

Shaken and stirred

NZIER business confidence falls in Q1

- **General business confidence fell in the wake of the Christchurch earthquake, although firms' own activity and expectations held up reasonably well.**
- **Rising costs are increasingly a concern for businesses, although the conditions for an inflationary spiral are not yet as ripe as they were last decade.**
- **The survey is consistent with weakly positive GDP growth in Q1, though we suspect this doesn't capture the full impact of the quake.**

The latest *Quarterly Survey of Business Opinion* was of particular interest, not just for its role as an early indicator of quarterly GDP. The survey was conducted in the weeks following the Christchurch earthquake on 22 February, which meant that respondents will have had some time to put this tragic event into perspective. So while the survey revealed an understandable blow to sentiment about the broader economy, firms' reports on their own performance were surprisingly robust. Outside of the Canterbury region, confidence was little changed for the quarter, and rising cost pressures are becoming at least as much of a concern as the slow pace of recovery.

General business sentiment fell to a net -11% in seasonally adjusted terms. That's the lowest since June 2009 – the point at which the economy tentatively exited recession – but well above the levels usually associated with recession. Not surprisingly the biggest hit to confidence was in Canterbury, and even then the drop will have been understated (NZIER estimates an undercount in the region of about 40%, with the worst-hit firms unable to respond). But confidence was down in all regions, demonstrating how the February earthquake dealt a nationwide psychological blow, much more so than the Darfield-centred quake last September.

In contrast, firms' reports of their own experiences and expectations held up relatively well. Activity over the past three months – the best single indicator of quarterly GDP – fell from a net -1% to -5%, consistent with (yet) another quarter of weak but positive growth. The biggest decline was seen

Key results – forward looking		
	Q4 survey	Q1 survey
Business confidence sa, next 6 mths	-1	-11
Trading activity, sa, next 3 mths	12	5
Pricing intentions, next 3 mths	22	14
Cost expectations, next 3 mths	32	44
Profitability, next 3 mths	-5	-22
Employment intentions, next 3 mths	4	0
Building investment intentions, next 12 mths	-8	-7
Plant investment intentions, next 12 mths	0	0

Key results – backward looking		
	Q4 survey	Q1 survey
Trading activity, sa, past 3 mths	-1	-5
Pricing, past 3 mths	12	11
Costs, past 3 mths	26	39
Profitability, past 3 mths	-21	-28
Employment, past 3 mths	-3	2
Ease of finding skilled labour, past 3 mths	-7	-10
Ease of finding unskilled labour, past 3 mths	19	15
Capacity utilisation	88.99%	89.38%

among retailers, although that reflected a strong bounce in the December quarter that was far from borne out in the official statistics (retail trade GDP fell by 2.3%).

Expectations for the next three months fell, but remained in net positive territory. Similarly, intentions to hire and invest in plant and machinery fell only slightly and held above their long-term averages. Building intentions were unchanged nationwide, although there was a whopping increase in Canterbury (oddly, the same wasn't seen after the September quake).

The other details of the survey suggested that natural disasters aren't the only thing on firms' minds – there is growing concern about rising input costs, along with a perceived inability to pass these on, leading to an expected squeeze on profitability. A net 39% of firms reported a rise in average costs in the last quarter, and a net 44% expected increases in the next quarter –

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both measures at their highest since mid-2008, when inflation peaked above 5%. Once again, soaring commodity prices are a big factor – although higher export prices will be a major plus for the economy over time, the impact of pricier imports, especially fuel, are being widely felt right now.

An important difference between then and now, however, is the relative slackness of the labour market. The unemployment rate has held above 6% for the last two years, compared to a pre-recession low of 3.4%. Unlike the 2002-08 period, labour barely registers as a constraint on growth at the moment. For now, this is likely to act as a circuit-breaker against a potential wage-price spiral. But in time it will become a concern for the RBNZ – it's worth noting that the difficulty of finding skilled workers continues to gradually tighten, and reported net hiring over the last quarter was the strongest in three years.

Market implications

There was no market reaction to the survey; the likelihood of a weak headline confidence measure had been flagged by other monthly business surveys.

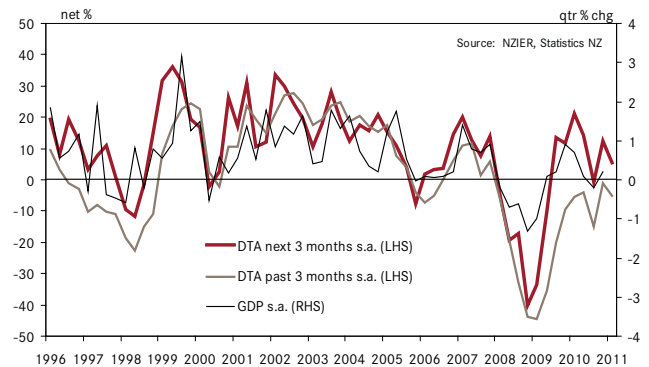
Our current forecast is a flat outturn for March quarter GDP, with risks to the downside, as the early momentum seen in the early part of the year was outweighed by the Christchurch earthquake. At face value, the *QSBO* is consistent with low but positive growth – but there are likely to be some gaps in the survey, both in terms of the hardest-hit firms that were unable to respond, and the service sectors that are not normally captured such as public health and education.

The survey was consistent with the RBNZ's growth outlook (the most recent projections implied a 0.1% fall in Q1 GDP), though it may have been more worrying on the inflation front. However, the RBNZ has clearly indicated that monetary policy will be dictated by the post-quake timeline: interest rates will remain low until the reconstruction of Christchurch ramps up (which is unlikely to be earlier than Q1 next year), then increased quickly as the economy's spare capacity is absorbed.

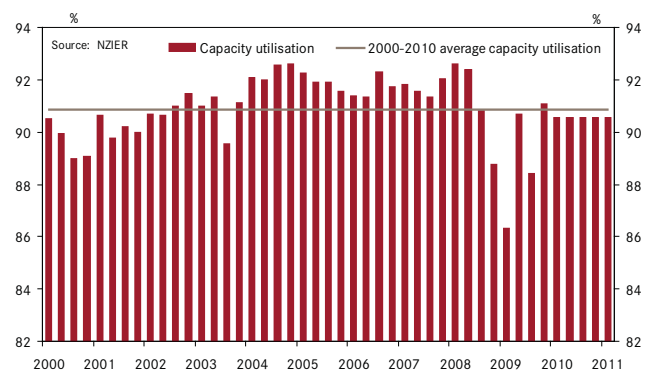
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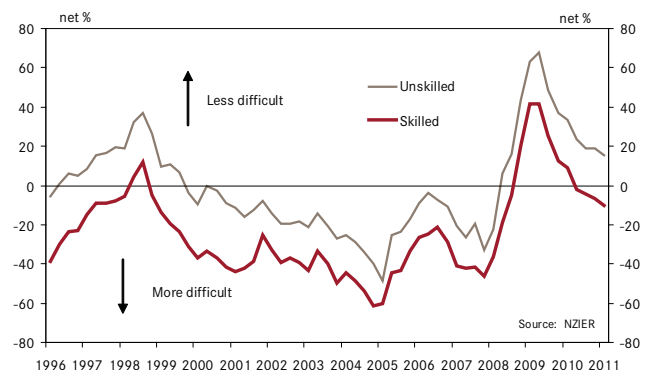
Domestic trading activity



Capacity utilisation



Firms' difficulty of finding labour



Pricing intentions vs CPI

