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Westpac InstitutionalBank

Taking the pressure off

NZIER business confidence rises in Q4

- **Business confidence rose in the December quarter, implying a return to a modest pace of expansion.**
- **Spare capacity and subdued cost pressures suggest that the RBNZ will be comfortable with a gradual pace of interest rate hikes.**

The December *Quarterly Survey of Business Opinion* was a welcome relief after the dire (and accurate) snapshot of the economy portrayed in the September survey. In fact, it was probably the best outcome that could be hoped for – actual and expected activity picked up, but inflation pressures showed no further tightening.

In seasonally adjusted terms, own-activity in the past three months – the single best indicator of quarterly GDP – rose from -15% to -1%, the highest level in three years. Similarly, expectations for the next three months rose from -1% to +13%, putting them back within the range seen during the first wave of the recovery in late 2009 and early 2010. The national result would've been even better were it not for the ongoing effects of the Canterbury earthquake, which saw reported activity for the region fall from -6% to -33%.

The finer details of the survey (which are not seasonally adjusted) were consistent with a modest improvement in activity in late 2010. Employment and investment intentions were broadly unchanged on Q3, and remained slightly above their long-run averages. Expected profits were around average.

As always, there was a great deal of variation across industries. Manufacturing, which bore the brunt of the economy's mid-year slump, appears to have fared better in Q4. Service industries were little changed on Q3. Retailers reported the biggest improvement in activity – a little surprising, given that the quarter started out with a post-GST drop-off in spending and, judging by yesterday's card transaction figures from Paymark, culminated in a poor Christmas trading period.

The building industry remains weak but showed some signs of hope in Q4, which will at least in part reflect the expected reconstruction activity after the Canterbury earthquake. Net hiring was positive for the first time since Q2 2007, and actual and expected sales both rose smartly.

Key results – forward looking

	Q3 survey	Q4 survey
Business confidence sa, next 6 mths	-8	3
Trading activity, sa, next 3 mths	-1	13
Pricing intentions, next 3 mths	30	22
Cost expectations, next 3 mths	38	32
Profitability, next 3 mths	-14	-5
Employment intentions, next 3 mths	5	4
Building investment intentions, next 12 mths	-10	-8
Plant investment intentions, next 12 mths	0	0

Key results – backward looking

	Q3 survey	Q4 survey
Trading activity, sa, past 3 mths	-15	-1
Pricing, past 3 mths	15	12
Costs, past 3 mths	29	26
Profitability, past 3 mths	-30	-21
Employment, past 3 mths	-12	-3
Ease of finding skilled labour, past 3 mths	-4	-7
Ease of finding unskilled labour, past 3 mths	19	19
Capacity utilisation	90.39%	88.99%

Reported cost increases in the building sector were the lowest since 2003, which is encouraging for two reasons. First, that suggests the sudden demand for labour and building materials in the Canterbury region hasn't led to a temporary price squeeze (at least not to date). Second, looking at the wider economy, the current level of homebuilding activity remains far lower than will be needed to meet population growth – but builders will only meet that need if they see some margin in it. A resurgence in building material costs, and a flat to negative outlook for house prices, probably played a large role in the slump in housing consents through 2010. We expect a more favourable mix of conditions in 2011.

Price pressures more generally were, if anything, slightly weaker in Q4. Capacity utilisation fell to its lowest since Q3 2009,

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driven mostly by the building industry. Skilled workers were again harder to find (especially for builders and retailers), but not so for unskilled labour. Pricing intentions fell back as expected, especially among retailers, now that the October GST increase is bedded down and the window of opportunity for raising prices has passed.

Market implications

There was no market reaction to the survey. The details were generally consistent with the RBNZ's forecast of 0.4% growth in Q4 GDP, as well as our pick of 0.5%.

With economic activity still running well below potential, the RBNZ will be pleased – but not surprised – that inflation pressures showed no sign of tightening up in Q4. Indeed, it's likely that domestically-generated inflation will look quite benign throughout this year. (Imported inflation, through soaring world commodity prices, may be another matter.) Interest rates will still need to be returned to normal levels over coming years, but the RBNZ has some breathing room in terms of the timing. We expect the next OCR hike to be in September.

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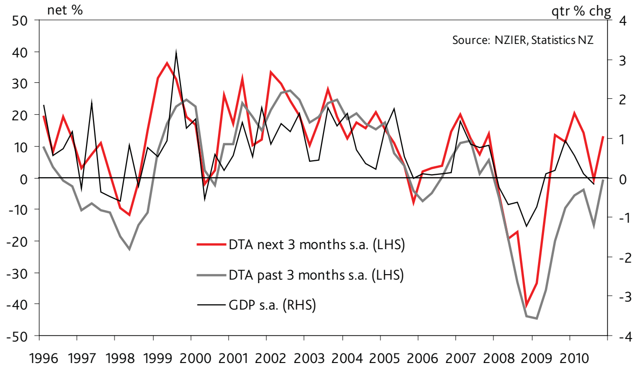
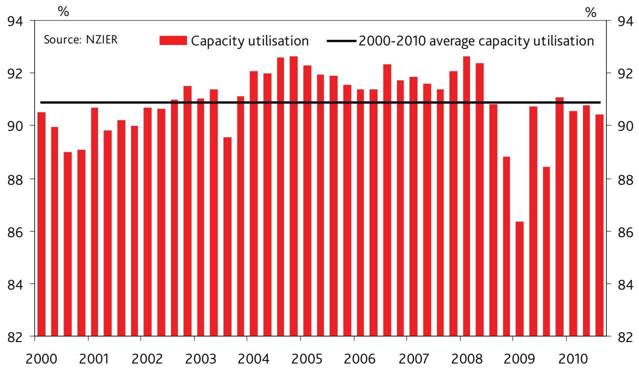
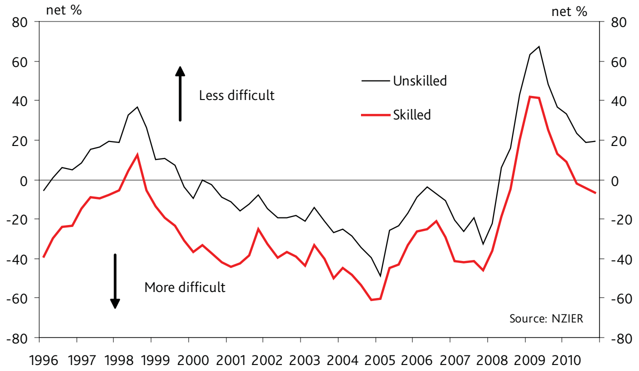
Domestic trading activity



Capacity utilisation



Firms' difficulty of finding labour



Pricing intentions vs CPI