Down in the dumps

NZIER *Quarterly Survey of Business Opinion,* September quarter 2018

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- Business confidence fell further in the September quarter, and is now at its lowest level since 2009.
- On its own today's data suggests some downside risk to our 0.7% GDP growth forecast for Q3. However, we're not leaping to conclusions too quickly. Q2 growth was much stronger than foreshadowed by business confidence, and other direct indicators of economic activity have held up much better.
- While firms face rising costs, they continue to be circumspect about their ability to pass these costs onto their customers. Reported profitability took another step down in September.
- The detail in today's release supports our view that there will be a lull in investment and hiring over the coming year.

Key results – forward looking (seasonally adjusted)

	Jun-18	Sep-18
General business sentiment, next 6 mths	-21	-28
Trading activity, next 3 mths	12	10
Pricing intentions, next 3 mths	29	30
Cost expectations, next 3 mths	40	41
Profitability, next 3 mths	-10	-10
Employment intentions, next 3 mths	8	8
Building investment intentions, next 12 mths	-5	-5
Plant investment intentions, next 12 mths	1	4

Key results – backward looking (seasonally adjusted)

	Jun-18	Sep-18
Trading activity, past 3 mths	7	0
Pricing, past 3 mths	23	23
Costs, past 3 mths	36	42
Profitability, past 3 mths	-16	-20
Employment, past 3 mths	13	0
Ease of finding skilled labour, past 3 mths	-44	-45
Ease of finding unskilled labour, past 3 mths	-30	-30
Capacity utilisation	93%	93%

Business confidence deteriorated in the September Quarterly Survey of Business Opinion (QSBO), falling to its lowest level since 2009. What's more, firms' view of their own activity also weakened. While firms remain more upbeat about their own activity than prospects for the economy more broadly, even this measure has fallen to its lowest level since 2012.

To some extent falling business confidence should come as no surprise. The pace of GDP growth has slowed from well over 4% per annum in 2016 to under 3% now. And broadly speaking our forecasts expect this slower pace of growth to be maintained going forward. However, indicators such as the Domestic Trading Activity component of the QSBO have fallen further than we would have expected given the extent of the slowdown in the economy.

This measure is a useful gauge of GDP growth in the September quarter, and on its own suggests some downside risk to the 0.7% growth we have pencilled in.

However, it's rarely that simple when forecasting the New Zealand economy. For example, the June QSBO suggested growth would be notably weaker than the 1% lift in the quarter StatsNZ eventually reported. Indeed, other data which directly tracks activity in the economy has held up much better than surveys of business confidence in recent months. Consequently, we're still inclined to treat business confidence readings with a pinch of salt and will continue to look at a wide range of economic indicators as we assess the outlook for the economy from here.

There has been much speculation about the extent to which businesses political leanings have been impacting on confidence. And while the QSBO doesn't have the obvious political slant of the monthly ANZ survey, firms clearly remain wary of the policies proposed by the new government. In response to the question "What do you see as the key issues affecting the general business situation in New Zealand over the next six months?" more than 50% of respondents cited government policy (the most common response). This response was more likely for those responding negatively on confidence, confirming a political aspect of the survey, but unfortunately doesn't articulate what it is they're concerned about. Perhaps surprisingly, larger firms were more likely than smaller firms to cite government policy as a major factor affecting the general business situation.

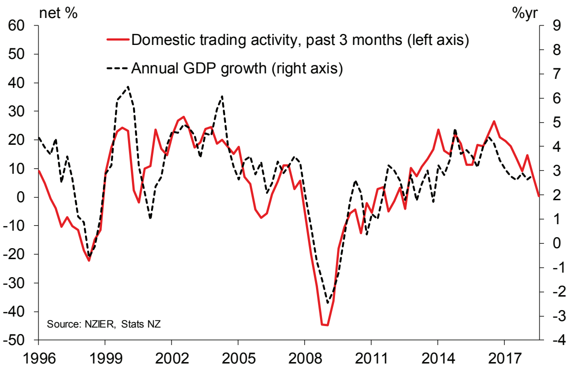
The underlying details of the survey remain soft, with labour market indicators particularly soggy in the September quarter. Firms reported a sharp drop in hiring and that they required less overtime to be worked over the last three months. However, this has apparently done little to change their expected demand for labour over the next three months with employment intentions unchanged – albeit at the lowest level since 2013. While the drop in employment supports our view that we will see employment growth stall in the coming year, it may also reflect ongoing challenges firms face finding the right people for the right jobs. Difficulty finding both skilled and unskilled labour was unchanged compared to June, and remain at levels consistent with a relatively tight labour market.

