Westpac Institutional Bank

A purple patch

NZIER business confidence rebounds in Q4

- **The December *Quarterly Survey of Business Opinion* once again confirmed the message from recent monthly data: firms' reported and expected activity has picked up strongly.**
- **Firms are preferring to meet capacity pressures by investing in plant and machinery rather than hiring more workers, particularly as the high dollar keeps the price of imported equipment low.**
- **The surveyed showed little in the way of generalised inflation pressures and will keep the Reserve Bank comfortably on hold for now.**

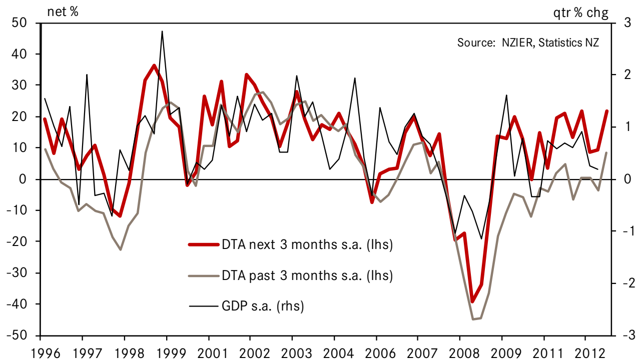
Key results – forward looking

	Q3 survey	Q4 survey
Business confidence sa, next 6 mths	-1	19
Trading activity, sa, next 3 mths	9	22
Pricing intentions, next 3 mths	14	9
Cost expectations, next 3 mths	26	16
Profitability, next 3 mths	3	2
Employment intentions, next 3 mths	4	3
Building investment intentions, next 12 mths	-3	-3
Plant investment intentions, next 12 mths	-1	5

Key results – backward looking

	Q3 survey	Q4 survey
Trading activity, sa, past 3 mths	-4	8
Pricing, past 3 mths	10	6
Costs, past 3 mths	26	19
Profitability, past 3 mths	-21	-3
Employment, past 3 mths	-9	-3
Ease of finding skilled labour, past 3 mths	-21	-20
Ease of finding unskilled labour, past 3 mths	4	8
Capacity utilisation	90.02%	90.53%

Domestic trading activity



Summary

We expected some rebound in business sentiment after a tough September quarter, and today's survey delivered. Indeed, on the face of it this was a very positive result. Real progress on the restoration of our second-largest city, strong growth in activity across many regions and industries, and little in the way of generalised inflation pressures – what's not to like?

Well for one thing, it's very much a near-term snapshot of the economy; the current optimism among firms is no guarantee that the growth momentum won't be derailed at some point in the future, or that inflation pressures won't rise. Secondly, it still tells a story of lopsided growth. The persistently high exchange rate stands out as a factor, favouring domestically-oriented firms over exporters, and investment in capital over labour.

Details

General business sentiment rebounded in the December *Quarterly Survey of Business Opinion*, with a net 19% of firms expecting an improvement over the next six months. This outturn is consistent with the recent tone of the domestic activity data, which suggested a brief but fairly wide-spread downturn in the September quarter before picking up again in the December quarter. In addition, much of the 'fear factor' in international markets has dimmed in recent months, notwithstanding the fun and games around the US fiscal cliff that were in full force at the time the survey was held (responses were accepted up until 3 January).

More significantly for short-term forecasting purposes, the own-activity measures also saw substantial gains for the quarter. Reported activity for the last three months rose from a net -4% to a net +8%, the highest since June 2007. Expected activity for the next three months rose from +9% to +22%, equal to the reading in the March 2012 quarter and in turn the highest since Q3 2003.

Reported activity improved across each of the broad sectors, with the greatest improvement coming from manufacturers and builders: up from -13% to +17%, the highest since late 2004.

Confidence around the Christchurch rebuild is clearly a factor - NZIER reported a particularly large bounce in reported activity in the Canterbury region (after an oddly weak Q3). However, there was a strong bounce for the rest of the country as well.

Other details were more mixed, with little change in expected profits, employment or investment in buildings, although intended investment in plant and machinery rose. The persistently high exchange rate increases the relative appeal of investing in machinery and equipment, which tends to have a large imported component.

