Westpac Institutional Bank

19 January 2016

A brighter mood

NZIER Quarterly Survey of Business Opinion, December 2015

- Business confidence improved in late 2015 after a notable slowdown in the first half of the year. However, it remains below the peak conditions seen in 2014.
- While firms report growing capacity constraints, evidence of cost and price pressures remains very limited.

Key results – forward looking (seasonally adjusted)

	Sep-15	Dec-15
General business sentiment, next 6 mths	-10	13
Trading activity, next 3 mths	18	20
Pricing intentions, next 3 mths	-1	11
Cost expectations, next 3 mths	17	17
Profitability, next 3 mths	9	4
Employment intentions, next 3 mths	13	13
Building investment intentions, next 12 mths	4	1
Plant investment intentions, next 12 mths	13	10

Key results – backward looking (seasonally adjusted)

	Sep-15	Dec-15
Trading activity, past 3 mths	12	18
Pricing, past 3 mths	-9	5
Costs, past 3 mths	17	19
Profitability, past 3 mths	2	-8
Employment, past 3 mths	13	14
Ease of finding skilled labour, past 3 mths	-24	-32
Ease of finding unskilled labour, past 3 mths	-4	-5
Capacity utilisation	92.3%	93.2%

The NZIER *Quarterly Survey of Business Opinion* showed that business confidence improved in late 2015, although it remains below the peak seen in 2014 when the economy was humming along at around a 4% annual growth pace. Indicators of pricing pressures also picked up compared to September, although they don't suggest a near-term breakout in inflation from its very weak recent pace.

The sharp rise in general business sentiment, from a net -10% to +13%, overstates the case: this measure of confidence had plunged in the September quarter even as the other details of the survey pointed to an improvement in conditions. Firms' own reported activity, which corresponds much more closely with GDP growth, saw a more modest increase from 12% to 18%.

Confidence at these levels is broadly consistent with our current forecast of 0.6% GDP growth in the December quarter, with some mild upside risk, following on from a 0.9% rise in the September quarter. There's no doubt that economic conditions strengthened over the second half of 2015 compared to the weak first half. Nevertheless, a number of headwinds to growth, including weak returns from dairying and the plateauing of the Christchurch rebuild, suggest that the days of 1% growth per quarter are well and truly past for this cycle.

The various indicators of price pressures painted a stronger picture compared to the September quarter, though still quite benign compared to a longer history. Capacity utilisation rose from 92% to 93%, nearing the record high reached last June, and 17% of firms reported that capacity was their biggest constraint on growth, the highest share in the history of the survey. Curiously, though, firms seem less inclined to address that constraint: planned investment in buildings and machinery fell for the third straight quarter.

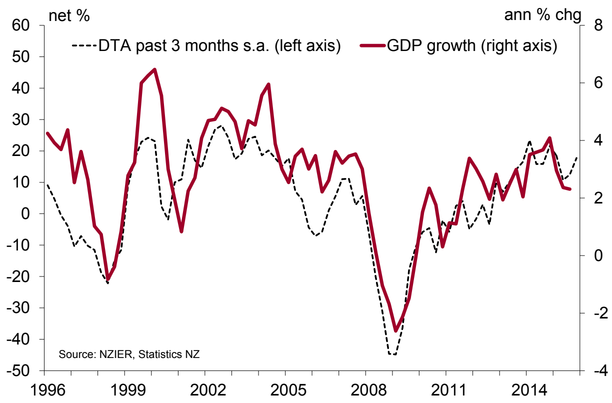
There are indications that firms may be looking to people power to address those constraints instead. Actual and intended hiring remained at historically high levels, and the reported difficulty of finding skilled workers rose again after having eased in the previous two quarters. Overall, though, labour remains a much less severe constraint today than it was during the mid-2000s boom.

Meanwhile, a net 5% of firms said that they had increased prices over the last quarter, compared to a net 9% reporting price decreases in the September quarter. However, the turnaround was concentrated in the services sector, and we suspect this was another case where the September quarter weakness was overstated. In sectors such as manufacturing and retailing, where the weaker New Zealand dollar could be expected to put upward pressure on costs and prices, there is certainly a desire to raise prices but little evidence that firms have been able to do so yet.

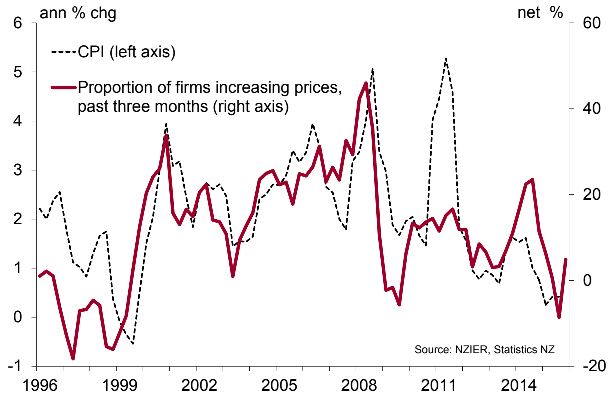
We still expect the lower exchange rate to have some effect on tradable goods prices over the next year. But with world oil prices plunging for the second time in two years, it now looks likely that headline inflation will remain below 1% for most if not all of 2016.

Michael Gordon
Senior Economist

QSBO domestic trading activity and GDP growth



Businesses' pricing decisions and CPI inflation



Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior 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

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