04 October 2011

Westpac Institutional Bank

Firms find the positives

NZIER business confidence down modestly in Q3

- **General business confidence fell in the September quarter, although firms' own-activity outlook was surprisingly resilient in the face of a weakening global economy.**
- **The construction sector remains buoyed by the impending Christchurch rebuild, and the retail and service sectors have high hopes for the Rugby World Cup.**
- **Inflation indicators were modest overall, but pockets of pricing power are starting to emerge, and skilled workers are increasingly hard to find.**

Summary

Business confidence dipped in the September *Quarterly Survey of Business Opinion* but remained at surprisingly robust levels. It seems that the steady improvement in the domestic economy, and factors such as the Rugby World Cup and the rebuild of Christchurch, are helping to allay concerns about the worsening global environment. The details suggest fairly average underlying growth in September quarter GDP, though we suspect the survey may not fully capture the impact of the RWC, and we'll stick with our forecast of 0.9% growth until we have a better handle on the tournament's impact on activity over September.

Details

In seasonally adjusted terms, general business confidence fell from 31% to 13% in the September quarter. The fact that it fell came as no surprise, as the monthly National Bank business survey had already hinted that the weakening world outlook was having an impact on confidence – although that survey was consistent with an outturn closer to zero for the QSBO.

Businesses' own activity for the past three months edged down from 4% to 2%, still the second-highest since the onset of the recession in 2008. The retail and service sectors reported further improvement, while manufacturers and builders were a little less upbeat than in the previous quarter. The outlook for the next three months was also remarkably resilient, with a net 20% expecting a pickup in sales, unchanged from last quarter.

Key results – forward looking

	Q2 survey	Q3 survey
Business confidence sa, next 6 mths	31	13
Trading activity, sa, next 3 mths	20	20
Pricing intentions, next 3 mths	31	22
Cost expectations, next 3 mths	40	28
Profitability, next 3 mths	–1	10
Employment intentions, next 3 mths	7	3
Building investment intentions, next 12 mths	–4	–6
Plant investment intentions, next 12 mths	9	6

Key results – backward looking

	Q2 survey	Q3 survey
Trading activity, sa, past 3 mths	4	2
Pricing, past 3 mths	16	18
Costs, past 3 mths	37	30
Profitability, past 3 mths	–23	–14
Employment, past 3 mths	–6	–4
Ease of finding skilled labour, past 3 mths	–15	–20
Ease of finding unskilled labour, past 3 mths	11	8
Capacity utilisation	88.73%	89.63%

Retailers also led the charge here, rising from 21% to 37%, the strongest since 2001. The temporary boost to spending from the Rugby World Cup is likely to have been front-of-brain for many businesses.

By region, confidence remained strong and lifted even further in Canterbury, in anticipation of the rebuild of Christchurch. While progress has been frustratingly slow for some, it does appear that things are moving ahead in the region, and not just in the construction industry. On that subject, the sharp rise in Canterbury dwelling consents in August is another sign that at least some of the barriers to progress have been overcome in the last few months.

Nationwide, near-term business intentions softened in line with the drop in general confidence. Intentions for hiring and

For further information, questions or comments contact Dominick Stephens, telephone (09) 336 5671, email dominick_stephens@westpac.co.nz

investment in plant and machinery remained positive and above their long-run averages; investment in buildings was slightly more negative. Profit expectations rose sharply for a second quarter to +10% – an unusually strong result for an indicator that has been mired in negative territory for almost every quarter of the last seven years. Again, this was largely driven by the retail and service sectors, which will be looking to make the most of the temporary boost from the Rugby World Cup.

The share of firms reporting price hikes in the last three months rose to a net 18%, the highest so far in this upturn (and around the average of the last decade). Pricing power was particularly strong in the building industry – an inevitable product of the Christchurch rebuild – but a relatively high number of retailers have also reported price increases in the last two quarters (21% and 20% respectively, compared to a 2008 peak of 30%).

