

Under a cloud

NZIER Quarterly Survey of Business Opinion, June quarter 2018

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- Business confidence fell sharply in the June quarter. And the underlying details in today's release were undeniably soft. Not only are firms more circumspect about their own prospects, they have significantly downgraded their profitability expectations and also expect to hire and invest less than they did three months ago.
- Today's data suggests the pace of activity in the NZ economy has dropped down a gear. It also supports the view underpinning our forecasts that this softer growth backdrop, combined with weaker confidence, will lead to a temporary lull in hiring and investment this year.
- There were signs of emerging inflation pressures in today's data. That's perhaps unsurprising given the lift in fuel and wage costs in recent months.

Key results – forward looking (seasonally adjusted)

	Mar-18	Jun-18
General business sentiment, next 6 mths	-10	-19
Trading activity, next 3 mths	16	13
Pricing intentions, next 3 mths	20	29
Cost expectations, next 3 mths	33	40
Profitability, next 3 mths	-1	-10
Employment intentions, next 3 mths	10	8
Building investment intentions, next 12 mths	1	-4
Plant investment intentions, next 12 mths	17	1

Key results – backward looking (seasonally adjusted)

	Mar-18	Jun-18
Trading activity, past 3 mths	15	7
Pricing, past 3 mths	17	24
Costs, past 3 mths	32	36
Profitability, past 3 mths	-9	-15
Employment, past 3 mths	10	14
Ease of finding skilled labour, past 3 mths	-45	-44
Ease of finding unskilled labour, past 3 mths	-28	-30
Capacity utilisation	94%	93%

Business confidence deteriorated in the June Quarterly Survey of Business Opinion (QSBO), falling to its lowest level since early 2011.

As well as becoming more pessimistic about the outlook for the broader economy firms were more circumspect about their own activity over the last three months. It is this measure, rather than headline confidence, which is most closely correlated to GDP growth. This makes sense. While business owners and managers will inevitably have a view on the outlook for the wider economy, they can be expected to have a much closer handle on how their own firm is faring on a day to day basis.

Although on balance firms remain more upbeat about their own prospects than those of the wider economy, the extent of the fall in their assessment of their own activity over the last three months suggests some downside risk to our current forecast of 0.7% GDP growth in June.

Consistent with this, firms also reported they are less likely to invest and employ over the coming quarter. In addition, they expect their profitability to deteriorate. It's these aspects of the QSBO survey that are particularly important for forecasting developments in the New Zealand economy.

Prior to today's data, investment intentions in this survey had actually been holding up relatively well, supported by factors such as the tight labour market, low interest rates and a high NZ dollar. But investment intentions fell sharply in today's release – particularly for plant and machinery. That's consistent with the view underpinning our economic forecasts, that weak business confidence would be one factor temporarily depressing investment activity this year.

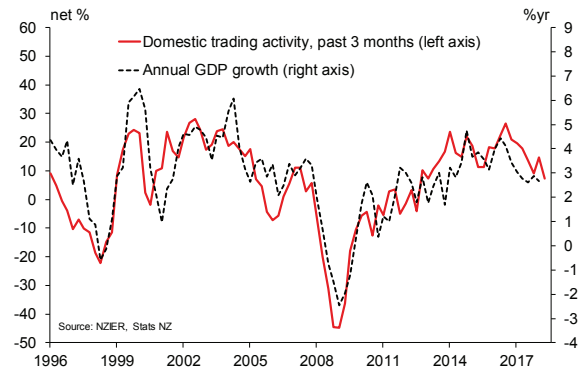
The employment indicators in the QSBO were a little more mixed. The survey indicates that the labour market remains very tight with only a small change in the difficulty in finding skilled and unskilled labour. Both remain at extreme levels. However, the forward looking components of the survey were a bit softer with firms reporting that they expect to do a little less hiring over the coming quarter.

In addition to activity and labour market indicators the QSBO provides information on how inflation gauges are tracking. Today's data provided some evidence of growing upward pressure. June saw a lift in both the cost of firms' inputs and their pricing intentions, with businesses in the retail sector reporting a particularly sharp rise. A big chunk of minimum wage earners are in the retail and hospitality sector so April's lift in the minimum wage could be a factor here. In addition, the backdrop of rising fuel prices may also be a consideration. Capacity utilisation ticked lower this quarter, but remains at historically high levels.

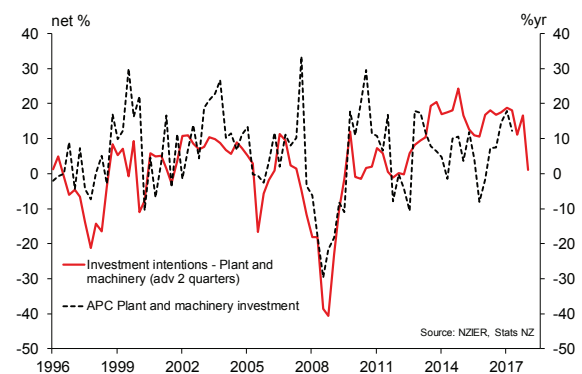
With capacity still tight, the NZ dollar falling sharply in recent weeks and growing pressure on wages (from both strong demand and changes in Government policy) we expect to see inflation edging higher in the coming quarters. We're forecasting CPI inflation to briefly edge above the mid-point of the RBNZ's 1-3% target band by the end of this year. However, our view is that this lift in inflation will prove temporary. The lift in international oil prices is not expected to be sustained, slower growth will reduce the upward pressure on non-tradables inflation and inflation expectations are forecast to remain well anchored given the weak inflation outturns we have seen in recent years. That said, today's survey serves as a useful reminder that after a sustained period of growth, the inflation backdrop is gradually starting to change. Something that may start to weigh on the RBNZ's thinking as the year progresses.

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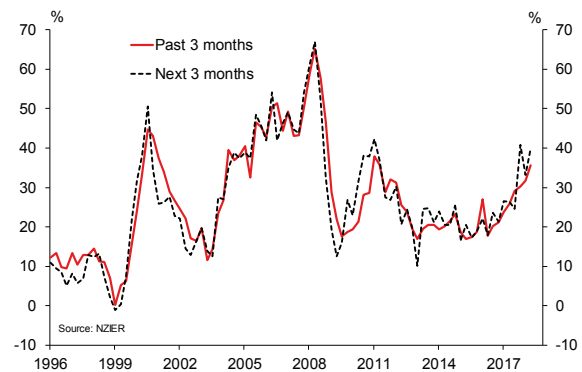
QSBO domestic trading activity and GDP growth



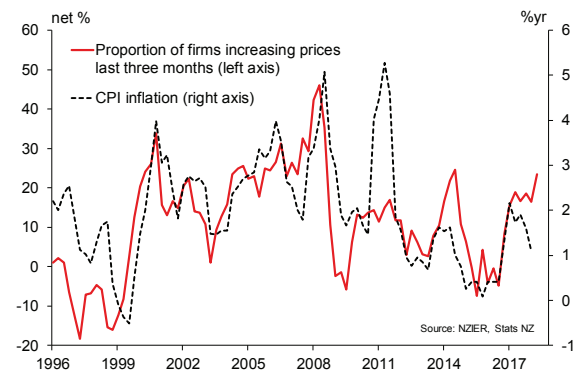
Investment intentions and Plant and Machinery Investment



Expected costs



Businesses' prices and CPI inflation



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