Westpac Institutional Bank

More of the good stuff

NZIER business confidence steady in Q2

- **The June *Quarterly Survey of Business Opinion* reinforced our view that the New Zealand economy has entered a self-sustaining expansion, notwithstanding the impact of the drought over the first half of this year.**
- **The Christchurch rebuild remains an important driver, but there is growing evidence that the upturn is becoming more widespread.**
- **Sustained growth will eventually soak up the country's spare capacity, and there are early signs that domestic prices pressures are re-emerging.**

The June *Quarterly Survey of Business Opinion* didn't offer much advance from the last survey in March, but it provided more support for the view that the New Zealand economy has at last entered a self-sustaining upswing. The ramp-up in the Canterbury rebuild has clearly been a driving force in the last few quarters, but there is good reason to believe that the effects of such a massive project are spilling over into other regions and industries.

The survey doesn't directly capture the agricultural sector, which led it to overstate the pace of GDP growth in the March quarter and will likely do so again for the June quarter. But beyond the impact of lost production as a result of the drought earlier this year, growth looks on track to accelerate to an annual pace of 3% or more over the next couple of years.

Details

The June survey found that a net 31% of firms expect general business conditions to improve over the next six months, matching the three-year high recorded in the March quarter. The own-activity measures eased slightly, with a net 4% of firms reporting better results in the last three months, down from a net 10% in March. Firms' own expectations for the next three months remained high with a net 19% positive, similar to the ten-year high of 22% reached in the December quarter last year.

The detailed activity questions were generally positive. Actual and expected employment both nudged up to their highest levels since the 2008 recession. Planned investment in buildings and capital equipment were little changed from March, but they remain near the top of their historical ranges.

The influence of the Canterbury rebuild shows through clearly in terms of the rampant confidence among architects, and the sustained high level of confidence in the building industry (where a net 46% expect better times ahead, the same reading for the last three quarters). The detailed questions showed a moderation for the building industry compared to the red-hot March quarter, but the general picture remained strong.

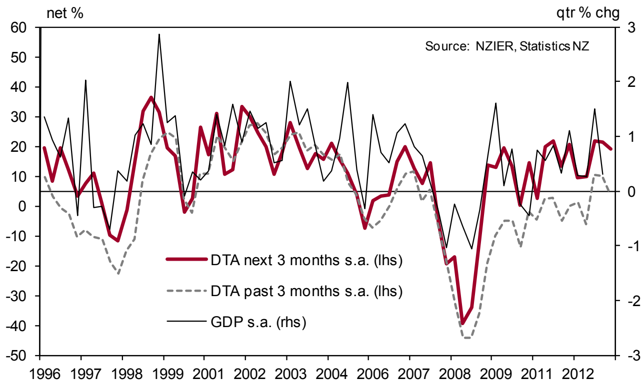
Key results – forward looking

	Q1 survey	Q2 survey
Business confidence sa, next 6 mths	31	31
Trading activity, sa, next 3 mths	21	19
Pricing intentions, next 3 mths	13	22
Cost expectations, next 3 mths	16	29
Profitability, next 3 mths	7	1
Employment intentions, next 3 mths	5	9
Building investment intentions, next 12 mths	3	4
Plant investment intentions, next 12 mths	8	10

Key results – backward looking

	Q1 survey	Q2 survey
Trading activity, sa, past 3 mths	10	4
Pricing, past 3 mths	4	11
Costs, past 3 mths	19	29
Profitability, past 3 mths	-12	-15
Employment, past 3 mths	4	3
Ease of finding skilled labour, past 3 mths	-25	-26
Ease of finding unskilled labour, past 3 mths	0	2
Capacity utilisation	91.52%	91.31%

Domestic trading activity



What may come as a surprise to some is that the manufacturing sector was the big winner in the June quarter. A net 35% of firms were positive about the next six months, compared to a net -1% the same time last year. Hiring intentions crept higher, and plans to invest in capital equipment rose to a net 22%, the highest in nearly 20 years. We've noted before that the manufacturing sector is actually quite closely linked to domestic demand and in particular the construction cycle; it's likely that the Canterbury rebuild is more than offsetting the soft export environment.

While the manufacturing sector was stronger, retailers reported a weaker quarter, with both sales and prices lower. That doesn't seem to fit with the electronic card spending figures though – the June figures released today indicate that the pace of spending has accelerated compared to the March quarter.

We were particularly interested in the indicators of price pressures from this survey, after the monthly ANZ business confidence survey had alerted us to a meaningful pickup in pricing intentions in recent months. The *QSBO* suggests that inflation pressures are gradually re-emerging, but that it's early days yet. A net 22% of firms intend to raise their prices in the next three months, the highest in five quarters. However, costs are still reported to be outpacing selling prices, suggesting that pricing power is still constrained.

