Westpac

Institutional Bank

11 July 2016

Getting on with the job

NZIER *Quarterly Survey of Business Opinion*, June 2016

- Business confidence rebounded over the June quarter, as firms appeared to overcome their earlier concerns about the impact of the dairying downturn.
- The survey results were consistent with the economy maintaining its recent pace of growth over the near term.
- But even with continued solid growth and a tightening labour market, there is little to suggest that inflation is on the verge of breaking higher again.

Key results – forward looking (seasonally adjusted)

	Mar-16	Jun-16
General business sentiment, next 6 mths	-2	**18**
Trading activity, next 3 mths	6	**19**
Pricing intentions, next 3 mths	11	**11**
Cost expectations, next 3 mths	23	**18**
Profitability, next 3 mths	14	**17**
Employment intentions, next 3 mths	11	**14**
Building investment intentions, next 12 mths	2	**9**
Plant investment intentions, next 12 mths	11	**17**

Key results – backward looking (seasonally adjusted)

	Mar-16	Jun-16
Trading activity, past 3 mths	18	**22**
Pricing, past 3 mths	-4	**1**
Costs, past 3 mths	27	**18**
Profitability, past 3 mths	-6	**3**
Employment, past 3 mths	9	**11**
Ease of finding skilled labour, past 3 mths	-32	**-38**
Ease of finding unskilled labour, past 3 mths	-8	**-15**
Capacity utilisation	93.2%	**92.9%**

Firms are feeling more confident about the near future, having overcome some nervousness at the start of the year, according to the NZIER *Quarterly Survey of Business Opinion.* The strong activity indicators in the survey suggest that the economy is continuing to grow at a solid pace. But, as has been the case for some time, there is little sign that economic growth is translating into greater inflation pressures.

In seasonally adjusted terms, general business sentiment rose from a net -2% to +18%, while firms' own-activity expectations for the next three months jumped from +6% to +19%. These measures had fallen sharply in the March quarter survey, which we had put down to concerns about the ongoing weakness in farmgate milk prices. While the agricultural sector isn't surveyed directly, it was reasonable for other sectors to expect an impact from the drop-off in dairying incomes.

It's not that the outlook for dairying has improved since then. Recent GlobalDairyTrade auctions have been a bit more positive, but Fonterra's starting forecast of a $4.25/kg milk price for this season was lower than expected, and confirmed that the industry is facing a third straight season of very weak returns.

Rather, what seems to have happened is that firms have seen their own results hold up, helping to allay fears about the knock-on effect from the dairying downturn. Firms' reported activity for the past three months was steady at a net +18% in the March quarter, and improved further to a net +22% in the June quarter. This measure is a useful early indicator of quarterly GDP, and the latest read suggests that GDP growth over the June quarter should match or beat the 0.7% increase seen over the March quarter.

The details of the survey generally supported the strong activity story. Firms reported more hiring and stronger profitability over the last three months, and employment and investment intentions also rose.

But the survey also highlighted that one of the great puzzles about the New Zealand economy remains in effect: strong growth in activity is not leading to any meaningful lift in inflation pressures. Fewer firms reported cost increases, and pricing intentions remained at a relatively low +11% for the third straight quarter. There was a slight increase in the number of firms reporting price increases in the last three months, but the result was in line with our forecast (and the RBNZ's) that annual inflation will tick up from 0.4% to a still very low 0.6% in the June quarter.

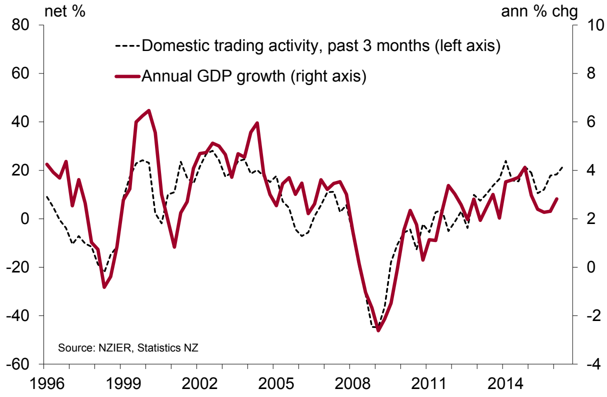
Some of the softness in inflation is no doubt related to the growth in the economy's capacity – strong net migration has boosted the growth in the labour force, resulting in only a gradual drop in the unemployment rate and muted upward pressure on wages. But that can't be the whole story, as firms have reported a persistent tightening in capacity constraints. The difficulty of finding workers continues to rise, and the share of firms reporting that supply factors (as opposed to demand) were the biggest constraint on growth had reached its highest since 2005.

