A mixed bag

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

10 April 2018

- Business confidence has improved in the March quarter, but only a touch. A look at the bigger picture suggests business confidence has been easing in line with slower growth in the economy since mid-2016.
- There was little sign of nascent inflation pressures in today's data. Although indicators of capacity pressure have generally trended higher over the last couple of years, most eased in the last three months.
- Our macroeconomic forecasts incorporate a lull in both hiring and investment over the course of 2018. The details of today's release tend to support our softer employment growth outlook, but suggest any hiatus in business investment could be short lived.

Key results – forward looking (seasonally adjusted)

	Dec-17	Mar-18
General business sentiment, next 6 mths	-11	-9
Trading activity, next 3 mths	17	16
Pricing intentions, next 3 mths	30	20
Cost expectations, next 3 mths	40	33
Profitability, next 3 mths	-3	-1
Employment intentions, next 3 mths	11	11
Building investment intentions, next 12 mths	2	1
Plant investment intentions, next 12 mths	12	16

Key results – backward looking (seasonally adjusted)

	Dec-17	Mar-18
Trading activity, past 3 mths	10	15
Pricing, past 3 mths	18	16
Costs, past 3 mths	30	31
Profitability, past 3 mths	-8	-8
Employment, past 3 mths	10	9
Ease of finding skilled labour, past 3 mths	-48	-45
Ease of finding unskilled labour, past 3 mths	-30	-28
Capacity utilisation	92.8%	93.5%

The NZIER Quarterly Survey of Business Opinion showed general business confidence firmed a little in the March quarter. However, confidence remains in pessimistic territory at -9 (previously -11).

Despite the increase, confidence remains below its pre-election levels. This suggests that firms remain circumspect about the outlook for the economy under the new Government's stewardship, but also that the broader economic growth backdrop has softened over the last couple of years. Headline business confidence was trending lower prior to the election after peaking in mid-2016. That's consistent with the pace of GDP growth falling over the period, from 4.4% in 2016 to just under 3% by the end of 2017.

While the rebound in confidence in the QSBO post-election has been more muted than in monthly surveys of business confidence, this comes as little surprise. The QSBO tends to be both less volatile from quarter to quarter than its monthly counterpart (the ANZ Business Outlook), and in the past hasn't reacted as strongly to changes in the political backdrop. This is emphasised by the relative stability in firms outlook for their own activity. This was broadly unchanged in the March quarter (easing from +17 to +16). Meanwhile firms' reported activity over the last quarter improved notably.

As well as indicators of activity and investment, the QSBO provides an insight into how the labour market is evolving. These indicators remained at firm levels in the March quarter, but eased a little from three months ago. Firms reported less difficulty finding skilled and unskilled labour, little change in hiring intentions and that looking ahead they expect to require less overtime. In this respect firms' and households appear to be on the same page, with the latest Westpac McDermott Miller employment confidence survey also indicating that job opportunities were becoming a little harder to come by. Although there will be many factors influencing firms' appetite for workers, given little change in the outlook for firms' own activity, lingering uncertainty about the impact of forthcoming labour market reforms may have played a part in dampening enthusiasm for taking on new employees.

The labour market indicators in the QSBO survey broadly accord with our view of more subdued employment growth in 2018. This softer employment growth outlook is likely to mean the unemployment rate struggles to head much below its current level of 4.5% - a level we would regard as pretty close to its long run sustainable rate.

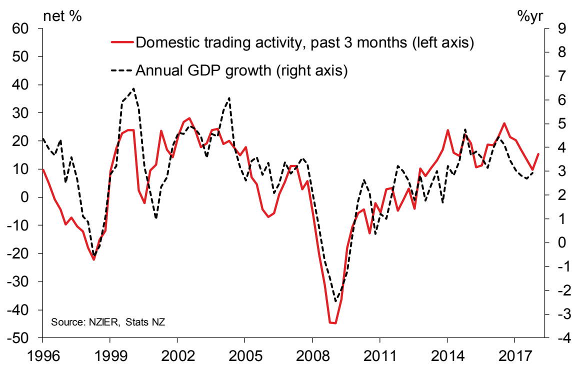
Yet while firms are becoming a touch more reticent about hiring new staff, they don't appear to be pouring cold water on their plant and machinery investment plans. Investment intentions (in plant and machinery) rebounded in Q1. That's consistent with recent import data showing imports of capital equipment tracking higher in recent months, suggesting any lull in business investment in 2018 could be relatively short lived.

The inflation gauges in the QSBO generally eased in the March quarter. Fewer firms expected their average costs to increase over the next three months (a net 33% versus 40% in December) while the proportion expecting average prices to increase (both over the last three months and the next) also fell. Firms were less likely to view capacity as the limiting factor on increasing production, and more likely to report demand as the limiting factor.

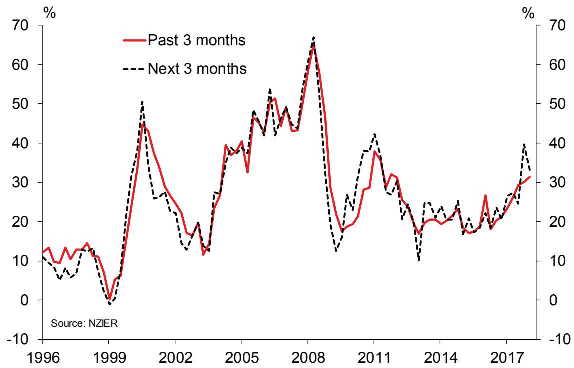
Certainly, there was nothing in today's data to suggest an imminent pickup in domestic inflation pressures. And with the NZ dollar continuing to defy gravity, and the RBNZ's new focus on maximising sustainable employment likely to encourage more gradual policy adjustments, the case for monetary policy remaining accommodative for an extended period remains compelling. We continue to think the Reserve Bank will leave the OCR unchanged until November next year.

Anne Boniface
Senior Economist

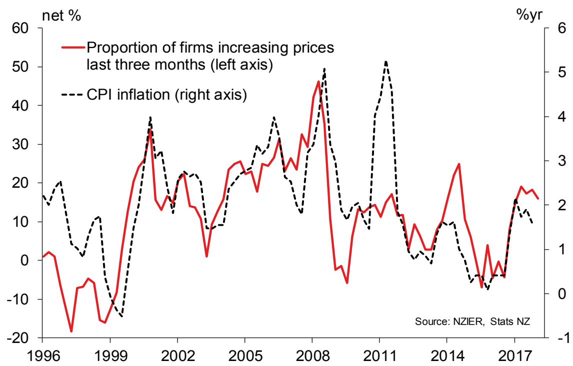
QSBO domestic trading activity and GDP growth



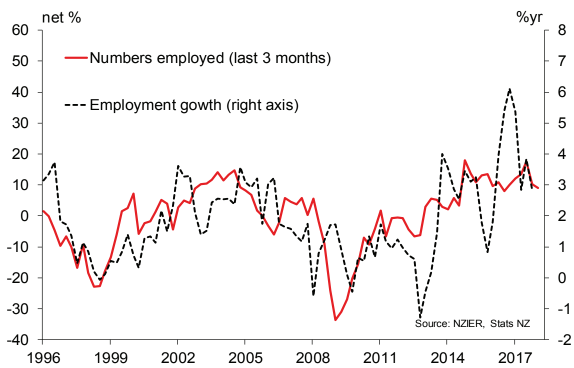
Businesses' average costs



Businesses' prices and CPI inflation



Hiring intentions employment growth



Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Disclaimer continued

Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) and well defined wall/cell crossing procedures;

(iv) a "need to know" policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.