There was mixed evidence of any further tightening of capacity constraints. The ease of finding workers was similar to the March quarter, and the overall capacity utilisation rate fell slightly. Capacity use by non-exporting firms was the highest in five years, but it is still some way below pre-recession levels.

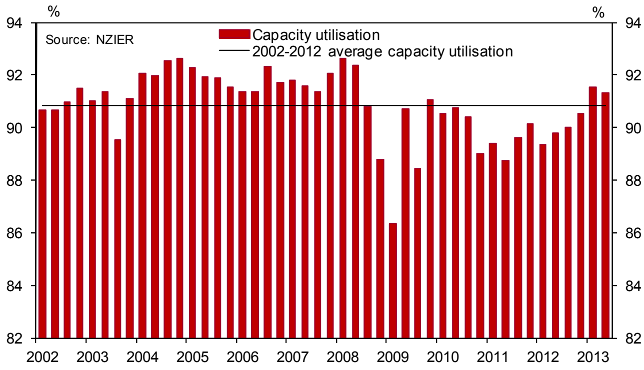
Market implications

At face value this survey suggests solid GDP growth in the June quarter – but with the drought likely to have a sizeable impact on output, we suspect that Q2 growth will be more comparable to the 0.3% pace in Q1. That aside, the survey is consistent with our view that the New Zealand economy has entered a self-sustaining expansion, with indicators of underlying growth strengthening and becoming more broad-based in the last few quarters.

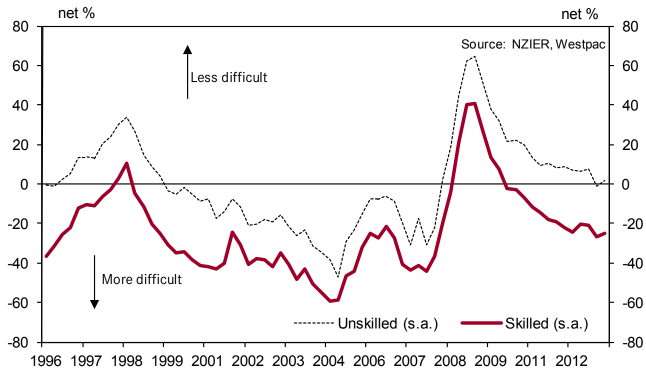
The tension for the RBNZ is between low inflation today and the expectation of higher inflation in the future. While the *QSBO* is not a particularly forward-looking survey, there's enough in there to support our view that annual inflation will soon return above 1% (though not before hitting a cycle low of 0.7% in the June quarter). That would reinforce the RBNZ's position as one of the few major central banks that is likely to raise interest rates in the next year – notwithstanding its recent enthusiasm for using unconventional tools to target the housing market.

Michael Gordon
Senior Economist

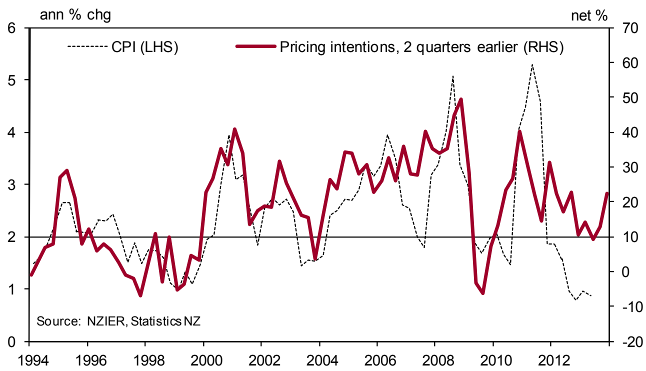
Capacity utilisation



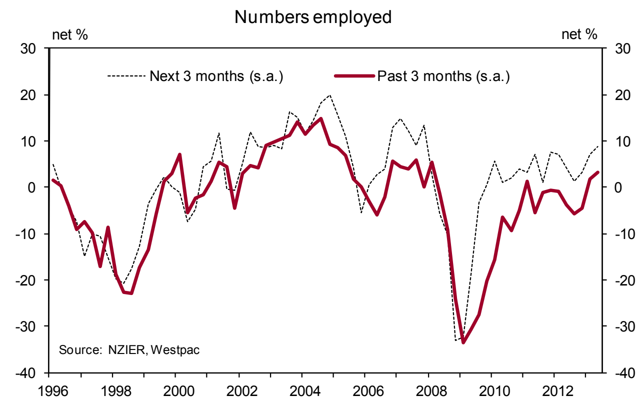
Firms' difficulty of finding labour



Pricing intentions vs CPI



Employment intentions s.a.



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