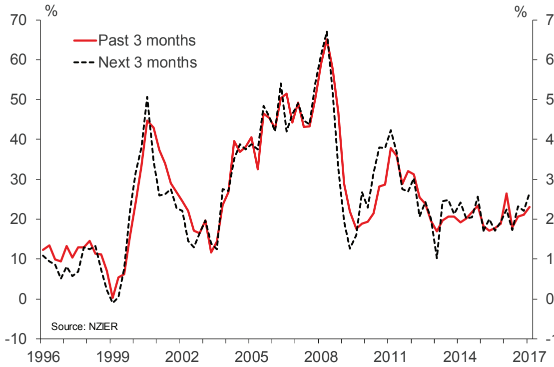
Firms' pricing indicators took a step higher this quarter, to the highest levels since September 2014. However, we view this lift in pricing intentions as consistent with a pick-up in inflation back to moderate levels, rather than signalling a persistent overshoot of the Reserve Bank's target mid-point of 2%. Indeed, the net 14% of firms that raised prices last quarter looks consistent with annual inflation jumping up near 2% in Q1 (our current forecast is 1.8%). We remain sceptical that this rise in inflation will be sustained over the next year, with low imported inflation expected to remain a drag on aggregate inflation. This quarter's survey highlighted ongoing difficulty of retailers in raising prices, with only a net 6% of firms raising prices in the past three months.

Sarah Drought
Economist

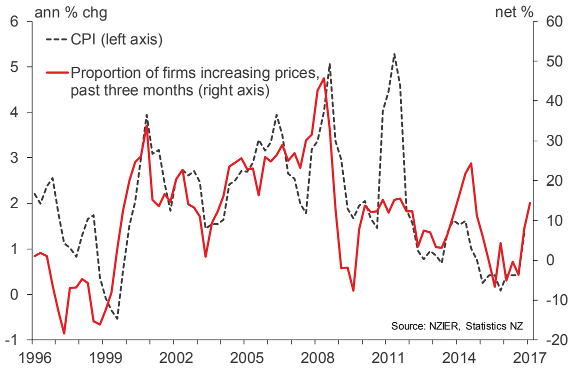
QSBO domestic trading activity and GDP growth



Businesses' average costs



Businesses' prices and CPI inflation



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