Inflation indicators were generally soft. Fewer firms expected costs to increase, while only a net 9% of firms intended to raise their prices in the next quarter - both measures were the lowest since mid-2009. Ease of finding labour increased slightly, although it remains tight for skilled labour and particularly for the construction industry. Capacity utilisation rose but remains slightly below its ten-year average.

Market implications

The survey is broadly in line with our pick for 0.7% GDP growth in the December quarter, possibly with some upside risk. Curiously the historical revisions to GDP that were published at the end of last year mean that the 'next three months' own activity measure from the QSBO is now the superior indicator for quarterly GDP, whereas previously the 'last three months' measure was the better gauge.

The survey points to the RBNZ remaining firmly on hold, in what was almost a goldilocks survey in terms of improving growth and low inflation. The economy-wide inflation indicators were benign, although there were some pressures in the construction industry as expected. At the same time, growth looks to be picking up from its low point in Q3.

Markets responded positively to the release, with the NZ dollar rising around 35pts to 0.8440.

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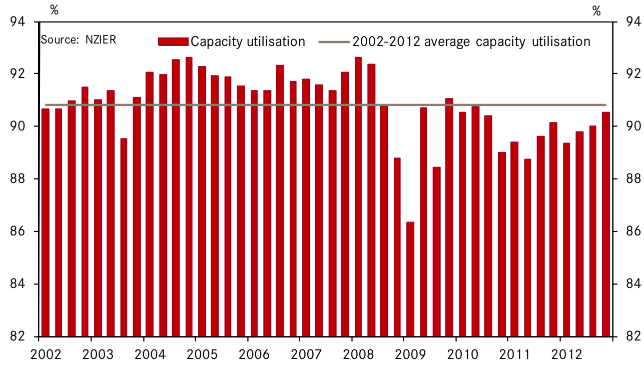
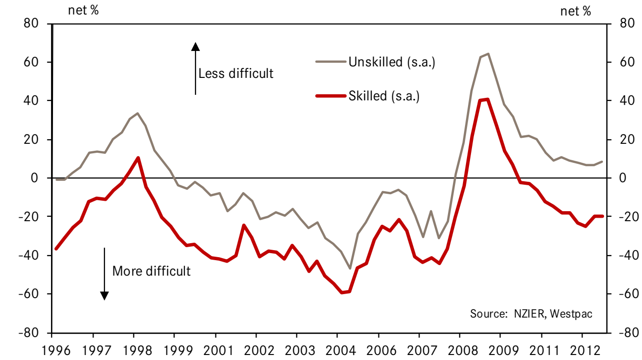
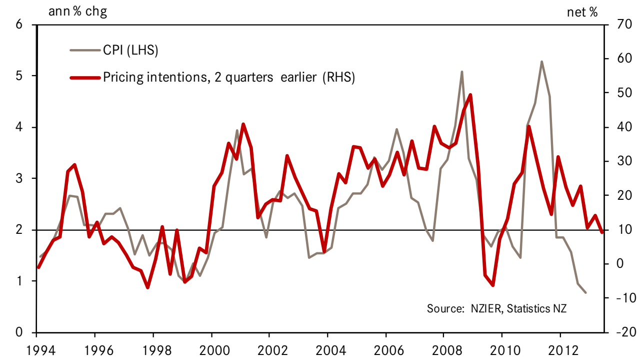
Capacity utilisation



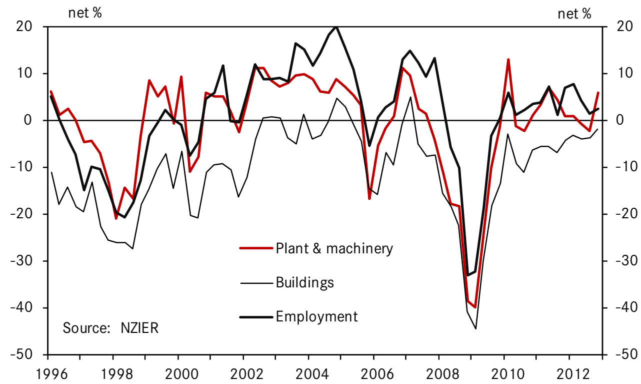
Firms' difficulty in finding labour



Pricing Intentions vs CPI



Investment and employment intentions s.a.



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