Westpac Institutional Bank

5 April 2016

Dairy scary

NZIER *Quarterly Survey of Business Opinion*, March 2015

- Businesses reported solid results over the last three months, suggesting some upside risk to our March quarter GDP forecast.
- However, they have become much less upbeat about the outlook for over the near term, which may reflect concerns about knock-on effects from the dairying downturn.
- Some firms reported rising costs, but there is little evidence of this being passed through into consumer prices.

Key results – forward looking (seasonally adjusted)

	Dec-15	Mar-16
General business sentiment, next 6 mths	13	-1
Trading activity, next 3 mths	20	6
Pricing intentions, next 3 mths	11	11
Cost expectations, next 3 mths	18	23
Profitability, next 3 mths	6	14
Employment intentions, next 3 mths	12	11
Building investment intentions, next 12 mths	1	0
Plant investment intentions, next 12 mths	10	9

Key results – backward looking (seasonally adjusted)

	Dec-15	Mar-16
Trading activity, past 3 mths	18	18
Pricing, past 3 mths	5	-4
Costs, past 3 mths	19	27
Profitability, past 3 mths	-8	-7
Employment, past 3 mths	13	9
Ease of finding skilled labour, past 3 mths	-32	-30
Ease of finding unskilled labour, past 3 mths	-5	-7
Capacity utilisation	93.2%	93.2%

The NZIER *Quarterly Survey of Business Opinion* for the March quarter suggests that the dairy sector's woes are playing on the minds of businesses across the country. While the survey does not cover the agriculture sector directly, there was a noticeable hit to sentiment spread across the manufacturing, construction, retailing and services sectors.

But the survey also highlights that the plunge in dairy prices has been a shock to incomes much more so than to activity, at least to date. Firms were significantly less upbeat about the near-term outlook, but they generally reported solid results for the past quarter, and their hiring and investment intentions were little changed.

General business sentiment fell from +13% in December to -1% in March. This was well below the average level of the last few years, though it was still an improvement on the -11% reading in the September quarter, when Fonterra's milk price forecast was first revised below $4/kg.

Firms' reported outcomes over the past quarter were steady at +18%. However, their expectations for the next quarter fell from +20% to +6%, the lowest reading since March 2011 (which was of course affected by the Canterbury earthquakes). Taken together, these survey readings suggest some upside risk to our March quarter GDP forecast (we currently expect a 0.5% rise), but with a growing risk of a slowdown later in the year as the loss of dairy income inevitably weighs on activity.

The survey suggests that the labour market is continuing to tighten, even with GDP growth past its peak. Actual and expected employment remained above their long-run averages, and workers are becoming harder to find. The share of firms reporting that labour is their biggest constraint on growth rose to 14%, its highest since 2008 (though it's still well below the peaks of last decade). These results are consistent with the recent Westpac-McDermott Miller confidence surveys, which showed a lift in confidence around labour market conditions even as consumer and regional confidence fell.

Finally, the QSBO suggests that inflation pressures are still very subdued. We've been waiting for evidence that the steep fall in the New Zealand dollar last year is being passed through into consumer prices, even if that passthrough is more muted than in the past. Firms' currency hedging may have delayed this process, but at some point these hedges will run out.

The latest survey did in fact show an uptick in the number of firms reporting higher costs over the last quarter (a net 27%, the highest since March 2012). But at the same time, there was no real sign that firms have been able to pass on these cost increases, or that they plan to do so. One notable exception was the building industry, where both costs and prices rose in the March quarter. That's hardly a surprise though, as strong demand and tight capacity have been driving prices higher in this sector for some time. Overall, the QSBO results leave us comfortable with our forecast of a flat CPI outturn for the March quarter, which would see annual inflation rise slightly from 0.1% to 0.3%.

Michael Gordon
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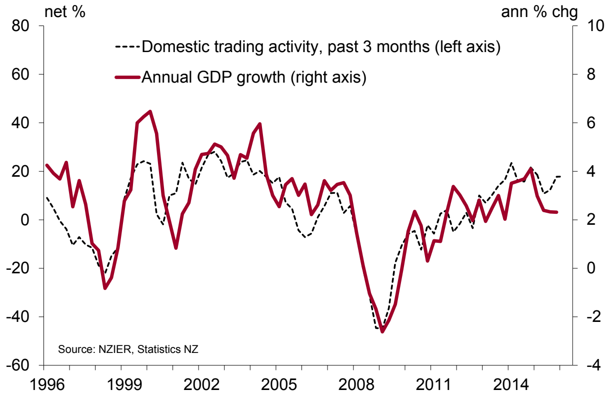
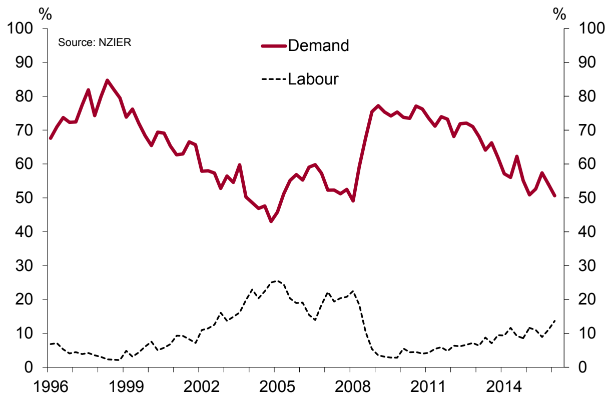
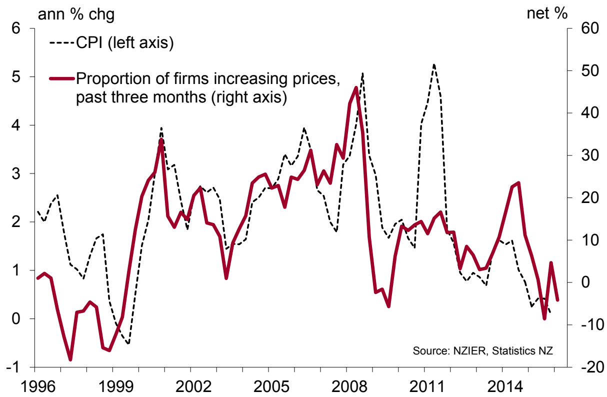
QSBO domestic trading activity and GDP growth



Biggest constraint on growth



Businesses' costs and CPI inflation



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