After plunging in June, plant and machinery investment intentions recovered a little in the September quarter. This is broadly consistent with our view that there will be a temporary lull in business investment in the coming quarters.

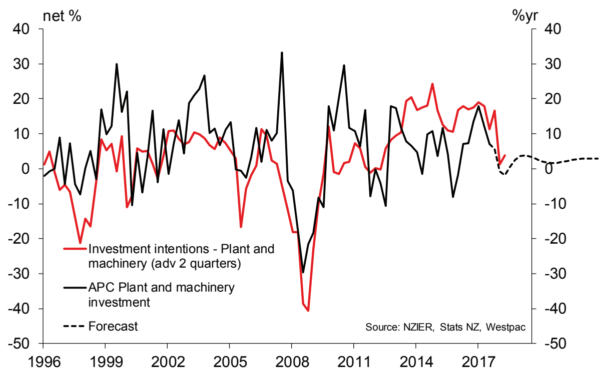
Recent confidence surveys have pointed to signs of growing inflation pressure with measures of costs rising further in September. However, firms continue to face challenges passing these cost increases onto their customers. Pricing intentions were relatively stable as firms remain circumspect about their ability to pass on higher costs. Consequently, reported profitability took another step down in the September quarter.

Soft business sentiment has been the talk of the town in recent months as headline business confidence has tumbled to levels not seen since the Global Financial Crisis. And it has certainly weighed on the RBNZ's thinking. Back in August the RBNZ was explicit that low business confidence could affect employment and investment decisions, generating a downside risk to growth. These risks probably remained at the forefront of the Bank's thinking when it again noted in the September OCR Review that "...downside risks to the growth outlook remain". Today's data will have done little to assuage these concerns and will likely leave the Bank comfortable with its current dovish view on the outlook for monetary policy.

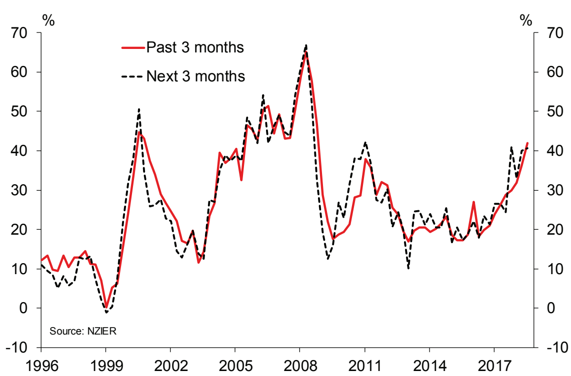
QSBO domestic trading activity and GDP growth



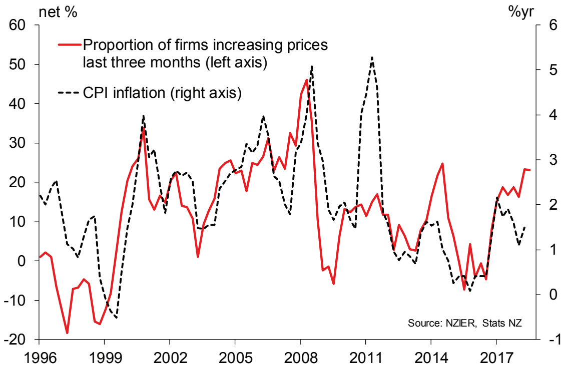
Investment intentions and Plant and Machinery Investment



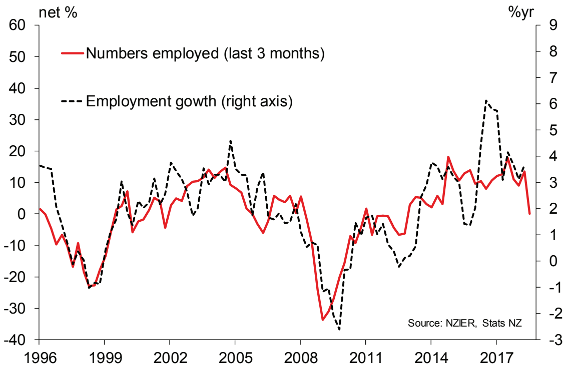
Expected costs



Businesses' prices and CPI inflation



Hiring intentions employment growth



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