The conundrum is most apparent in the construction sector, where confidence surged in the latest quarter. That optimism is understandable in light of the growing pipeline of building work across the country, even if the level of quake rebuild activity in Canterbury has peaked. Builders report that the difficulty of finding workers, both skilled and unskilled, is close to its highest levels in the history of the survey. Yet fewer firms are reporting cost increases than at almost any time in the last decade. We suspect that something will eventually have to give – if the industry is going to deliver the volume of work it expects, it will need to bid up wages to attract more workers. But it's notable that this tension has persisted for several years already.

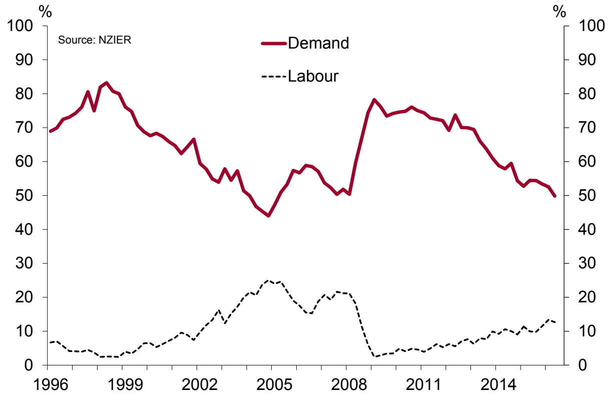
We should acknowledge that the June quarter survey closed before the Brexit vote in the UK, which has since added to the uncertainty around the outlook for the world economy. That said, the fact that the next survey is almost three months away makes it more likely that we'll see a considered response from New Zealand firms.

Michael Gordon
Acting Chief Economist

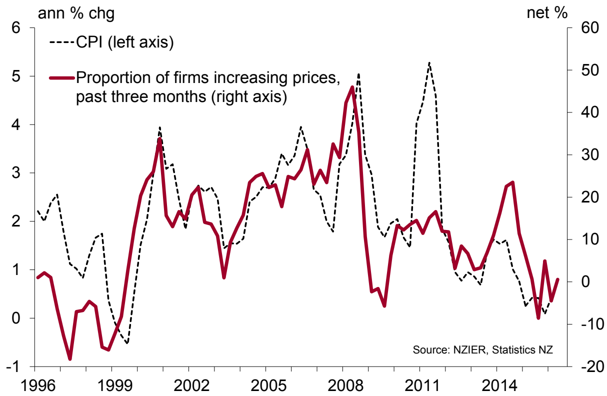
QSBO domestic trading activity and GDP growth



Biggest constraint on growth



Businesses' costs and CPI inflation



Contact the Westpac economics team

Michael Gordon, Acting Chief Economist +64 9 336 5670
Satish Ranchhod, Senior Economist +64 9 336 5668
Anne Boniface, Senior Economist +64 9 336 5669
David Norman, Industry Economist +64 9 336 5656
Any questions email: economics@westpac.co.nz

Disclaimer

Disclaimer continued

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “Order”) or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as “relevant persons”). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for “eligible counterparties” and “professional clients” as defined by the rules of the Financial Conduct Authority and is not intended for “retail clients”. With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission (“CFTC”) as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC (‘WCM’), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (‘the Exchange Act’) and member of the Financial Industry Regulatory Authority (‘FINRA’). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

Investment Recommendations Disclosure

Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) Strict and well defined wall/cell crossing procedures;

(iv) a “need to know” policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) reasonable steps by Compliance to ensure that the Chinese Wall/ Cell arrangements remain effective and that such arrangements are adequately monitored.