

Off the lows

NZIER Quarterly Survey of Business Opinion, December quarter 2018

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- Business confidence rebounded from a nine year low in the December quarter. However, confidence remains at historically low levels and continues to suggest downside risk to our near-term GDP growth forecasts.
- Beneath the headline, key indicators of firms' own activity also improved in the December quarter. But rising costs and limited pricing power continue to eat into firms' profit margins.
- Plant and machinery investment intentions improved further in December, consistent with our view that the recent downturn in business investment is likely to be temporary.
- Today's survey should further assuage the RBNZ's concerns that weak confidence presents a downside risk to the growth outlook. Consequently, it has done nothing to change our outlook for the OCR. Our central view remains that the next move in interest rates will be up, but this isn't on the cards for some time yet.

Key results – forward looking (seasonally adjusted)

	Sep-18	Dec-18
General business sentiment, next 6 mths	-28	-18
Trading activity, next 3 mths	11	17
Pricing intentions, next 3 mths	30	21
Cost expectations, next 3 mths	40	40
Profitability, next 3 mths	-11	-12
Employment intentions, next 3 mths	8	12
Building investment intentions, next 12 mths	-5	-5
Plant investment intentions, next 12 mths	4	7

Key results – backward looking (seasonally adjusted)

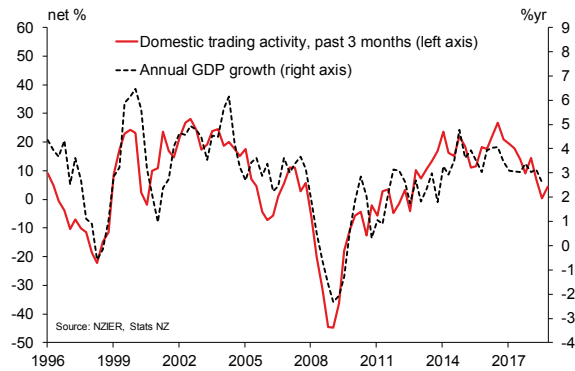
	Sep-18	Dec-18
Trading activity, past 3 mths	0	4
Pricing, past 3 mths	23	20
Costs, past 3 mths	43	48
Profitability, past 3 mths	-21	-24
Employment, past 3 mths	0	2
Ease of finding skilled labour, past 3 mths	-46	-52
Ease of finding unskilled labour, past 3 mths	-31	-34
Capacity utilisation	93%	93%

The December Quarterly Survey of Business Opinion showed firms had a somewhat less pessimistic take on the outlook for the economy in the final months of 2018. Although confidence remains at relatively low levels, headline (seasonally adjusted) business confidence improved from -28 in September to -18 in the December quarter. In addition, firms tended to have a more upbeat assessment of both their own recent activity and their prospects over the months ahead.

Concern about business confidence has dissipated somewhat over recent months as the downside risks to growth posed by plunging business confidence through the middle of last year have failed to materialise. While the pace of growth in plant and machinery investment has cooled, employment growth has remained firm as caution about the outlook has been more than offset by a desire to secure the right skills in a tight labour market.

That said, there's no denying the pace of growth in the economy has cooled from the heights reached a couple of years ago. And despite the improvement in the backward looking Domestic Trading Activity component of today's QSBO survey, on its own this useful gauge of near term GDP growth still suggests some downside risk to our forecast of 0.8% GDP growth in Q4.

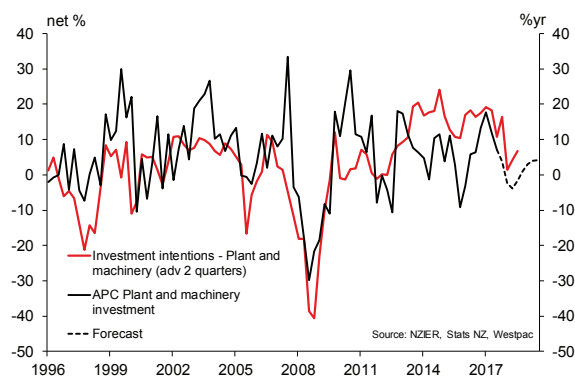
QSBO domestic trading activity and GDP growth



One striking feature of recent confidence surveys has been increased pressure on firms' bottom lines as rising costs and limited pricing power eat into profitability. In the December quarter, a net 48% of firms reported rising costs (up from 43% last quarter) while over the same period the proportion of firms reporting that they raised prices actually fell slightly, from 23% to 20%. This dynamic is particularly apparent in the retail sector where retailers have been squeezed by increasing costs, including a rising minimum wage, but have little opportunity to pass these costs on to consumers given intense competition from the likes of online retailers.

This dynamic is one reason we're doubtful that we'll see a near term acceleration in inflation to levels which will concern the Reserve Bank. Retail prices in particular look set to be an ongoing drag on the broader inflation outlook for some time yet.

Investment intentions and Plant and Machinery Investment

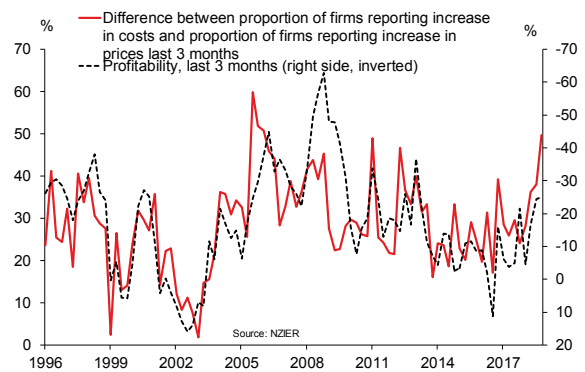


Despite the pressure on profitability, firms are still looking to add more workers to their payrolls relative to three months ago and continue to expect to lift headcounts next

quarter. In addition there was a small lift in investment intentions for plant and machinery equipment although firms remain circumspect about investing in buildings. Interestingly, while both skilled and unskilled labour shortages are becoming more acute across the economy, the construction sector bucked this trend with firms in this part of the economy reporting that it was slightly easier to find workers in the December quarter.

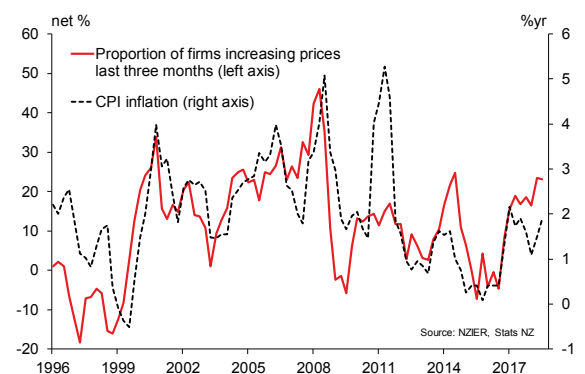
Signs of improvement in investment intentions broadly accords with our forecasts which have long anticipated that soft confidence would induce a period of weak investment growth that would ultimately prove temporary. Growth in plant and machinery and transport equipment in the year to March 2019 in particular is expected to be subdued before a period of firmer economic activity, supported by a new lease of life in the housing market and a lift in government spending, gradually encourage firms to once again have the confidence to undertake investment.

Profitability, costs and prices for merchants



Today's data, in conjunction with monthly surveys of business confidence, suggests business confidence has found a floor. And with our own projections for the NZ economy anticipating a modest pickup in growth from current levels over 2019, we expect the Reserve Bank's concerns about the risks posed by very weak business confidence should continue to fade. That said, any hints of a further fall in confidence will see indicators such as the QSBO quickly making their way back up the RBNZ's watch list.

Businesses' prices and CPI inflation



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