The forward indicators of inflation pressures were mixed, as they often are. Capacity utilisation rose nearly a percentage point to 89.6%, but it remains below year-ago levels. But workers, particularly skilled ones, have become steadily more difficult to find over the last two and a half years, despite the widening in unemployment over that time.

Market implications

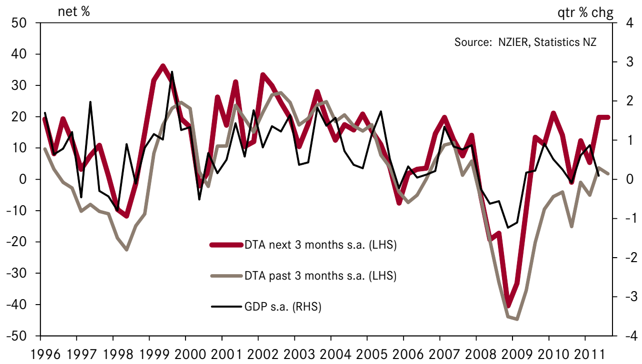
There was no market reaction to the release. While the survey reinforced the sense of a resilient domestic economy, global concerns will continue to monopolise the market's attention for the foreseeable future.

Firms' own activity over the last three months – the survey's single best indicator of quarterly GDP – is consistent with underlying growth of around 0.5% in the September quarter. However, with most of the responses having been received by mid-September, we suspect that this backward-looking measure understates the impact that the Rugby World Cup (which kicked off on 9 September) will have had over the full quarter. As well as the boost to spending from increased tourism (overseas and domestic), there are a few technical factors to consider – for example, match tickets that were bought as early as last year aren't counted as 'consumed' until the games are played. By the end of next week we'll have more detail on electronic card spending and overseas arrivals over the September month, and then we'll review our Q3 GDP forecast which currently sits at 0.9% growth.

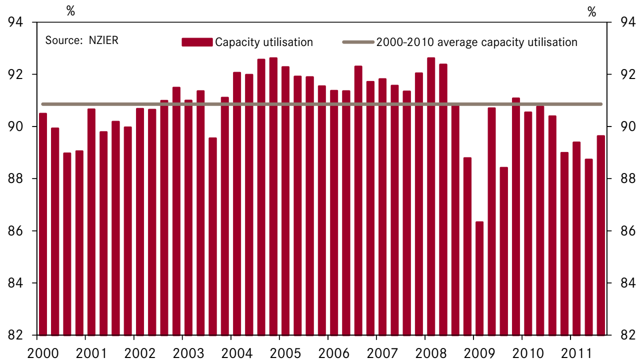
For the Reserve Bank, there is nothing in this survey to shake its outlook for a steady pickup in activity and modest growth in inflation pressures, requiring a gradual increase in interest rates over the next couple of years. The deterioration in global conditions, particularly around the European sovereign debt crisis, remains the biggest threat to this view.

Dominick Stephens, Chief Economist, Ph: (64-9) 336 5671
Michael Gordon, Senior Economist, Ph: (64-9) 336 5670

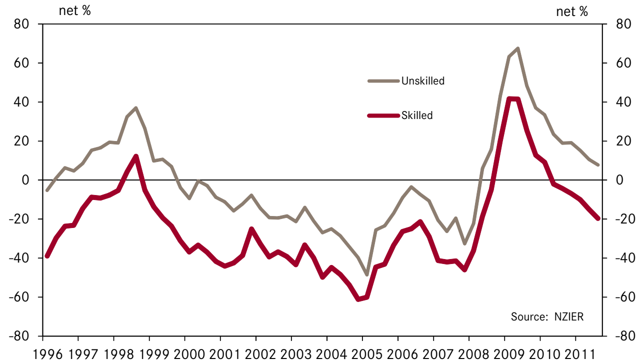
Domestic trading activity



Capacity utilisation



Firms' difficulty in finding labour



Pricing Intentions vs CPI