Westpac Institutional Bank

17 January 2017

Pause for breath

NZIER *Quarterly Survey of Business Opinion*, December 2016

- After a strong rise in September, business confidence and firms' expectations for their own activity eased back in the December quarter. These data suggest that momentum in the economy remained solid heading into the new year.
- Firms' pricing intentions rose sharply, but underlying price pressures look more subdued than the headline suggests. While inflation has passed its trough, we forecast a gradual rise back to the Reserve Banks's 2% target.

Key results – forward looking (seasonally adjusted)

	Sep-16	Dec-16
General business sentiment, next 6 mths	28	**26**
Trading activity, next 3 mths	32	**25**
Pricing intentions, next 3 mths	9	**22**
Cost expectations, next 3 mths	23	**21**
Profitability, next 3 mths	18	**12**
Employment intentions, next 3 mths	24	**16**
Building investment intentions, next 12 mths	10	**11**
Plant investment intentions, next 12 mths	18	**16**

Key results – backward looking (seasonally adjusted)

	Sep-16	Dec-16
Trading activity, past 3 mths	26	**21**
Pricing, past 3 mths	-3	**7**
Costs, past 3 mths	21	**21**
Profitability, past 3 mths	2	**-2**
Employment, past 3 mths	9	**10**
Ease of finding skilled labour, past 3 mths	-42	**-36**
Ease of finding unskilled labour, past 3 mths	-16	**-19**
Capacity utilisation	92.7%	**92.5%**

Businesses paused for breath in the December quarter, with the NZIER Quarterly Survey of Business Opinion showing that general confidence eased back slightly following the strong rise in September. In seasonally adjusted terms, a net 26% of firms were optimistic about the general outlook. With many positives still in play for the New Zealand economy it's not surprising to see that confidence remained robust through the latter part of the year.

Indeed, record levels of net migration continue to boost demand across the spectrum, tourist arrivals are growing strongly, and solid gains in house prices and construction are being seen in many parts of the country. In addition, the recovery in dairy prices over the second half of 2016 has been a game changer for dairy-exposed regions, whereas at the beginning of the current dairy season (in June last year), a third consecutive year of negative cashflow was on the cards for many farmers.

A notable event in the quarter was the 7.8 magnitude earthquake that struck near Kaikoura in mid-November, which disrupted activity and caused significant damage to parts of North Canterbury and the Wellington CBD. However, this doesn't appear to have fazed Wellington firms, with confidence there rising to the highest level since September 2014.

In terms of how firms are seeing their own activity, it looks like they may have gotten a bit carried away with optimism last quarter. Consequently, both the number of firms reporting stronger activity in the past quarter and expecting stronger activity next quarter eased back this time, largely unwinding last quarter's gains. These activity metrics typically provide a good early read on economic growth (December quarter GDP isn't released until 16 March), and point to a pull-back in quarterly growth following the strong 1.1% result in the September quarter. We've pencilled in 0.8% growth at this stage, which would see annual growth ease slightly to 3.3%.

One of the most notable over-estimations in the September survey, was firms' hiring intentions. This spiked higher last quarter with a net 24% of firms expecting to increase employment, which was the strongest result since 1973. However, now that we've rolled forward three months, only 10% of firms reported an increase in employment in the past quarter. This points to a continuation of the moderate pace of employment growth that we've seen of late. Perhaps a lack of available workers thwarted firms' intentions to hire, although the evidence is mixed. This quarter, more firms are reporting increasing difficulty in finding unskilled staff, but the pressure in finding skilled staff appears to have eased a bit – potentially helped by the strong run of net migration through the latter part of the year.

The QSBO painted a mixed picture for inflation pressures. Firms' cost pressures remained stable, while pricing intentions rose to the highest level in two years. However, we think that the strong rise in the forward looking component (with the number of firms expecting to increase prices spiking from 9% to 22%) overstates the degree of inflation pressures in the economy. While some rise in pricing intentions is consistent with annual inflation being past its trough, a notable driver of the rise in pricing intentions was service sector firms. And financial services tend to have an important influence here, with the rise in expected prices likely reflecting the rising mortgage rate environment, rather than a rise in general inflation pressure.

Outside of this, there was a resurgence in builders' pricing intentions, which flags a continuation of strong construction cost inflation. This is not surprising given the capacity pressures facing the industry. However, retailers' pricing intentions remain muted, potentially as the lingering strength in the NZ dollar and soft global inflation keep a lid on imported inflation. So while CPI inflation has passed its trough and is expected to increase over the year ahead, we expect inflation to rise only gradually towards the RBNZ's 2% target. As such, we see the RBNZ keeping the OCR on hold at 1.75% for some time to come.

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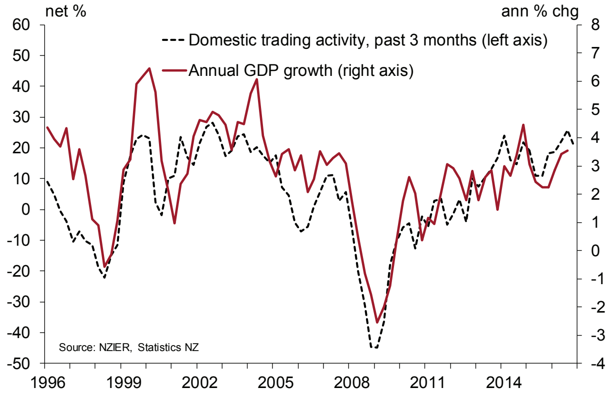
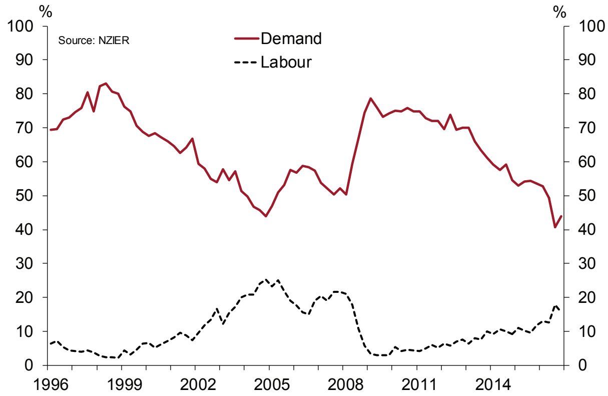
Economist

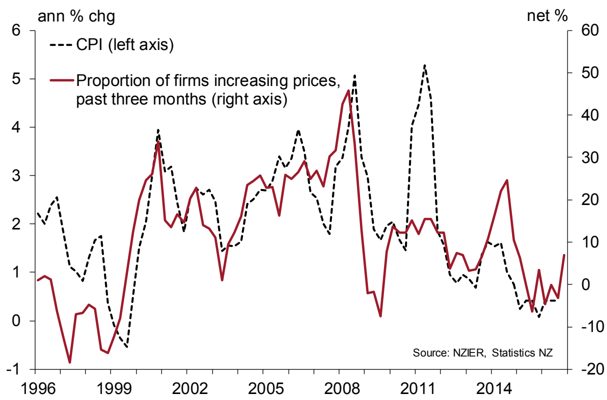
QSBO domestic trading activity and GDP growth



Biggest constraint on growth



Businesses' costs and CPI inflation



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