

Easing back

NZIER business confidence fell again in Q3

- The September *Quarterly Survey of Business Opinion* suggests that while the economy is continuing to grow at a healthy pace, the rate of growth has taken a step down since early 2014.
- General business sentiment fell back for a second quarter in September, with a net 20% of firms expecting overall economic conditions to improve over the coming six months (down from 32% in June). However, businesses' own-activity measures fell back only modestly, as did measures of capacity pressure.
- While the number of businesses who reported that they are increasing prices remained firm, this has not been a good indicator of inflationary pressures in recent quarters. The survey's more reliable cost indicators remained contained in September, suggesting little need for the RBNZ to increase interest rates in the near term.

The pace of economic growth has taken a step down since early 2014

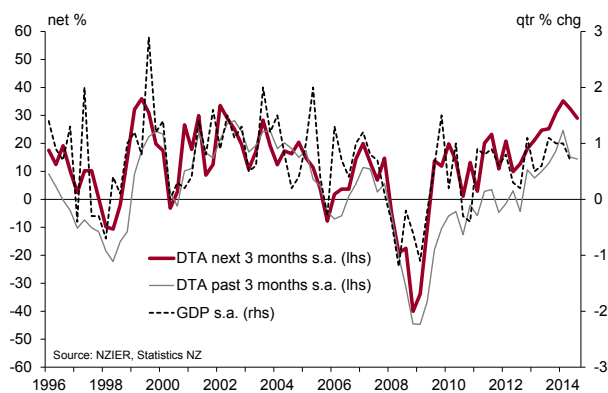
The September *Quarterly Survey of Business Opinion* indicates that the pace of GDP growth has taken a step down since early 2014. Businesses' confidence in general economic conditions declined sharply for a second quarter, down from 32% in June to 20% in September. This now well down from the lofty levels reached at the start of the year.

The moderation in business confidence in recent months is not surprising. It follows the 100 basis points of tightening by the RBNZ in recent months, as well as the sharp decline in prices for some of our key exports. Uncertainty around the outcome of last month's election may also have been weighing on the minds of some business.

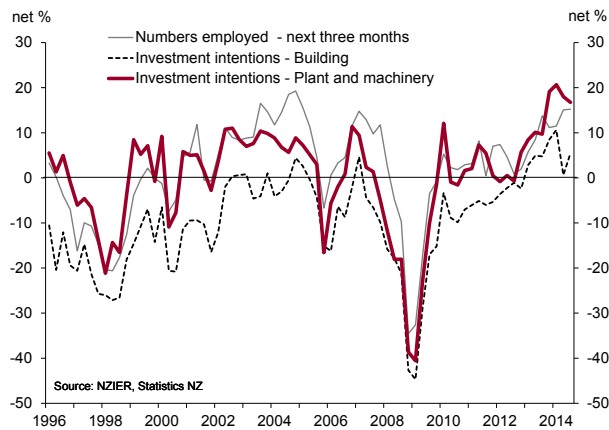
But while confidence in general economic conditions has declined, businesses have reported that their own activity has been more resilient. The number of businesses who reported increases in their trading activity moderated only slightly in September (down to 14% from 15% in June), with expectations for the coming three months also slipping down only modestly. These trends are consistent with the economy continuing to expand at a healthy pace supported by continuing increases in construction activity (particularly in Auckland and Canterbury), as well as the boost to demand from strong population growth. Importantly, these factors appear to be contributing to more generalised strength in economy activity, with the number of businesses planning on increasing capital expenditure and staff numbers remaining at above average levels. This resilience in activity combined with a recovery in agricultural production suggest some upside risk to our forecast for 0.7% growth over the September quarter.

The details of the survey showed that conditions in the building industry remained healthy in the September quarter, with both output and orders edging up. In addition, the manufacturing sector has been strengthening with the number of businesses reporting an increase in export orders rising from 10% to 18%. Conditions have been moderating in the service and retail sectors, however.

Domestic trading activity and GDP growth



Investment and hiring intentions

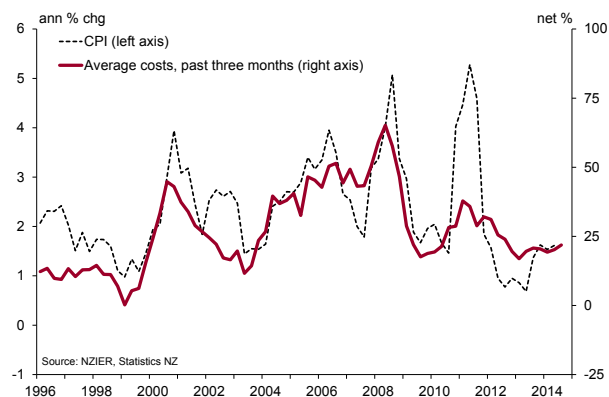


Inflation to remain contain in the near term

The number of businesses reporting that they increased prices continued to push higher in September, rising to 24% from 22%. However, even though an increasing number of businesses have been raising prices, the extent of such increases has been modest. Limited wage inflation, low global inflation and, at least until recently, the strength in the NZD have all helped to limit the extent of cost increases for businesses. Indeed, the number firms highlighting increases in costs has been steady for around a year now. Consequently, although output in the economy grew at a robust pace in recent quarters, inflationary pressures have not increased to the extent that might have been expected.

Inflation will gradually increase as the economy continues to strengthen. However, capacity and labour market pressures did ease back in September. Furthermore with growth past its peak and cost pressures remaining limited, the RBNZ has scope to keep the OCR on hold for the time being (as they signalled they would do at the time of their September interest review rate). This is despite of the marked depreciation of the NZD over recent weeks.

Businesses' costs and CPI inflation



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Key results – forward looking

| | Q2 survey | Q3 survey |
|--|-----------|-----------|
| Business confidence, next 6 mths | 32 | 20 |
| Trading activity, next 3 mths | 32 | 29 |
| Pricing intentions, next 3 mths | 32 | 29 |
| Cost expectations, next 3 mths | 21 | 20 |
| Profitability, next 3 mths | 9 | 12 |
| Employment intentions, next 3 mths | 15 | 15 |
| Building investment intentions, next 12 mths | 0.6 | 5.4 |
| Plant investment intentions, next 12 mths | 15 | 15 |

Key results – backward looking

| | Q2 survey | Q3 survey |
|---|-----------|-----------|
| Trading activity, past 3 mths | 15 | 14 |
| Pricing, past 3 mths | 22 | 24 |
| Costs, past 3 mths | 20 | 22 |
| Profitability, past 3 mths | -3 | -9 |
| Employment, past 3 mths | 5 | 3 |
| Ease of finding skilled labour, past 3 mths | -30 | -26 |
| Ease of finding unskilled labour, past 3 mths | -10 | -7 |
| Capacity utilisation | 90.63% | 90.57% |

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