

Under pressure

NZIER Quarterly Survey of Business Opinion, June quarter 2019

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- Business confidence fell further in the June quarter, to its lowest level since 2009.
- Firms continue to be squeezed between rising costs and an inability to pass these on as higher prices.
- Labour shortages are an ongoing refrain for businesses, although reported hiring actually fell in the June quarter.
- The QSBO shows that the slowdown has been deeper and more prolonged than we or the Reserve Bank expected.
- We are expecting growth to pick up gradually in the coming quarters on the back of construction, fiscal spending and lower interest rates. But there is little sign of that in the data to date.

Key results – forward looking (seasonally adjusted)

	Jun-19	Mar-19
General business sentiment, next 6 mths	-31	-28
Trading activity, next 3 mths	-4	5
Pricing intentions, next 3 mths	14	27
Cost expectations, next 3 mths	39	40
Profitability, next 3 mths	-24	-18
Employment intentions, next 3 mths	9	10
Building investment intentions, next 12 mths	5	0
Plant investment intentions, next 12 mths	3	-1

Key results – backward looking (seasonally adjusted)

	Jun-19	Mar-19
Trading activity, past 3 mths	-4	-2
Pricing, past 3 mths	11	17
Costs, past 3 mths	43	39
Profitability, past 3 mths	-26	-23
Employment, past 3 mths	-5	3
Ease of finding skilled labour, past 3 mths	-43	-50
Ease of finding unskilled labour, past 3 mths	-33	-34
Capacity utilisation	93.7%	92.4%

The June *Quarterly Survey of Business Opinion* showed a further deterioration in business confidence. General sentiment about the near-term outlook fell from -28 to -31, its lowest level in 10 years. Firms' expectations about their own activity over the next quarter also turned negative for the first time since 2009.

There was a relatively small drop in firms' reported performance over the last quarter, from -2 to -4. This measure is the most useful early indicator of GDP, and the latest result reinforces the extent to which growth has slowed in the last year and a half. We've revised our June quarter GDP growth forecast from 0.6% to 0.4%, which would see the annual growth rate slow to 2%. That's not a recessionary signal by any stretch, but it is fairly sluggish – not much more than population growth over the last year.

The details of the survey showed an intensification of the pressures that businesses have faced in recent quarters.

On the one hand, a growing number of firms are reporting a rise in their average costs. No doubt some of this has to do with government policies that have added to business costs, such as minimum wage hikes, changes to employment law, and increasing regulatory and compliance requirements.

On the other hand, firms are struggling to pass these rising costs on to their customers. Technology changes and international competition have put more power in the hands of consumers, and moreover, demand isn't expanding quickly enough for firms to be able to justify price increases.

As a result, firms are seeing a squeeze on their profitability, and have scaled back their expansion plans accordingly. While hiring intentions held up in June, on balance firms reported that they had actually shed workers over the last three months. Investment intentions improved a little in the June survey, but they remain well down from their earlier highs.

Rising costs are not the only factor, however. While the availability of workers remains a significant constraint on growth, a growing number of firms are reporting a lack of demand as the main constraint.

The details across industries were a mixed bag. The steepest fall in confidence was in manufacturing, which is arguably the most exposed to the recent cooling in global growth. But labour shortages have also emerged as a major challenge for this sector.

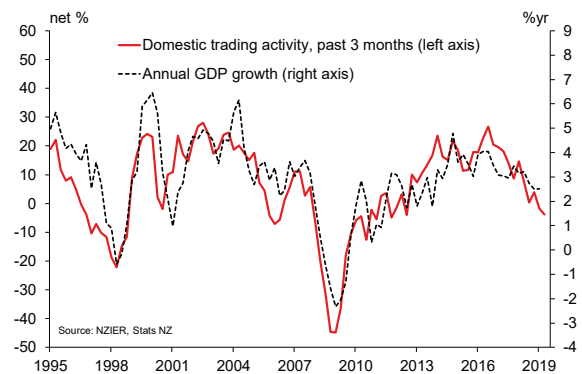
We suspect that to some extent the manufacturing sector has been a casualty of the building boom, as the two industries tend to compete for a similar pool of workers. The QSBO showed that hiring has held up in the building industry, and the difficulty of finding skilled workers has actually eased a little over the last few years. Overall confidence in the building industry remained weak in June, but it's hard to reconcile this with the buoyant level of activity in this sector (today's building consent figures underscore just how much more work there is in the pipeline).

Retailers were less confident in June, though they did report an improvement in profits on the back of higher prices. In contrast, service sector firms reported a sharp slowdown in actual and expected price increases, and a further drop in profitability. Overall, firms' reported pricing was consistent with inflation remaining short of the Reserve Bank's 2% target midpoint over the rest of this year – in line with our forecast.

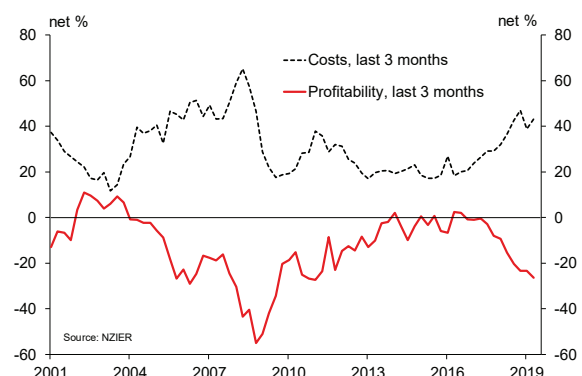
We're expecting economic growth to pick up gradually from the second half of this year, peaking at around 3% in 2020. Increased fiscal spending, a strong pipeline of building work, and fresh stimulus for the housing market in the form of lower mortgage rates will help to lift domestic demand in the coming months.

However, the weakness in the QSBO, along with some other recent indicators, raises the spectre that conditions could get worse before they get better. That presents a challenge for the Reserve Bank in particular, which assumed a strong pick-up in growth in the near term in its most recent forecasts. This reinforces our view that the RBNZ will lower the OCR further at its next review in August.

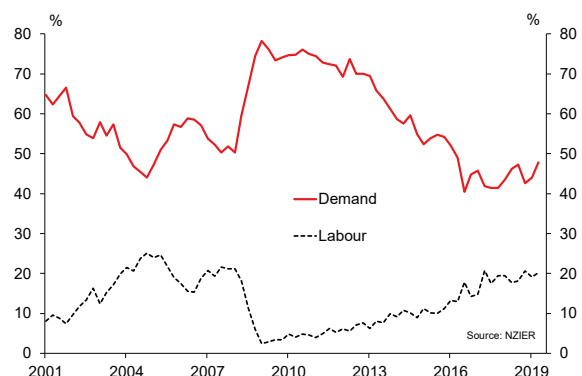
QSBO domestic trading activity and GDP growth



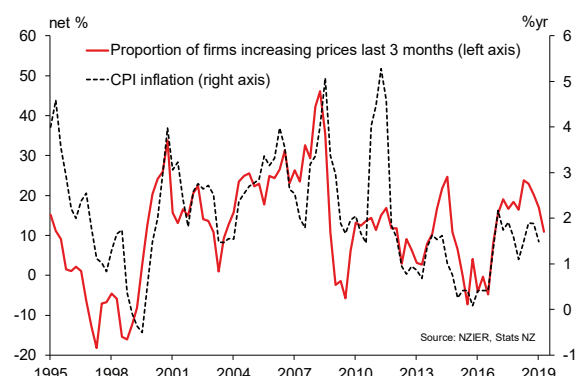
Costs and profits



Main constraints on growth



Businesses' prices and CPI inflation



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